OECD Reviews of Regulatory Reform

Regulatory Reform in Spain

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FOREWORD

The OECD Review of Regulatory Reform in Spain is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, launched in 1998 in response to a mandate by OECD Ministers.

The Regulatory Reform Programme is aimed at helping governments improve regulatory quality – that is, reforming regulations which raise unnecessary obstacles to competition, innovation and growth, while ensuring that regulations efficiently serve important social objectives.

The Programme is part of a broader effort at the OECD to support sustained economic development, job creation and good governance. It fits with other initiatives such as our annual country economic surveys; the Jobs Strategy; the OECD Principles of Corporate Governance; and the fight against corruption, hard-core cartels and harmful tax competition.

Drawing on the analysis and recommendations of good regulatory practices contained in the 1997 OECD *Report to Ministers on Regulatory Reform*, the Regulatory Reform Programme is a multi-disciplinary process of in-depth country reviews, based on self-assessment and on peer evaluation by several OECD committees and members of the International Energy Agency (IEA).

The country Reviews are not comprehensive, but, rather, targeted at key reform areas. Each Review has the same structure, including three thematic chapters on the quality of regulatory institutions and government processes; competition policy and enforcement; and the enhancement of market openness through regulatory reform. Each Review also contains chapters on sectors such as electricity and telecommunications, and an assessment of the macroeconomic context for reform in the country under review.

The country Reviews benefited from a process of extensive consultations with a wide range of government officials (including elected officials) from the country reviewed, business and trade union representatives, consumer groups, and academic experts from many backgrounds.

These Reviews demonstrate clearly that in many areas, a well-structured and implemented programme of regulatory reform has brought lower prices and more choice for consumers, helped stimulate innovation, investment, and new industries, and thereby aided in boosting economic growth and overall job creation. Comprehensive regulatory reforms have produced results more quickly than piece-meal approaches; and such reforms over the longer-term helped countries to adjust more quickly and easily to changing circumstances and external shocks. At the same time, a balanced reform programme must take into account important social concerns. Adjustment costs in some sectors have been painful, although experience shows that these costs can be reduced if reform is accompanied by supportive policies, including active labour market policies, to cushion adjustment.

While reducing and reforming regulations is a key element of a broad programme of regulatory reform, country experience also shows that in a more competitive and efficient market, new regulations and institutions are sometimes necessary to assure that private anticompetitive behaviour does not delay or block the benefits of reform and that health, environmental and consumer protection is assured. In countries pursuing reform, which is often difficult and opposed by vested interests, sustained and consistent political leadership is an essential element of successful reform efforts, and transparent and informed public dialogue on the benefits and costs of reform is necessary for building and maintaining broad public support for reform.

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The policy options presented in the Reviews may pose challenges for each country concerned, but they do not ignore wide differences between national cultures, legal and institutional traditions and economic circumstances. The in-depth nature of the Reviews and the efforts made to consult with a wide range of stakeholders reflect the emphasis placed by the OECD on ensuring that the policy options presented are relevant and attainable within the specific context and policy priorities of each country reviewed.

The OECD Reviews of Regulatory Reform are published under the responsibility of the Secretary-General of the OECD, but their policy options and accompanying analysis reflect input and commentary provided during peer review by all 29 OECD Member countries and the European Commission and during consultations with other interested parties.

The Secretariat would like to express its gratitude for the support of the Government of Spain for the OECD Regulatory Reform Programme and its consistent co-operation during the review process. It also would like to thank the many OECD committee and country delegates, representatives from the OECD's Trade Union Advisory Committee (TUAC) and Business and Industry Advisory Committee (BIAC), and other experts whose comments and suggestions were essential to this report.

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In the OECD Secretariat, the following people contributed substantially to the review of Spain: **Head of Programme and lead drafter:** Scott H. Jacobs; **Document preparation:** Jennifer Stein; **Economics Department:** Chapter I was principally prepared by Richard Kohl, and benefited from work by Giuseppe Nicoletti on regulatory indicators; **Public Management Service:** César Córdova-Novion; **Trade Directorate:** Denis Audet, Sophie Bismut, Didier Campion, Mark Warner, Anthony Kleitz; **Directorate for Financial, Fiscal and Enterprise Affairs:** Sally Van Siclen, Michael Wise, Patricia Heriard-Dubreuil, Bernard J. Phillips, **Directorate for Science, Technology, and Industry:** Patrick Xavier, Dimitri Ypsilanti; **General Secretariat:** Daniel Blume. In the **International Energy Agency:** Peter Fraser, John Paffenbarger.

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Part I

OECD REVIEW OF REGULATORY REFORM IN SPAIN

EXECUTIVE SUMMARY

The experience of Spain provides strong evidence of the value of structural and regulatory reforms in supporting economic growth. Among the factors behind Spain's high economic growth of the past few years, market liberalisation and market opening have been crucial. Spain has implemented far-reaching trade and foreign investment liberalisation, privatised almost all formerly state-owned manufacturing and infrastructure enterprises, liberalised state controls, engaged in sectoral re-regulation and institution-building, and strengthened competition policy. Implementation of the European Single Market Programme from 1989 supported major reforms. A huge array of regulations and technical standards was eliminated, as Spain implemented the single market framework in less than six years.

Spain has gained significant economic benefits from these measures in terms of lower prices and interest rates, increased supply-side flexibility, wider consumer choice, and quality of services. With labour market reforms, regulatory reforms have contributed to large reductions in unemployment. Spain's unemployment rate, while still the highest in Europe, decreased by more than eight percentage points (from more than 23% to 15.4%) between 1994 and 1999. The Spanish experience supports that of other OECD countries in showing that structural reform can enhance economic performance, helping stimulate the virtuous circle of higher growth, lower unemployment and inflation, improved competitiveness, and fiscal and external balance.

Spain still faces problems attributable to supply side rigidities: high unemployment and low employment rates, relatively high inflation, mostly due to the service sector, and a lack of innovation. In the past, these problems made adjustment to external shocks particularly costly.

Reform of Spain's institutions of economic control has been difficult and time-consuming because of a long history of state ownership and centralised regulation. However, democratisation, devolution to regions, and convergence with the rest of Europe have transformed the Spanish governance system, particularly its administrative and legal environments. Many of the reforms substantially reduced the direct role of the state in the economy and improved the efficiency of remaining state intervention.

The government has announced that continued improvement of its regulatory regimes is a major priority with respect to the competitiveness of the Spanish business sector, as commitments to the European Monetary Union and the EU Stability Pact constrain other economic policy tools such as monetary, exchange rate, and fiscal instruments. In this new context, the importance of establishing a sound regulatory framework that increases competition and minimises domestic obstacles to growth is more crucial than ever. The Spanish authorities should continue to be vigorous in their approach to structural reform, creating the appropriate institutional and legal frameworks to improve economic performance, such as through the use of competition policy, to reinforce market mechanisms and competition throughout the economy. To converge further in real terms with the rest of the EU, Spain needs to exceed average EU performance in implementing regulatory reform and introducing competition.

Chapter 1: Structural reform, initiated 15 years ago, speeded up in the mid-90s, helping to bring about the impressive economic performance in the second half of the decade. EC membership increased private sector confidence in Spain, engendering high levels of foreign and domestic investment and rapid growth, but the re-emergence of balance of payments problems and high unemployment revealed that substantial supply-side problems remained. More balanced macroeconomic policy and important structural reforms entailed strong growth and allowed Spain to meet the Maastricht criteria. Sustaining high growth rates to continue real economic convergence will require ongoing supply-side reform, since Spain still faces the problems

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of high unemployment and inflation. Prior to recent reforms, lack of competition in Spain was widespread and, while substantial price and entry liberalisation has occurred, lack of competition still characterises some sectors, with negative effects on economic performance. Liberalisation and regulatory reforms have begun to yield benefits in some sectors, and further reforms will in future generate additional benefits through reduced prices, increased productivity and higher incomes.

Chapter 2: Reforms to regulatory governance have responded to European and domestic pressures. Substantial reforms have been made, and the institutions and incentives of the public administration are adjusting to a market-oriented environment. Disciplines and capacities for improving the quality of regulation and its implementation are being built into the public administration. To promote consistent quality control, a reform policy and explicit quality principles are needed, with a high-level and specialised unit to supervise adherence to regulatory quality standards throughout the public administration. Regulatory transparency has greatly improved as regulators have expanded public consultation. The use of regulatory impact analysis is still undeveloped, though. Regulatory institutions, such as sectoral regulators, are improving in accountability and effectiveness, though strengthening their independence would support market transparency and confidence. Regulatory complexity is a particular problem in Spain, due to traditions of detailed controls and layers of government, and simplification of formalities and barriers to entrepreneurship is an urgent task.

Chapter 3: Spain's competition policy strengthened as Spain aligned policies with the EU, and has been vital in promoting pro-competitive reforms throughout the economy. In launching the reform programme, comprehensive sectoral action plans from the competition authority targeted likely competition problems, notably in non-traded services. Following through on these principles, many sectors were privatised and liberalised. However, the reforms either left, or produced, market power in several sectors that may produce competition problems in future. Formal exemptions from competition policy are narrow, due in part to determined actions by the competition authorities. At the sub-national level, regulations are sometimes invoked to avoid competition policy. The *Tribunal* and the *Servicio* are increasingly active, but need more resources to do their jobs effectively. Merger oversight is becoming more vigorous, which is essential given current problems and the pace of continuing restructuring.

Chapter 4: Trade and investment liberalisation commitments stimulated economic growth and injected competition into previously closed or semi-closed sectors. Spain performs well in implementation of the OECD efficient regulation principles, and attention to remaining regulatory barriers can boost the benefits of market liberalisation. Transparency in the development of Spanish regulations has improved from a market openness perspective, and would be assisted by a more careful assessment of the market openness impacts of proposed regulations. Spain is among the leading OECD countries in the efficiency of its customs procedures, and has built into its legal and institutional structures an obligation to use international standards wherever possible. Spain also supports the recognition of equivalence of other countries' regulatory measures. Application of competition principles is sound from an international perspective, but continued vigilance by competition authorities is needed as markets restructure to maintain open access for foreign partners.

Chapter 5: Regulatory reform in the electricity sector accounts for a range of economic and social policy objectives. Introducing consumer choice and market competition are the major strategies of current reforms in this sector and the industry is now beginning to respond in ways that should improve efficiency. The market will not, however, drive major efficiency improvements without more steps to create a neutral environment and complete the regulatory framework. Further, a vigorous market will be slow to emerge because the structure of the sector is not conducive to effective competition. Resolving the problem of concentration may require reversing the consolidation of the past decade. Other competition problems could emerge from current restructuring, and the Spanish government is taking steps to reduce the risk. Further liberalisation of the gas sector is key, given the fact that gas is going to become an essential input in electricity generation. Competition in distribution of electricity is also weak, and regulation that induces efficiency should be strengthened. Regulatory institutions for the electricity sector are not sufficiently transparent and independent to meet good international practices. Prices of electricity are still highly distorted in Spain. Pricing is not reflective of costs of supply, and hence distorts investment and consumption decisions, thus raising costs. Re-examination of the plan to recover transition costs may identify ways to further reduce costs and speed up restructuring in the industry.

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Chapter 6: Regulatory reform in the telecommunications sector is advanced in Spain, and the regulatory framework compares well to those in other countries. Regulatory reform is beginning to reduce prices, boost investment, and improve service quality which will help remedy continuing performance problems. The regulator has had important successes in regulating the industry in consumer interest, but its independence and responsibilities should be increased. Interconnection prices are properly based on Long Run Average Incremental Costs. Spectrum frequency should be awarded by auctions and tradable rights should be established. Rules pertaining to the accounting separation of costs have not been enforced, but are important to reduce the risk of anti-competitive behaviour. To actively promote competition in the local loop including for Internet access, access to the local loop should be promoted in different ways, including through resale and unbundling. Several key regulatory issues should be resolved to establish the conditions for consumer choice and competition, such as improving the timeliness and efficiency basis of pricing regulation. The introduction of cost accounting principles for Telefónica should be given emphasis before the universal service concept and funding are addressed. Consumer protection should be strengthened to ensure that abuses do not occur in competitive markets.

Chapter 7: *Conclusions and Policy Options*. The pace of change in Spain toward market-oriented policies and government institutions has accelerated in recent years. These economic reforms are working their way through the regulatory system, deepening and widening the scope of regulatory reform. Actions that, based on international consensus on good regulatory practices and on concrete experiences in OECD countries, are likely to be beneficial to further improving regulation in Spain include:

- *Sustained strong political support will be needed at the highest levels to continue reform in the next several years.* The reform agenda is becoming more complex as Spain converges with Europe in policy frameworks. Sustained political support to market-oriented and quality regulation will be necessary to meet challenges in institutional development, co-ordination among multiple layers of government, careful oversight of restructuring markets, and meeting the demands of citizens for high levels of regulatory protections.
- *Adopt at the political level a broad policy on regulatory reform that establishes clear objectives, accountability principles, and frameworks for implementation.* The 1997 OECD *Report to Ministers on Regulatory Reform* reads, "Regulatory reform should be guided by coherent and transparent policy frameworks that establish concrete objectives and the path for reaching them… Such programmes will enhance the credibility of reform, and reduce the costs of reform by signalling to the wide range of affected interests what is to come. The emphasis on broad programmes is deliberate, since the likelihood of success is increased by including at the outset the full mix of policies needed to gain full benefits of reform."
- *Strengthen the capacities of the public administration* to make high quality regulatory decisions to prevent regulatory problems early in the policy process.
- *Build on current reforms to improve regulatory transparency and simplicity to improve the acceptance of reform and the environment for business investment and growth.* Clear, public objectives for regulation and reform, taking consumer interests into account, and independent monitoring are important elements for ensuring that the reform process is open and inclusive. Particularly as reform involves social policies more deeply, dialogue with important stakeholders will be needed to maintain legitimacy and support.
- *Involve regional and local governments*, which have an increasing role in regulatory matters, in regulatory reform to ensure that gains are extended throughout the national regulatory system.
- *Build on the effective competition policy and authorities* and take further steps to increase the application of competition principles to economic regulations and structural decisions.
- *Improve the policy foundation for the efficiency, independence, and accountability of new independent regulators by developing guidelines for their systems of governance, policy coherence, and working methods, while ensuring that relations with the competition authority support the consistent application of competition principles across sectors. A high-level and independent review of these issues would be a useful step.* Increased attention in Spain to the creation of market-oriented regulatory institutions will improve the legal and administrative envi-

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ronment for competition and business growth. This is even more consequential when new markets are opened in areas formerly reserved to monopolies.

– *Take further steps to integrate market openness principles* into national regulatory and administrative regimes.

– I*n the electricity and gas sectors, a number of steps are needed to establish a regulatory regime supportive of market entry and competition that benefits energy consumers*. In both sectors, reforms should aim to open more opportunities for competition, to strengthen the role of the independent energy body, and to make prices more cost-reflective. Each of these reforms will contribute to the efficiency and innovativeness of the sector.

– Much progress is seen in telecommunications. F*urther reforms will stimulate competition* and promote a dynamic market that serves Spain's communication needs.

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Chapter 1

REGULATORY REFORM IN SPAIN

Regulatory reforms have contributed to high growth, flexibility, and convergence.

The experience of Spain is strong evidence of the value of structural and regulatory reforms in supporting economic growth. Among the factors behind Spain's high economic growth of the past three years, market liberalisation and market opening have been crucial. These reforms, began over 15 years ago and accelerated since 1996, have also contributed to a more flexible and competitive domestic economy, and accelerated Spain's economic convergence in Europe.

A sound regulatory framework that minimises domestic obstacles to growth is more crucial than ever.

The government has announced that continued improvement of regulatory regimes is a major priority with respect to the competitiveness of the Spanish business sector, as commitments to the European Monetary Union and the EU Stability Pact constrain monetary, exchange rate, and fiscal policy instruments. In this new context, the importance of establishing a sound regulatory framework that minimises domestic obstacles to growth is more crucial than ever.

Market-opening reform was complemented by large-scale privatisation.

Spain's reforms included market opening, privatisation, liberalisation of state controls, sectoral re-regulation and institution-building, and competition policy.

Spain's reforms were a mix of market opening, large-scale privatisation, liberalisation of state controls, sectoral re-regulation and institution-building, and strengthening of competition policy. Implementation of the European Single Market Programme from 1989 supported major reforms, which accelerated in 1996. A huge array of regulations and technical standards was eliminated, as Spain implemented the single market framework in less than six years.

In 1992, as the domestic market was opening to international competition under the European Single Market, the government concentrated on reform of service sectors, privately and publicly owned.[1] Stimulated by a comprehensive report on structural reforms released in 1992 by the competition authority, reform of telecommunication, electricity, gas, oil product distribution, and air transport regulations got underway, with initial steps to strengthen competition policy, and improve regulations in land, retail distribution, professional services, postal services, and water. A Convergence Programme approved in 1992 to meet the requirements of the Treaty of Maastricht supplemented the microeconomic reforms with plans to reform macroeconomic policy.

In 1996 the government accelerated the reforms with the State Enterprise Modernisation Programme. This programme, in just two years, restructured and sold practically all of Spain's biggest state-

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owned companies in a wide range of sectors, keeping a core of companies concentrated in mining, defence, and loss-making strategic companies (*i.e.* railways, shipbuilding, etc.). In some cases, the government retained a "golden share". Spain was among the OECD countries with the highest shares of privatisation receipts in 1996-1998. The programme also reduced aids to state-owned enterprises. The privatisation process is nearly over. By 2000, the only activities in the tradable sectors left within the public enterprise sector will be mining and certain defence companies.

To counter the weakening of demand-side instruments, further emphasis will be needed on supply-side policies and structural reforms.

With Spain a founding member of the EMU, a new and ambitious policy was articulated in the 1998-2002 Stability Programme. The programme stated that, to counter the weakening of demand-side instruments such as monetary and fiscal policy, further emphasis will be needed on supply-side policies and structural reforms of factor and product markets. The government will further open competition in protected sectors and take additional steps to improve regulatory quality in relation to specific sectors and the general business environment.[2]

Changes to governance have accompanied economic reforms.

Reforming Spain's institutions of economic control has been difficult and time-consuming because of a long history of state owner-

Box 1.1. **What is regulation and regulatory reform?**

There is no generally accepted definition of regulation applicable to the very different regulatory systems in OECD countries. In the OECD work, regulation refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations include 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. Regulations fall into three categories:

- ***Economic regulations*** intervene directly in market decisions such as pricing, competition, market entry, or exit. Reform aims to increase economic efficiency by reducing barriers to competition and innovation, often through deregulation and use of efficiency-promoting regulation, and by improving regulatory frameworks for market functioning and prudential oversight.
- ***Social regulations*** protect public interests such as health, safety, the environment, and social cohesion. The economic effects of social regulations may be secondary concerns or even unexpected, but can be substantial. Reform aims to verify that regulation is needed, and to design regulatory and other instruments, such as market incentives and goal-based approaches, that are more flexible, simpler, and more effective at lower cost.
- **Administrative regulations** are paperwork and administrative formalities – so-called "red tape" – through which governments collect information and intervene in individual economic decisions. They can have substantial impacts on private sector performance. Reform aims at eliminating those no longer needed, streamlining and simplifying those that are needed, and improving the transparency of application.

Regulatory reform is used in the OECD work to refer to changes that improve regulatory quality, that is, enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform. Deregulation is a subset of regulatory reform and refers to complete or partial elimination of regulation in a sector to improve economic performance.

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ship and centralised regulation. Democratisation, devolution to regions, and convergence with the rest of Europe have transformed the Spanish governance system, particularly its administrative and legal environments. Many of the reforms substantially reduced the direct role of the state in the economy and improved the efficiency of remaining state intervention in some policy areas and sectors. Spain strengthened its regulatory management system infusing more transparency and accountability.

In part due to these reforms, Spain is well-placed to complete the process of real convergence within Europe and address structural problems such as high unemployment levels.

Combining broad-based regulatory reform with supporting structural reforms can help sustain high growth, lower unemployment and inflation, and improve competitiveness.

Spain now has the opportunity to complete the process of catching-up with Europe in terms of GDP per capita, and address its structural problems, particularly high unemployment levels. In the context of EMU membership and the associated constraints on macropolicy, this will be a formidable challenge, one that demands that the Spanish authorities continue to be vigorous in their approach to structural reform, creating the appropriate institutional and legal framework to improve economic performance, particularly through the use of competition policy, to reinforce market mechanisms and competition throughout the economy. The Spanish experience supports that of other OECD countries in showing that structural reform can enhance economic performance, helping stimulate the virtuous circle of higher growth, lower unemployment and inflation, improved competitiveness, and fiscal and external balance.

THE MACROECONOMIC CONTEXT OF REGULATORY REFORM

Structural reform, initiated 15 years ago, speeded up in the mid-90s, helping to bring about the impressive economic performance in the second half of the decade. The challenge of Spain's participation in the euro entailed a more balanced macroeconomic policy based on fiscal consolidation and an ambitious structural reform program. In fact, privatisation, liberalisation of product and factor markets and competition policy were enhanced. Indeed, as Spanish economic policy objective was to progress on real convergence, the pace of economic reform had to go ahead of European average. Nevertheless, liberalisation among sectors and factor markets was uneven and there remains some progress to be done.

The ten years from the mid-1970s were focused on economic and political reforms.

It is important to realise how far and how fast Spain has come in economic development. Spain began the post-Franco era in the middle 1970s with a per capita income level about 75% of the EU average. The share of agriculture and industry in the economy were much larger than in most EC countries. Productivity levels in industry were low, largely attributable to tiny average firm size and lack of investment financing. The labour market was characterised by large outmigration from poor rural areas,[3] creating pressures for job creation.

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Box 1.2. Spanish labour markets and high unemployment

During much of the 1980s, Spain had the highest levels of unemployment in the OECD. Unemployment was highly concentrated geographically and among youth and women. Performance improved in the last five years thanks to labour market reforms and rapid economic growth, in particular in labour intensive activities (tourism and construction). Nonetheless, unemployment remains very high, imposing significant costs on the Spanish economy in terms of transfer payments and lost production, as well as important social costs.[1] Despite their decline, youth unemployment rates continue to be the highest in Europe.

The explanation for Spain's unemployment problem lies in the interaction of labour market regulations with demographic trends and economic transition. The delayed opening up of Spain's large and inefficient agricultural and industrial sectors to international trade and their subsequent restructuring led to rapid outflows of low-skilled workers[2] which were not absorbed by services. In part, this was attributable to slow economic growth during the stabilisation period but also to labour market rigidities. Foremost among them was a strict system of employment protection – among the most strict in the OECD – which made firing of permanent workers difficult and extremely expensive, discouraging hiring.[3] The result was high unemployment and creation of a segmented-labour market or "insider-outsider" problems,[4] a development reinforced by liberalisation of part-time and temporary contracts in the early 1980s. Currently one-third of wage earners are under temporary contracts, the highest in the OECD.

Problems attributable to the system of social protection were reinforced by product market rigidities and the collective bargaining system. Two issues have particularly affected labour market performance: artificial restrictions on land use raised housing costs, inhibiting labour mobility, and the widespread presence of public monopolies[5] in network industries, which put upward pressure on economy-wide wage levels. Combined with a system of collective bargaining somewhere between centralised national bargaining and firm-level negotiations, these factors have prevented wages from reflecting firm-level conditions,[6] encouraged real wage rigidity, and discouraged hiring.

In 1984, some flexibility was introduced in the labour market through the new regulation of temporary contracts and employment grew rapidly, as this flexibility was accompanied by high overall growth rates, particularly in construction.[7] Nonetheless unemployment remained high as labour supply continued to increase. Moreover a large proportion of jobs created were under temporary contracts. The authorities finally moved to introduce labour market reforms in 1994 as growth stalled, large numbers of jobs were destroyed and unemployment rose substantially. Reform measures were targeted to increasing the employment of key groups and allowing a closer relationship between wage bargaining and productivity. They included easing the conditions for collective dismissals, introducing flexibility in working hours, further liberalising part-time contracts and increasing the possibility of collective bargaining at the firm level. Reforms in 1997-99 have aimed to discourage the use of temporary contracts and to foster the use of part-time contracts while easing rules on indefinite contracts by reducing severance payments and social contributions. These reforms have not succeeded in reducing the share of temporary employment in total employment.

1. There is some evidence that official measures overstate unemployment as the informal sector remains large, and it is widely believed that the negative effects of very high levels on unemployment are cushioned by extended family networks so that most households have at least one employed member. Nonetheless even adjusting for these factors unemployment has been a very serious problem in Spain for 20 years and has contributed to its highly unequal income distribution and substantial regional pockets of poverty.
2. The attendant increase in labour supply was amplified by the return of migrant workers, rising women's labour force participation and the entry of the baby-boom into the labour market, which in Spain was longer and more pronounced than in other EC countries.
3. Contributing to high regional unemployment have been special work programs and unemployment assistance in certain low-income regions which discourage job search incentives and labour mobility.
4. These terms refer to a labour market divided between workers in the primary sector, or insiders, who hold full-time jobs, often prime age males, enjoy rising real wages, comprehensive benefits and worker protection and workers in the secondary sector or "outsiders", often youth, women and the poorly educated/low-skilled, who suffer high rates of unemployment, and find only temporary or part-time work with low wages and few rights when employed. Wages and working conditions in the primary sector do not respond to conditions faced by outsiders.
5. Another source of poor labour market performance has been in land regulation, discussed at length below.
6. Research on other OECD countries has tended to show that either highly centralised or decentralised bargaining systems work most effectively, but Spain has a mixed system in which a substantial component of wages is set at the regional and sectoral level, with bargaining at the level often dominated by firms capable of paying higher wages.
7. Much of this came from projects to improve infrastructure (and prepare for the 1992 Olympics), often at least partly funded with EC Structural Adjustment funds.

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Box 1.2. **Spanish labour markets and high unemployment** (*cont.*)

Job creation in 1997/99 was rapid and wage growth was quite low but additional reforms are still needed to further reduce unemployment and prevent its resurgence in the next recession. Three key areas are dismissal costs, which remain above the European average, the structure of collective bargaining systems, and, in some specific cases, unemployment benefits. These reforms are discussed in the OECD Economic Survey 2000, Table 15, and the accompanying text.

In the 1980s stabilisation policies were supplemented by industrial restructuring, liberalisation and privatisation to prepare for EC membership, achieved in 1986.

The new government which came into office in 1982 was able to pursue the goals of modernisation and integration into Europe. High inflation necessitated another devaluation to restore competitiveness, it was accompanied by more restrictive monetary policy and continued fiscal expansion while incomes policies were continued. The Socialist government placed heavy emphasis on improving infrastructure, increasing public investment, which had the added benefit of creating jobs in construction. These policies were accompanied by financial market liberalisation and labour market and structural reforms, often undertaken with an eye towards EC membership. These included introduction of part-time and temporary labour contracts, restructuring of major overbuilt industries (iron and steel, shipbuilding and textiles), the liberalisation of housing rents, retail shopping hours, foreign investment, and a program of privatisation of state-owned companies."[4]

Adoption of a European system of social protection and heavy spending on industrial restructuring led to a secular rise in public spending and debt and chronic fiscal deficits.

The transition period of 1978-85 was characterised by a steady expansion of the share of public expenditures in the economy. As the result of the adoption of a social welfare system similar to those of other European countries, government spending grew steadily driven by increases in social expenditures (transfer payments) and public investment to cover the costs of industrial restructuring and was accompanied by a continuous increase in public debt and large budget deficits.

Stabilisation permitted the government to pursue structural reforms and the adoption of a European system of social protection.

As the economy stabilised in the 1980s after the two oil shocks, the government was able to pursue structural reforms: improving infrastructure; increasing public investment (which had the added benefit of creating jobs in construction); liberalising financial markets; restructuring of major industries; and, a program of privatisation of state-owned companies. Economic restructuring was accompanied by strengthening of workers' rights and a social welfare system similar to those of other European countries. Some regulatory reforms were initiated, such as the liberalisation of housing rents and retail shopping hours. Privatisation and restructuring of loss-making industries generated large increases in labour productivity as employment in these industries declined. They also resulted in a fall in the public enterprises share of employment to 1½% of total in the fourth quarter of 1999, one of the lowest rates in the OECD.

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EC membership increased private sector confidence in Spain, engendering high levels of foreign and domestic investment and rapid growth.

EC membership brought with it high levels of foreign direct investment and increased openness.

EC membership in January 1986 was a powerful signal to the rest of the world, and particularly to business investors, that Spain was committed to convergence with Europe, committing itself to market openness and sound economic policies. Combined with the lagged effect of earlier structural reforms, the boost to confidence generated a boom in investment. Foreign direct investment (FDI) was particularly stimulated by liberalisation of restrictions on foreign ownership, opportunities presented by the integration of Spain into the single market, and by the ongoing privatisation program.[5] FDI inflows and private investment were supplemented by government investment spending and EC structural funds, which focused on the construction of infrastructure, particularly in poorer regions. Employment increased rapidly and the unemployment rate fell by more than 5 percentage points in the second half of the 1980s.

The re-emergence of balance of payments problems and high unemployment revealed that substantial supply-side problems remained

Despite trade and investment liberalisation, the economy was not yet capable of sustaining high non-inflationary growth, indicating that substantial structural problems remained.

However, strong domestic demand growth, fed by an expansionary fiscal stance, real wage rigidity and lack of competition in the non-traded sector kept Spanish inflation well above that of the rest of Europe. The result, given that the peseta was now fixed within the European Exchange Rate mechanism was a substantial real appreciation of the currency, loss of competitiveness, and balance-of-payments problems as Spanish industry, outside of sectors affected by FDI, had difficulty facing more direct European competition.

Resulting in another balance-of-payments crisis, devaluation and contractionary macroeconomic policy.

The government responded as it had in 1975 and 1982 with restrictive monetary policies and devaluation – the peseta was devalued three times in 1992-93. The resulting recession was accompanied by substantial job destruction and the budget deficit widened substantially as transfer payments increased; like other EU members Spain emerged from the recession far from able to meet the Maastricht criteria

More balanced macroeconomic policy and important structural reforms entailed strong growth and allowed Spain to meet the Maastricht criteria.

Macroeconomic performance has been strong.

Economic recovery in Spain started in 1994 and speeded up in 1997, with GDP growth well above the EU average (Box 1.2). Per capita GDP relative to the rest of Europe rose to over 80% of the average levels in the EU15. Inflation has come down sharply and converged to rates near those prevailing in the rest of the EMU member countries and unemployment has fallen by several percentage points (more than 8 percentage points between 1994 and 1999).

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More balanced macroeconomic policy drove down interest rates and created a stable policy context for sustainable growth...

The government reversed the long-term tendency for expansionary fiscal policy: the deficit was brought down significantly between 1995 and 1999 from 6.9 to 1.1% of GDP. The government granted the Bank of Spain independence in 1995, which it used to initiate a policy of directly targeting inflation. As a result of these policy changes and increased credibility with financial markets, the risk premium on Spanish debt fell substantially (more than 2 2/3 percentage points between 1995 and 1999). Together this stimulated investment and dramatically lowered the cost of working capital, increasing the competitiveness of Spanish firms, especially SMEs. Aided by increased awareness on the part of labour unions that competitiveness must be maintained in the context of the EMU, Spain has maintained simultaneously competitiveness, high growth rates and employment creation in the recent past.

... accompanied by structural reforms to improve supply side performance.

These policies were accompanied by a broad set of reforms designed to increase business access to investment capital, introduce more flexibility in the labour market, extend privatisation and improve product market performance. Labour market measures eased high barriers to hiring and firing, and reduced non-wage labour costs for some workers (see Box 1.1 above). The government further expanded privatisation into energy, banking and industry selling off major shares of the telephone company (Telefonica), the oil, gas and electricity companies, (Repsol, Gas Natural and Endesa) and additional holdings in steel.[6] Privatisation was followed by cuts in subsidies to those loss-making firms remaining in government hands.[7]

Box 1.3. Macroeconomic performance since 1993 in comparative perspective

Compared with other OECD countries, Spanish economic growth since 1993 has been generally better. In particular Spain's:

- Per capita GDP growth was among the most rapid of any European country. Growth was nearly a full percentage point greater than that of France, Germany or Italy, though slower than that of the UK, US or Ireland.
- Employment growth in the second half of the 1990s was among the highest of the OECD (particularly in services, where it was the highest). In the 1990s net growth in business sector employment was better than most European countries, but not as good as that in the US, UK or the Netherlands. As a result, Spain's unemployment rate, while still the highest in Europe, decreased by more than eight percentage points (from more than 23% to 15.4%) between 1994 and 1999. Therefore, Spain is considered to be one of the countries where labour market reforms have been successful (OECD, 1999, Implementing the Jobs Strategy).
- Poor performance in terms of apparent productivity growth was the flip side of good employment growth. Apparent labour productivity growth in both manufacturing and services in 1990's was near the bottom of the OECD; productivity growth in services was actually negative. TFP growth for the business sector was also negative and among the lowest of any OECD country (see discussion in OECD (2000) Economic Survey of Spain).
- Consumer inflation rate has rapidly converged towards that of other EU countries but remains above average in the EU. While Spain's inflation rate in traded-goods was nearly identical to that of the rest of the EU, the inflation rate for non-tradables was much higher.

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At the same time the government instituted regulatory reforms in these and other sectors. Reforms were often driven initially by the need to implement EU directives but in many sectors actual implementation went beyond what was required. The government strengthened the Competition law and the supporting institutional framework (see Chapter 3 for a discussion and evaluation). It introduced competition and liberalised prices in telecommunications (see Chapter 5) and domestic air transport, and set a timetable for the gradual introduction of competition in energy (see Chapter 6). Reforms in other sectors ranged from curtailing the power of liberal professions associations to fix prices and restrain competition to liberalisation of most refined petroleum prices. At the same time reregulation took place in a few politically sensitive areas[8] like housing rents and retail distribution.

More recently, the government has taken important measures in several sectors to enhance competitiveness and stimulate service improvement, in particular in gas distribution, oil product retailing, electricity supplier choice, telecommunications and water.

Sustaining high growth rates to continue real economic convergence will require supply-side reform. Spain still faces the problems of high unemployment and service sector inflation

Inflation and unemployment remain as problems.

Despite improved performance, Spain still faces some structural problems. Spanish inflation and unemployment rates have come down substantially but remain higher than other countries. Service sector inflation is still high and the unemployment rate is still the highest in the OECD. This combined with low labour force participation to generate the lowest *employment* rate in the OECD,[9] implying an enormous income loss due to under-utilised resources. Despite the labour market reforms of the last five years, substantial rigidities still remain. Much of Spain's growth in the past has come from the shift in the working population from low to higher productivity activities. This process is now largely complete and will no longer serve as an engine of growth. In the future if Spain is to sustain higher than EU average growth rates they will have to come from increases in productivity within sectors and from higher employment rates.[10]

Growth will face additional challenges, increasing the importance of regulatory reform to stimulate aggregate supply flexibility, help achieve fiscal balance and stimulate productivity growth.

Joining the EMU has added to the motivations to pursue regulatory reform. Like other EMU countries, Spain will lose use of independent monetary and exchange rate policy and face constraints on the fiscal side. The Spanish authorities have recognised that reform can help achieve fiscal balance and increase aggregate supply flexibility. Greater supply-side flexibility will allow for less costly adjustment to asymmetric shocks and permit faster growth without the overheating which has occurred in the past. Regulatory reform can improve fiscal performance directly by lowering subsidies, reducing the costs of government procurement and the production of public sector goods – and indirectly through stimulating overall economic growth.

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Prior to recent reforms, lack of competition in Spain was widespread and in some areas still remains a problem, with negative effects on economic performance

Barriers to product market competition were widespread historically.

Like most European countries prior to the EU reforms of the last decade, lack of competition characterised many Spanish sectors. Spain has faced the commonly-encountered problems of privatising or opening up to competition of publicly owned and operated infrastructure services, and of anti-competitive self-regulation of price and advertising in professions. These problems were part of a larger historical pattern of central direction and promotion of national-scale firms. In Spain (as elsewhere), prior to regulatory reforms entry in many sectors was prohibited or strictly limited. In other sectors where state ownership has not been the case, regulation has tended to be extensive, centralised and highly legalistic and has tolerated private monopolies and oligopolies – such as in oil refining and distribution or road transport. Practices limiting competition were also widespread in service sectors, through self-regulation by associations (*colegios profesionales*). These sectors included liberal professions such as lawyers, architects, notaries and property and mercantile registrars. In these cases the state intervened to control prices, or tolerated these practices on the part of the *colegios*. Regional and local governments have not always followed the central government's signals to increase market competition in areas such as retail trade and the urban real estate market.

Lack of competition has resulted in higher prices...

In Spain, as in many other EU member countries, there is widespread evidence that prior to recent reforms these barriers resulted in poor performance on both the macroeconomic and sectoral level. Prices in key infrastructural sectors in the first half of the 1990s tended to be above average OECD levels and well above best practices.[11] Despite the drop in telecommunications and electric power

Box 1.4. **Economic analysis of regulatory reform**

Few empirical studies are available in Spain which estimate the economic costs of regulation or the potential benefits (and costs) of regulatory reform and liberalisation: a comprehensive summary of what literature does exist, especially of the public enterprise sector, was summarised in the 1998 OECD Survey of Spain. At the sectoral level what few studies there are have largely been confined to telecommunications, electric power and financial services. The OECD was not able to locate any Spanish study of the overall macroeconomic effects.*

The explanations for the lack of Spanish policy research are several. Regulatory reform and sectoral liberalisation in Spain are relatively recent phenomenon, occurring mostly in the last 5-10 years, and driven to a great degree, at least initially, by sectoral directives as part of the EU's single market programme. As such, in many other EU countries, until recently there has been no demand for such analysis. This general problem is reinforced in the case of Spain by: (1) the highly legalistic tradition of regulation (see Chapter 2); (2) the weakness of consumer groups; and (3) the small number and size of independent economic policy research institutes. The lack of hard analysis has meant that the internal domestic debate is largely political and strongly influenced by vested interests groups whose potential losses are clear, whereas the benefits to consumers (and businesses) at large are unspecified or at best qualitative, slowing down the pace of reform. Additional economic analysis of regulatory reforms both inside and especially outside the government in Spain is urgently needed and the transparency or relevant data needs to be increased to facilitate this.

* The Secretariat's own estimates were published in the 1997 OECD *Report on Regulatory Reform* and the 1998 Survey.

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prices brought about by recent reforms, prices are still substantially above average (see Chapters 5 and 6).

... driven by high wages and profits and at best average productivity performance...

High prices were largely attributable to either excess profits, excess wages, low productivity levels or some combination of the three, though productivity levels have played a relatively smaller role as they have tended to be around average levels in the EU. Profits were high in a number of sectors such as energy and telecommunications and past OECD reports identified most infrastructure sectors as having excessive wage levels. Moreover in many of these sectors service quality was poor: until recently Telefonica did not offer many services available in other countries, billing was poor and installation times long.

... higher overall levels of inflation.

As noted above, Spain has had a higher inflation rate in the service sector as compared with other EU countries whereas inflation in traded-goods sectors has converged. While part of this is due to a long-term trend in the relative price levels of services as per capita GDP converges with the rest of the EU, and to the differential growth of the Spanish economy, some of this could be due to insufficient competition. Indirect estimates by the Bank of Spain have shown that margins in a number of key service sectors have been rising sharply, even while labour costs have been flat or falling, so that higher prices do appear to reflect high profits.[12] While the retail distribution sector appears competitive, in fact entry of new stores has been constrained by restrictions on the opening of large stores and high real estate costs due to artificial restrictions on the supply of land for development.

Poor sector performance had a negative effect on overall economic performance.

No comprehensive estimates of the macroeconomic impact of barriers to competition exists: the Secretariat has estimated that the combined impact of reforms in a few key infrastructure sectors would increase GDP by 2-2½%.[13] Indirect indicators suggest that the costs to the economy are substantial given the importance of regulated sectors in the economy in terms of backward and forward linkages.[14] The energy, transportation, communications, water and financial services sector account for around 30% of total inputs (intermediate demand)[15] and financial services, electric power, and distribution are in the top five in terms of forward linkages. Given their economic weight, high prices in these sectors contribute to higher prices throughout the economy and hurt competitiveness. Reforms have had and will have a major impact.[16] While no direct evidence is available in Spain, it is generally accepted that lack of competition contributes to poor performance in terms of R&D levels and product innovation.

Regulatory reform has often been driven by the EU and implementation of the legal framework has largely exceeded EU norms.

Reforms in key network and infrastructure industries have focused on changing the legal framework regarding competition in line with the EU single market directives, often exceeding EU norms in many sectors.

The government followed a comprehensive structural reform plan that in some cases was in line with the EU directives and in others with the 1992 report by the *Tribunal de Defensa de la Competencia*. The plan targeted sectors where competition problems appeared to exist and immediate action was both feasible and beneficial: telecommunications, transport, energy, funeral services, urban real estate, and other locally provided services. This included: restructuring state-owned monopolies in preparation for privatisation, introduction of

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competition through regulatory reform, and moves to increase the independence of sectoral regulators; increased enforcement of the new competition law; reform and removal of anti-competitive regulations; and gradual privatisation of state-owned firms (see discussion in Chapters 2 and 3). Spain fulfilled its commitments well ahead of the deadlines and in most cases the actual legal framework implemented has exceeded the minimum EU requirements, giving Spain a more liberal framework than in many other EU countries, such as in telecommunications and electricity.

Substantial price and entry liberalisation has occurred but lack of competition still characterises some sectors

Price liberalisation has been completed in some sectors but not in others.

Prices are fully liberalised in many sectors previously subject to control, such as air transport, road freight, refined oil products, financial services and professional services. However prices remain partly controlled in important sectors such as natural gas, electric power, and pharmacies. Price controls remain in place in water, some postal services and specific professional services, such as notaries public, and property and mercantile registrars. However, the integration of the two corps of public authenticating officers (notaries public and commercial brokers) has been recently approved, leading to increased competition.

Entry has been opened up in most sectors, but in some of them effective competition has not yet been achieved, as other barriers remain and dominant firms have persisted. Additional measures to encourage competition are still necessary.

More progress has been made in liberalising entry. Entry is now completely open in airlines, road freight, telecommunications, electricity and oil distribution. Natural gas will be gradually opened up, with free entry achieved in 2007. Though contestability has increased in most of these sectors, in a number of them competition remains limited either because of the presence of a dominant firm(s) controlling most of the market, e.g. local fixed telephony and distribution of natural gas, or because of the continued presence of other barriers affecting entry: limited number of airport slots in air transport; high and costly licensing and access requirements in telecommunications.

ECONOMIC IMPACT OF CURRENT AND FUTURE SECTORAL REGULATORY REFORM

Liberalisation and regulatory reforms have begun to yield benefits in some sectors.

Prices and margins have come down in a number of sectors.

In many sectors, reforms are recent and their effects have not yet been seen. Results have been achieved in some sectors: telecommunications, air transport and related services, and electricity. In fixed telephony, prices for long distance phone calls have fallen as competition has increased: in telephony Telefonica has lost 14% of market shares for intercity calls ("interprovinciales"), 11% for international calls, and 4% for "provincial" calls since January 1998. Overall, until 1999 Telefónica had lost 19% of market share. Service quality has improved in air transport, flights have become more frequent and telephone services have witnessed an explosion in new products and services. In electricity, the supplier choice for medium size customers has been extended, reducing their input cost and enhancing their competitiveness, so that by July 2000 54% of total demand

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will be eligible to buy direct in the wholesale market, gaining price reductions in the range of 10 to 20%.

Competition continues to increase in financial services. Full liberalisation has led to a dramatic decline in margins on many products; margins on mortgage have dropped from 4.0 to 0.5 percentage points, among the lowest in Europe, and there have been similar trends on other products.[17] Overall however the effect on financing costs has been positive and quite important: combined with the convergence in Spanish interest rates to Europe-wide levels, financing costs have fallen substantially since 1996 and this has stimulated overall levels of investment and disproportionately lowered the cost of working capital to SMEs.

In other sectors, price declines have not yet occurred or been a result largely a result of administrative actions.

In other sectors, price declines have not yet occurred or been largely a result of administrative actions rather than the introduction of competition. Prices have been reduced in electricity, gas canisters, highway tolls, and for business telephony. In electricity, domestic consumers have seen their regulated tariffs cut by 11% in nominal terms in the period 1997-2000. These tariffs account for some 30% of national consumption. In a few sectors prices have actually risen, such as residential consumers in local telephony as cross-subsidies are eliminated.[18]

Effects of many reforms will emerge in the future, generating additional benefits in terms of reduced prices, increased productivity and higher incomes

Substantial additional price declines can be expected.

In certain sectors, additional regulatory reform could result in a further decline in prices. In fact, prices are still above average in sectors like electric power for households and some telecommunications services. Increases in competition should drive down prices over and above the administratively-induced declines of recent years (see Chapters 5 and 6). In sectors like rail transport and water, true costs are increasingly taken into account, together with substantial improvements in service quality and allocative efficiency, with important forward linkages into other sectors.

Improvement in capital and total factor productivity are expected, particularly if reforms are pursued in a number of sectors simultaneously.

If the structural reform programme continues, large labour productivity gains are expected in a number of sectors. Excess and costly capacity in electric power will be cut as competition in generation increases, if driven by market forces rather than purely administrative planning and restructuring. Management in the rail network could substantially improve performance. In transportation, reform is leading to gains in TFP through greater intermodal competition and the increased application of information technology, allowing firms to optimise routing, customise pricing and services, and offer new products such as guaranteed delivery times. This is similar to experiences in other OECD countries. Similar synergies have occurred in energy sectors where sophisticated financial market instruments have developed, allowing trading in energy options and futures, facilitating investment and business planning in the whole economy and reducing business costs. These considerations highlight the importance of greater European integration of transportation and energy markets.

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Negative effects on employment in sectors under reform are likely to be small and can be diminished by a combination of labour market reforms and an overall buoyant economy

Employment losses are likely to be small and easily absorbed if rapid growth is maintained and labour market reforms continue.

Additional losses of employment are likely to be small. No losses may be expected in retail distribution, as experience in other countries shows that the more important effect on employment is a shift in the job composition away from the self employed towards younger, part-time workers. Moreover, reforms in product and labour markets have more than offset employment declines in individual sectors by stimulating overall growth, illustrating the need for product market reform to be accompanied by other structural reforms (see below) and a supportive macroeconomic climate.

Regulatory reform is projected to increase potential growth.

As noted, the Secretariat has estimated the gains from liberalisation in several infrastructure sectors at around 2¼% of GDP. This measure can be taken as a lower bound, since it ignored indirect effects on other sectors and dynamic effects and did not include a number of important sectors, such as water, financial services and natural gas. In fact, increasing competition, especially when combined with labour market reforms, has substantially improved the trade-off between output growth/unemployment *vs.* inflation *i.e.* lower the NAIRU, and thereby increased the rate of sustainable non-inflationary growth.

Complementary structural reforms are necessary to maximise the benefits of regulatory reform

Fiscal and regulatory reforms are mutually reinforcing.

Fiscal reform is necessary in Spain, both to help achieve additional fiscal consolidation and to support regulatory reform; in fact the two are mutually reinforcing. Regulatory reform can support the process of fiscal consolidation by stimulating overall levels of economic growth, reducing the cost of inputs into the public sector, and through the introduction of competition in the provision of public sector services directly. In turn fiscal reform can help support competition in the private sector: reducing remaining subsidies in key sectors will not only generate fiscal savings but help transition these sectors to a more competitive environment,[19] and will lower operating costs in other sectors. Reviewing financing arrangements between the national, regional and local governments is essential for reforms to land use and health-care to proceed. Currently local governments are forced to rely heavily on revenues from building permits (land ceded to them), causing them to restrict supply to raise prices and maximise revenues. Pending reforms of land use and health-care are very important.

Government red tape and bureaucratic hurdles need to be reduced.

Government reforms to eliminate red tape are necessary to reduce the costs of doing business in Spain (see Chapter 2 for details). Obstacles for opening a new business are much higher in Spain than in comparable OECD countries, for example, administrative requirements for opening a new business increase start-up times to five months in Spain, as opposed to two months in France and Germany. However, reforms to reduce the administrative burden on SMEs are part of the current government's reform agenda.

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Labour market reforms to dismissal costs and wage bargaining will help absorb workers displaced by regulatory reforms in individual sectors.

Labour market reforms are ongoing and continuing reform is necessary to further improve labour market performance. Labour market reforms have had important positive synergies with regulatory reform: they allow for the employment gains of regulatory reform to be realised in potentially dynamic growth sectors like telecommunications and at the same time facilitate the absorption of workers displaced from declining sectors or those sectors undergoing restructuring faced with new competition. The authorities have already reduced dismissal costs on permanent contracts but more can be done, particularly in resolving legal ambiguities in defining a justified dismissal. Greater decentralisation of collective bargaining is necessary to allow for more flexibility in relative wage adjustments, which should help increase employment among low-skilled and younger workers. Finally, additional reforms to unemployment benefits and duration are necessary to reduce disincentives to job search, such as tightening eligibility for benefits, improving surveillance to reduce fraud and abuse, and tying employment subsidies to "workfare" or training requirements to help the long-term unemployed reintegrate into the workforce.

ANTICIPATED EFFECTS OF FURTHER SECTORAL REFORMS

The extent of reforms has been impressive and have begun to show results but important problems and new challenges need to be faced.

The extent of reform to date has been impressive and have yielded significant benefits.

Economic reforms started 15 years ago were significantly speeded up in the mid-1990s. Spain has implemented far-reaching trade and foreign investment liberalisation, privatised almost all formerly state-owned manufacturing and infrastructure enterprises, and introduced important reforms liberalising key sectors. Spain has already gained significant economic benefits from these measures in terms of lower prices and interest rates and increasing supply-side flexibility – rapid growth since 1994 has not, to date, engendered the substantial loss of competitiveness or deterioration of the external balances which characterised past expansions.

Nonetheless, some old problems remain and new challenges have appeared.

Spain still faces some problems: high unemployment and low employment rates, relatively high service sector inflation, and a lack of innovation, all largely attributable to supply side rigidities. In the past, these made adjustment to external shocks particularly costly. While the economy is now more flexible than it was even ten years ago, membership in the EMU means that Spain now faces the new challenge of sustaining high economic growth and achieving convergence in per capita GDP with no discretionary use of monetary or foreign exchange rate policy and substantial constraints on fiscal policy.

To further converge in real terms with the rest of the EU, Spain needs to exceed average EU performance in implementing regulatory reform and introducing competition.

Regulatory reform has been significant, but the job is not finished.

Reforming at the EU average has been a tremendous accomplishment. Yet if Spain will persevere in its process of real convergence with the rest of Europe and bring down unemployment,

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performing at average will not suffice. Regulatory reform is even more important in Spain than elsewhere in Europe and Spain must seek to exceed *average* European progress in introducing competition. Regulatory reform in Spain has largely focused on privatisation, liberalisation, and reinforcement of competition policy, with less progress in restructuring sectors *i.e.* natural gas, and in building pro-competitive regulatory regimes and institutions.

Additional reforms introducing more competition and market pricing mechanisms will bring substantial benefits. Steps could include:

Further product-market and public sector service reforms could substantially boost economic growth, lower inflation, improve supply-side flexibility and competitiveness, and generate employment growth. At the same time they can decrease fiscal expenditures and the structural deficit by reducing the need for subsidies and generating greater efficiency in public sector activities, giving Spain greater manoeuvrability within the EMU constraints. Among the most important reforms necessary are:

… ease entry in air transport by improving allocation of airport slots…

– In air transport introducing a more transparent and market based system of allocating slots at Madrid and Barcelona's congested airports, such as through an auction system, would be an important step in encouraging competition through new entry.

… review concessions procedures and systems…

– Clear benefits have been gained in Spain and other OECD countries from competitive bidding for concessions in passenger transport, some port services and highways. Where possible, moving to more transparent general regulations, shortening the maximum terms of concessions, and introducing new auctioning mechanisms to correct some of the shortcomings of the fixed term franchise could generate substantial additional benefits.

… increase the role of the private sector in health care provision and insurance…

– As noted in the OECD 1996 Economic Survey, reforms to the health care system are needed to help reduce fiscal spending and improve service quality. Outsourcing has already generated important savings but has only been applied to a limited extent (some hospitals and ambulatory care) and in certain regions. Outsourcing needs to be increased and liberalisation pursued in complementary areas, such as pharmaceuticals.

Improve and lowering cost of network access in network industries.

– Opening access to the network in telecommunications has already generated important benefits from new competition. Lowering the cost of interconnection in this sector and in other network industries – electric power, natural gas, oil distribution – should continue. European member states should encourage connection between network industries.

Allowing the greater operation of market forces in the allocation of land and water.

– Land and water markets in Spain remain tightly regulated, inducing substantial economic distortions in not only these sectors but throughout the economy because of their implications for the locational decisions of labour and enterprises. Reforming the zoning and building permit process to remove artificial restraints on supply could generate substantial declines in land, office and housing prices, with substantial knock-on effects such as improving competition in retail distribution and increasing labour mobility. Increasing the use of market pricing in water may incur some transition costs but will

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lead to greater long-term allocative efficiency, improved environmental performance and sustainable water resource management.

Complementary reforms will be essential for maximising the benefits of structural reform.

Sectoral reforms will need to be complemented by other structural reforms and by the maintenance of a stable macroeconomic environment. The former include:

- Labour market reforms to extend the recent reduction in dismissal costs for all workers, and move towards greater decentralisation of collective bargaining.
- Fiscal reforms to reduce distortionary revenue measures and subsidies, *i.e.* eliminating electricity surcharges that subsidise domestic coal and removing restrictions on land supply.

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Chapter 2

GOVERNMENT CAPACITY TO ASSURE HIGH QUALITY REGULATION

Improving Spain's governance capacities and institutions has been key to the effectiveness of structural and regulatory reforms.

In the past quarter century, Spain experienced a profound transformation of its governance structures that continues today. Within this broad context of governance reform, regulatory regimes and institutions have been extensively reshaped. The Spanish government has reinforced structural reforms by improving the capacities of national and subnational administrations to ensure that regulation is transparent, efficient, necessary, and consistent with market-oriented policies.

Reforms to regulatory governance have responded to European and domestic pressures.

The three key policies shaping regulatory governance are…

Three policies have been important in driving Spain's regulatory governance: European convergence; devolution of regulatory and other governance capacities to the autonomous communities; and modernisation of the national public administration. Spain's participation in the European Monetary Union will place greater attention on the efficiency of its regulatory institutions, processes, and policies.

… European integration…

Spain has steadily integrated its national regulatory regimes with the European framework. Even before the Maastricht and Amsterdam Treaties, more than half of Spain's legal framework implemented EU policies.[20] Today, the European Commission considers Spain as one of the most advanced EU countries in transposing EU Directives.[21] Legal integration of this magnitude has far-reaching impacts on regulatory institutions, and legal traditions and doctrines.[22]

… decentralisation…

– Spain's legal and administrative frameworks are being remolded in the process of reconciling what was previously a highly-centralised state with growing regional autonomy. Devolution was launched by the Constitution of 1978. The speed and scope of decentralisation is different for various autonomous communities (Box. 2.4), but today all 17 autonomous communities have established institutions and legal and regulatory frameworks. Devolution requires that national administrative functions be reinvented, such as by replacing regulatory functions with policy co-ordination to provide consistency across communities.

… and boosting public sector efficiency.

– Since the 1980s, the government has accelerated changes to improve the efficiency of the public sector through professionalisation of the civil service, organisational restructuring, legal rationalisation, and privatisation.

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Substantial reforms have been made, and the institutions and incentives of the public administration are adjusting to a market-oriented environment.

Recent steps create a sound basis for aspects of regulatory quality such as transparency and market-orientation.

Steps taken in recent years (see Box 2.1) create a sound legal base for such aspects of regulatory quality as transparency and market-orientation. Further steps will improve policy effectiveness and build on these foundations to create a sustainable regulatory management system needed for business growth, in particular for small and medium-sized enterprises, and enhanced accountability.[23] The Spanish regulatory system is moving gradually from a command-and-control, legalistic approach to a market-based, compliance-friendly, and results-oriented approach.

As in many countries, reforming public organisations and cultures has been a lengthy and complex process. Traditionally, the Spanish administration is compartmentalised into strong ministries, and horizontal oversight bodies and co-ordination mechanisms to implement government-wide policy decisions and reforms are often weak. The civil service suffers from rigidity in personnel and staffing.[24] Decentralisation that led to large increases in civil servants at subnational levels was not matched by a significant reduction of public servants at the national level, creating inefficiencies and co-ordination problems between levels of government (see Box 2.4). Reliance on command-and-control regulations and controls on market competition is prevalent. Similar problems are also seen at regional and local levels.

Disciplines and capacities for improving the quality of regulation are under construction in the public administration, but a general reform policy and explicit quality principles are needed…

However, Spain has no broad policy on how the state is to use its regulatory powers, nor on regulatory quality, and this has slowed reform.

The 1997 OECD *Report on Regulatory Reform* recommends that countries adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.[25] In Spain, the government has pursued many important reforms that have had direct and indirect impacts on regulatory capacities in the public sector (Box 2.1). There is a long-standing policy, under the responsibility of the Council of State, to improve the juridical quality of laws and regulations.[26] However, there is no broad policy on how the state is to use its regulatory powers, nor a policy on regulatory reform and regulatory quality in particular. Spain has moved faster in improving the quality of sectoral economic regulations than social and administrative regulations that cut across the economy.

In addition, principles of "good regulation" are needed to guide ministries in determining when and how to regulate. The OECD principles accepted by Ministers in 1997 read:

> *Good regulation should: i) be needed to serve clearly identified policy goals, and effective in achieving those goals; ii) have a sound legal basis; iii) produce benefits that justify costs, considering the distribution of effects across society; iv) minimise costs and market distortions; v) promote innovation through market incentives and goal-based approaches; vi) be clear, simple, and prac-*

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tical for users; *vii) be consistent with other regulations and policies*; *and viii) be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.*

The Spanish government should build on current regulatory evaluation procedures by adopting explicit quality criteria for regulations, supported with written guidance to ministries. Such objective criteria will help the public administration regulate only when necessary, and at lowest cost, to protect health, safety, the environment, and other public goals. They would provide a firmer basis for efforts in the ministries and to hold ministries more accountable for performance.

Box 2.1. Managing regulatory quality in Spain

Ensuring regulatory transparency:

- Spain established in 1992 a Public Administration Legal Regime and Administrative Procedure Law, replacing the 1958 Law. Complementary laws, such as the Government Law (1997) and the Organisation and Operation of the General administration of the State Law (1997), have increased accountability and transparency across the administration.
- Strengthening the 1992 reforms, a 1999 reform of the Public Administration Legal Regime and Administrative Procedure Law established criteria for administrative procedures involving citizens. The criteria set minimum standards on, among other elements, the time for responses, the use of the "silent is consent" rule, quality and readability, and redress mechanisms for formalities. Autonomous regions can establish more stringent standards than national ones.
- New laws and regulations must be published in the *Boletín Oficial del Estado*.
- The Government Law sets basic requirements for consultation. Practices vary across ministries and no harmonised procedures have been developed..
- Ministry of Public Administration (MAP) has issued a guidebook on "plain language" in administrative communications. In 1998, MAP created an electronic inventory of administrative procedures and formalities at the national level. It is accessible by the Internet.

Promoting regulatory reform and quality within the administration:

- An Administrative Simplification Commission, under MAP supervision, was established in 1999 to institutionalise and further the work of simplification programmes launched since the early 1990s. The Commission is in charge of eliminating all "unnecessary" formalities and implement, if appropriate, a "silence is consent" rule for the remaining ones. It also oversees and co-ordinates the yearly simplification programmes prepared by ministries and agencies.
- The Council of State, an independent body from the government, is in charge of improving the legal quality of proposals of laws and regulations.

Assessing regulatory impacts:

- Proposals for laws and subordinate regulations must be accompanied by a report on its necessity, and an economic memorandum estimating budgetary costs, with additional assessments to guarantee the appropriateness and legality of the text.
- An Evaluation Questionnaire was developed to help ministries to comply with such requirement. However, no quantification of costs and benefits is required.
- Some autonomous communities, such as Catalonia, are developing regulatory impact assessments, based on a cost-benefit approach, for new regulations.

Toward accountable and results-oriented regulation

- The Simplification Commission prepares a yearly report to the Council of Ministers on progress in the field.

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It is important to establish the principle that regulations should be adopted only if the benefits justify the costs.

The OECD recommends as a key principle that regulations should "produce benefits that justify costs, considering the distribution of effects across society." This principle is referred to in various countries as the "proportionality" principle or, in a more rigorous and quantitative form, as the benefit-cost test. This test is the preferred method for considering regulatory impacts because it aims to produce public policy that meets the criterion of being "socially optimal" (*i.e.*, maximising welfare).[27] The principle of proportionality is insufficiently developed in Spain (see below). It is important to establish this explicit test of policy optimality for regulatory decisions to create an explicit standard by which ministries justify the need for regulations and publicly test their conclusions.

... as is a high-level and specialised unit to supervise adherence to regulatory quality standards throughout the public administration.

An expert government-wide institution, independent from the regulatory ministries, is needed to promote reform and oversee compliance.

Quality standards and principles are, in themselves, not enough to improve regulatory habits. An expert government-wide institution, independent from the regulatory ministries, is needed to promote reform and oversee compliance. Promotion of regulatory quality would be considerably strengthened by an independent body or dedicated commission with a clear mandate and adequate resources. In Spain, there is currently some capacity to oversee compliance with regulatory policies. Review of legal proposals and high-level regulations (Royal Decrees) is done by a General Commission of General Secretaries and Sub-secretaries (CGSYS), before a decision is made by the Council of Ministers. The *Consejo de Estado* reviews the legal quality of laws and high-level regulations. There is no review, however, of other subordinate regulations, such as ministerial orders and technical rules produced by ministries and agencies.

One of the reasons why more progress has been made in Spain on structural reforms is that the institutional basis for progress is stronger. The Delegated Commission of the Government for Economic Affairs (*Comisión Delegada del Gobierno para Asuntos Económicos*) has authority from the Council of Ministers to deal with the most important economic issues. The *Comisión Delegada* has influenced most structural reforms and economic liberalisation measures of the past decade, and it initiates and supervises reforms. This powerful commission is composed of all ministers directly involved in economic affairs. The Minister of Economy and Finance chairs it and the Secretary of State of Economy acts as its secretariat with the technical assistance of the Director General for Economic Policy and Defence of Competition. The Ministry also hosts the executive branch of the Competition Authority (*Servicio de la Competencia*), which has had an important advocacy role in the structural reforms (see Chapter 3). A similar arrangement could be envisioned for regulatory reform.

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Regulatory transparency has improved as regulators have expanded their use of public consultation…

Spain has taken significant steps to improve transparency in its regulatory and administrative activities…

Transparency of the regulatory system is essential to establishing a stable and accessible regulatory environment that promotes competition, trade, and investment, and helps ensure against undue influence by special interests. In the past two decades, Spain has taken significant steps to improve transparency in its regulatory and administrative activities.

The 1978 Constitution elevated a procedure called *trámite de audiencia* to a constitutional obligation, strengthening transparency and accountability as well as reducing corporatist practices. The Government Law of 1997 clarified procedures to ensure that regulatory decisions are made appropriately, predictably, and openly. It clarified that all regulations should be published in the Official Bulletin and be subject to public consultation, though it did not specify when or how consultation should occur. The autonomous communities and municipalities have adopted similar processes, although usually with fewer constraints.

The ministries usually organise the *trámite de audiencia*, by circulating proposals to selected parties, by discussing with official consultative bodies, such as the Economic and Social Council (*Consejo Económico y Social*), or, increasingly, through notice and comment. For subordinate regulations, consultation should take at least 15 working days. Regulators are required to prepare a written statement summarising comments and justifying the consultation mechanism. At the end of the process, the Council of State assesses the extent and results of consultation. After entering into force, laws and regulations may be annulled due to a lack of adequate consultation through legal appeal.

New electronic procedures hold the promise of opening up these consultations to a wider range of interests. The Ministry of Justice is experimenting with a new consultation procedure based on the Internet. "Notice and comment" should be required for all new proposals to strengthen consultation.

… though some transparency issues are not yet resolved.

The 1997 law is a clear break with older practices, and is a positive step towards a more transparent, uniform, and structured consultation system. However, some challenges are not yet resolved. The discretion of regulators to choose the consultation strategy is too wide to ensure accessibility, provide an independent quality control, and protect against capture. Practical access to regulations in force is not easy in Spain, for instance a business survey conducted in 1997 found for instance that most businesses were having difficulties in identifying existing environmental regulation.[28] The most problematic issue concerns the lack of a consolidated code or registry that can improve certainty for users of regulation. An important scheme has been the setting up of a consolidated registry of administrative procedures on the Internet, the publication of the *Boletín Oficial del Estado* on the Internet, and the new citizen's assistance centres (*Centros de Atención al Ciudadano*).

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… but there remains room for improvement in the use of Regulatory Impact Analysis.

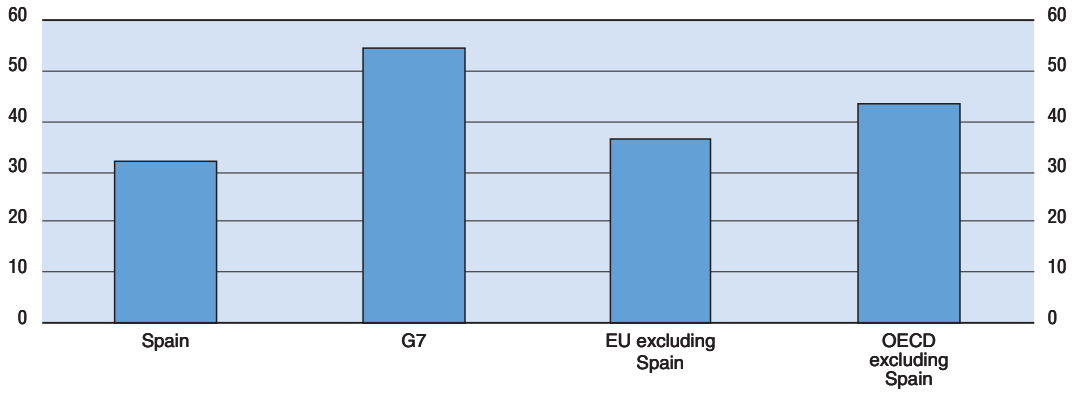
Regulatory impact analysis could assist in improving the efficiency and effectiveness of Spanish regulation.

The 1995 OECD *Recommendation on Improving the Quality of Government Regulation* emphasised the role of RIA in systematically ensuring that the most efficient and effective policy options were chosen. Each new Spanish law and regulation must be accompanied with a report justifying its necessity, with a memorandum estimating its foreseen budgetary costs. No guidance or directive specifies the content of these documents, though for laws and royal decrees regulators may use the Evaluation Questionnaire for Norms (*Cuestionario de Evaluación de Proyectos Normativos*). The Questionnaire has 20 questions divided in three sections: *i*) necessity of the project, *ii*) legal and institutional impacts, and *iii*) social and economic impacts.

In practice, RIAs have been legalistic and descriptive assessments that are often too vague to support good decisions. Incentives within the ministries to perform good RIA are not strong. No central body scrutinises the quality of the analysis on a consistent basis, no analytical criteria or parameters exist, and no method is specified to analyse the impacts of regulation. The absence of a cost-benefit principle, of a reference to economic compliance costs for citizens and businesses, and of a structured approach to assessing benefits are particularly important. The law does not require regulators to share the reports with consulted parties. In brief, a number of steps would

Box 2.2. **The formal scope and breadth of Regulatory Impact Analysis**

This indicator looks at several aspects of the use of RIA, and ranks more highly those programmes where RIA is applied both to legislation and lower-level regulations, where independent controls on the quality of analysis are in place, and where competition and trade impacts are identified. Spain lags behind OECD countries and rest of the EU member states on this criterion. Key shortcomings are that the quality of the impact assessment reports and evaluation questionnaire are not reviewed by a body independent of the regulator, RIA is not applied to all cases, and RIA is not released for consultation. Systematically reviewing the quality of these documents, making them mandatory, and integrating them with consultation are a key policy priority.



Source: Public Management Division, OECD, 1999.

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be needed to turn the existing Evaluation Questionnaire into full-fledged regulatory impact analysis.

Regulatory institutions are improving in accountability and effectiveness.

Spain has created new institutions to manage the market-oriented regulatory frameworks.

Like other countries, Spain has created new institutions to manage the market-oriented regulatory frameworks. In the past five years, several regulatory bodies have been established to regulate economic sectors. These include the National Commission for Electricity (CNSE) established in 1995, replaced at end 1999 by a new commission on energy (CNE) including the gas sector (see Chapter 5); the Commission for the Telecommunication Market (CMT) established in 1997 (see Chapter 6); the National Commission of the Securities Market (CNMV), reformed in 1997[29] and the Commission for the Tobacco Market established in 1998.

The Organisation and Operation of the General Administration of the State Law of 1997 provided clearer institutional guidance for developing such agencies to reduce the heterogeneity of their design. The performance of these agencies, with respect to providing high quality regulatory frameworks for market competition, depends on several factors, including governance issues:

- Establishing clear regulatory roles and objectives, particularly between ministers and regulators, makes regulation more effective by removing conflict and uncertainty. In Spain, policy powers are kept in the ministries, and regulatory powers delegated to the agencies. However, in some cases, the line is not clear. Important regulatory functions like scrutinising entrants and deciding on entry concessions are shared between the regulators and the ministry and key sectoral decisions have not been accepted by the government (see Chapter 5).

- Autonomy helps to ensure that regulators are free to satisfy their stated objectives transparently and neutrally. Spanish agencies enjoy substantial autonomy in staffing and budget policies. Autonomy must be accompanied by accountability for performance. The Spanish system of accountability is based on a submission to Parliament of an annual report, and appeals to the judicial system.

- Transparency requires that regulators publish and explain their actions. By law, Spanish agencies publish and explain their decisions. Additional transparency is provided through *ad hoc* consultative bodies. The government has also tried to ensure transparency in the process of granting market entry concessions for electricity and telecommunication services. That can be difficult to achieve, though, because the granting of concessions is inherently discretionary. Increasingly, OECD countries are turning to open auction procedures to grant such permits because they convey a clearer guarantee of transparency and protection against undue discretionary power, and reveal more clearly the price set by a free and open market.

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Regulatory complexity is a particular problem in Spain, due to traditions of detailed controls and layers of government…

Spanish regulations tend to be legalistic and command-oriented, rather than user-oriented.

Spanish administrative culture demonstrates a highly-developed legalism, reliance on precedent, and formalism in actions and procedures. This has made it difficult to move toward policy practices that are results-oriented and responsive to citizens and businesses. For example, the legalistic approach contributes to the practice of using command and control regulations rather than market-based instruments to solve problems.

Constant legal changes and an increase in the flow of new regulations, linked in part to the devolution to subnational governments, has also increased the complexity of the overall Spanish regulatory environment. Use of fragmented legislation and the lack of a systematic and rigorous abrogation of old rules have consequences for legal security, particularly for a civil law system based on an exhaustive and explicit set of rules.[30]

….and simplification of formalities affecting entrepreneurs is an urgent task.

Setting-up, operating and closing a business in Spain appears to be a more cumbersome process than in other countries…

Setting-up, operating and closing a business in Spain appears to be a more cumbersome process than in other countries (see Box 2.3). The main culprit is a complex system of authorisations, permits, and licences at all levels of government. Government authorities have traditionally relied on *ex ante* controls, instead of relying on *ex post* surveillance, self-regulation or other performance-related regulations. This is even more important in Spain, where SMEs represent a much higher proportion of the private sector than elsewhere in Europe.[31]

Box 2.3. **Administrative compliance costs in Spain**

Irrespective of an entrepreneur's decision to incorporate the firm, new enterprises must carry out 13 to 14 general formalities to start a business, and additional ones in particular sectors.[1] Legal registration of a business involves a minimum of five steps. On average, each step requires four pieces of documentation, and involves a minimum of six different agencies. The total time required to fulfil these legal requirements is estimated to be between 19 and 28 weeks, although for a non-incorporated firm, the period can now be reduced to one day. In contrast, it takes around half a day to establish a new enterprise in the United States.[2] On average, according to the business confederation CEOE, an entrepreneur needs 500 000 PTAs (3 000 euros) and six months to start a business. Operating a business is also burdensome. An OECD business survey in 1999 estimated that the administrative compliance costs related to fiscal, employment and environmental regulations for SMEs in 1998 was several billion pesetas.[3]

1. These steps are set out in detail on the website of the Ministry of Economics *http://www.ipyme.org/temas/empresas/crea.htm*.
2. OECD (1998), *Economic Surveys: Spain*, Paris, p. 144-146.
3. SMEs analysed were firms with 1 to 500 employees in the manufacturing and service sector (*i.e.* self-employees, large firms, and firms in agriculture, mining were excluded). The estimates are based on a labour unit cost of 1 878 pesetas/hour, and a GDP in business sector at factor cost in 1998 of 82 650 billions pesetas. The survey was conducted between April and June 1998, based on a common framework developed by the OECD in consultation with the OECD's Regulatory Management and Reform Group. It was implemented by the *Direccion General de Politica de la Pequeña y Mediana Empresa, del Ministerio de Economia y Hacienda* in co-operation with Gallup, Spain. PUMA/OECD (1999), *Multi-Country Business Survey on Benchmarking the International Regulatory and Administrative Business Environment: Report on the Results for Spain*, (forthcoming).

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... though Spain ranks high among OECD countries in its efforts to reduce administrative barriers for SMEs.

Spain ranks high among OECD countries in its efforts to reduce administrative barriers for SMEs. The policy to establish the "silence is consent rule" (tacit authorisation) and the programme to review and reduce the number of licences and permits promise significant improvements. Transparency was enhanced by the creation of national inventories of administrative procedures. The 1999 reform of the Administrative Procedure Act established an inter-ministerial Administrative Simplification Commission to eliminate unnecessary formalities and implement more widely the tacit authorisation rule. The Commission also provides opinions on new administrative procedures contained in legal or regulatory proposals. Creation of the commission is a good step to build a crosscutting view of the central administration procedures, improve consistency and transparency, and promote reform throughout the central government. The government also drew up in July 1999 a Plan to Simplify the Regulatory Framework for SME Competitiveness, which has promoted significant reforms to formalities. Closer co-ordination between SME policies and the Simplification Commission has recently been established.

Further steps could be taken to strengthen this process. The Simplification Commission lacks binding powers and relies mainly on peer pressure and transparency, such as an annual report on compliance by ministries. It has not established clear economic principles or methods for eliminating and simplifying procedures. Without objective standards and methods, ministries could generously interpret the benefits and minimise the costs of each formality. It will be important that the Commission be exposed to citizens' inputs and have dialogue with stakeholders to understand burdens and weigh costs and benefits.

There has also been success in using information technology to provide better and faster access to public services and products. An ambitious project to create one-stop-shops (*Ventanilla Unica*) was launched, and will soon be supported by citizens' assistance centres (*Centros de Atención al Ciudadano*). To help businesses start ups, the government has set up "start-up shops" to provide entrepreneurs with information on all business and administrative issues, and to authorise on the spot some licences and permits.

Regulatory compliance merits continued attention to safeguard the effectiveness of social and economic policies.

Attention to regulatory compliance could help balance reform between economic deregulation and stronger regulatory protections for citizens and the environment.

Where regulatory compliance is low, the effectiveness of regulations, public policies, and ultimately the capacities and credibility of governments in taking action, is threatened. In Spain, regulatory compliance is a complex issue, in part because regions and municipalities are predominantly in charge of implementation and enforcement. Further action in this area could balance regulatory reform in Spain between economic deregulation on one hand, and stronger regulatory protections for citizens and the environment, on the other hand.

Some innovations were recently launched. The tax revenue agency is implementing a scheme to improve tax compliance by multinational and large firms. In these pacts, the firm and the agency agree on the value of the transactions between the firm and its subsidiaries (advance price agreements) in exchange for a less complex

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Box 2.4. Regulatory reform in a decentralising Spain

The Constitution does not define Spain as a federation, though the relations between the central government and the autonomous communities increasingly operate like one. The Constitution creates a continuing process to devolve powers according to local capacities to exercise them. This has resulted in a multi-speed devolution, in which the degree of devolution varies from community to community. As a result, sub-national governments are closely tied into the national regulatory framework. The policies and mechanisms for co-ordinating regulations between the regions and municipalities on one hand, and the European level on the other, are essential to the establishment of a high quality regulatory environment in Spain.

Regulatory relations between the central and community levels generally take one of two forms:

- Policy making is often kept at the central level, while the implementation and administration of regulations is delegated to autonomous or local levels.
- In many areas, such as the environment, the central government sets minimum standards to be met and leaves each autonomous community, or even municipality, the capacity to adapt them according to environmental, social, political, and cultural situations.

Expansion of regional and local regulatory power has sometimes stimulated the emergence of regulatory innovations. Some autonomous communities are laboratories of new ideas. For instance, although the "tacit authorisation" rule for all administrative procedures was discussed in the central government since the late 1980s, the Catalan government was able to implement the measure a few years earlier. But such innovations are the exception, and in many policy areas decentralisation has had negative effects on regulatory quality. Enactment of dissimilar regulations by regional and local governments has reduced legal security and increased complexity. Regional and local administrations have in many ways inherited the cultural and traditional rigidities of the national administration. An alarming re-emergence of interventionist policies and attitudes is signalled by the acquisition by autonomous communities and municipalities of hundreds of public enterprises.[1]

The government has taken steps to correct these problems, for instance through reform of administrative services at local levels. Given the political momentum toward devolution, it has concentrated on violations of the competition law (see Chapter 3) and focused its resources in reinforcing co-operation. A web of intergovernmental boards or "sectoral conferences" was created since the early 1980s to prevent conflict and improve communication between the national government and the autonomous regions. In mid-1999, 27 sectoral conferences were operating. Chaired by the responsible national minister, each conference specialises in policy areas (education, health, industry and energy, labour, etc.). The meetings cover the subjects of interest to both parties, though the national government decides whether a consultation is necessary.[2] It is through these fora that each national ministry consults with the autonomous communities on legal proposals and European Directives before they are submitted to Parliament.[3]

As a complement to the sectoral conferences, the government established in January 1999 new institutions and co-operation instruments.[4] The Bilateral Co-operation Commissions (Comisiones Bilaterales de Cooperación) between the national government and individual autonomous communities are intended to permit a more focused and prompt approach to problems. These new bodies reflect a successful model developed for environmental policy; the European Environmental Agency, for example, has considered as best practice the co-ordination tools developed in Spain to integrate environmental concerns with other policies at regional levels. Agencias del Medio Ambiente (AMA) or Environment Agencies have been established in four autonomous communities. They bring together sectoral ministries to develop environmental policy and regulations, thus spreading the "ownership" of environmental protection measures and facilitating their implementation.[5]

The 1999 reform also reinforced an important co-ordination tool, the "co-operative covenants", to strengthen the institutional framework to develop joint plans and programmes between the governments on particular issues.

1. OECD (1998), *Economic Surveys: Spain*, Paris, p. 94.
2. It should be noted that in the case of the *Comisión de Política Fiscal y Financiera*, formed by the financial counsellors of all regional governments and chaired by the Ministers of Economy and Finance and Public Administrations to discuss and reach agreements on the financing of regional governments, meetings can be convoked by the national government but also by regional governments when a certain number of them ask for it.
3. OECD/PUMA (1996), p. 337.
4. Reforms of the Common Administrative Procedure Law (4/1999).
5. European Environmental Agency (1998).

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and burdensome regime and supervision. A network involving the autonomous communities and the ministries in charge of European structural funds is monitoring the enforcement of European Directives and regulations.

One aspect of compliance is the ability to choose the most efficient and effective policy tool, whether regulatory or non-regulatory. Reform authorities must take a clear leading role supportive of innovation and policy learning – if alternatives to traditional regulation are to make serious headway into the policy system. Spain has lagged in the use of economic instruments, though a series of voluntary agreements between firms and government authorities in the environmental area is a good step.

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Chapter 3

THE ROLE OF COMPETITION POLICY IN REGULATORY REFORM

Over the last 10 years, effective competition policy became central to economic policy as Spain abandoned interventionist practices. Spain's competition authorities, among the most activist in OECD countries in promoting reform, have been essential to the success of market liberalisation process by ensuring that the benefits pass through to consumers through effective competition. The national government has said that competition policy should be further strengthened as the Spanish economy converges with Europe and as the EMU intensifies competition.

Spain's competition policy strengthened as Spain aligned policies with the EU.

Competition policy was revived in the 1980s, following constitutional reform. In the 1990s, competition institutions became leaders of reform.

Since 1977, the government and the private sector have been adapting Spain's competition policy, and its business practices, to European policies. Spain had a competition law since the early 1960s, but its actions, budgets, and personnel declined over the 1960s and 1970s. The constitution of 1978 established competition policy as a regulating function of the state and called for modifying competition policy institutions. The ensuing economic reforms finally produced a stronger Competition Act in 1989. With its greater authority, including clearer advocacy powers, the independent *Tribunal de Defensa de la Competencia* became much more active in the 1990s, taking a prominent position in the debate over regulatory reform.

The legal criteria and available sanctions in the competition law are generally comprehensive enough to cover competition problems that may have been required or encouraged by regulation, or that will appear as regulatory structures change. Uncertainty about the role and priority of competition policy in decisions about mergers had been a weakness, but, as noted below, recent actions to strengthen legal tools and apply them more aggressively suggest that has changed.

Comprehensive sectoral action plans targeted likely competition problems, notably in non-traded services.

A report by competition authorities in 1992 laid out a blueprint for sectoral reforms.

In response to a government request, the *Tribunal* prepared a comprehensive report on structural reforms in 1992. This report became a blueprint for sectoral regulatory reform in Spain, and is a model of how to integrate competition agency expertise into reform processes. Recognising that the Spanish economy was constrained by more restrictions on competition than was the case in most other

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European economies, the *Tribunal* chose sectors for study and recommendation based on three criteria:

- Impact on the economy's competitiveness.
- Severity of the restriction on competition.
- Success in liberalisation in other countries.

The original reform priorities were electric power, local monopolies, public utility installation and maintenance, telecoms, and urban real estate. But the list quickly grew to include water and gas distribution, publications, postal services, taxis, mass media, seaports, pharmacies, and contracting.

The report set out sound principles about regulatory methods.

The report also recommended changes in legislation, and outlined ways to overcome inevitable opposition to market reform from the groups that benefit from rents in the sectors:

- Regulators should be fully independent from the regulated businesses.
- Reform should be implemented by specific government actions pursuant to general parliamentary instruction.
- Social policies and objectives should not be jeopardised by competition.
- Cross-subsidies should be eliminated by removing monopolies from public holdings.

The *Tribunal* presented annual reports on reform, with a general survey and in-depth analysis of competition in particular sectors, through 1995.

Following through on these principles, many sectors were privatised and liberalised, but the process either left, or produced, market power in several sectors that may produce competition problems in future.

The role of competition principles during the transition to competitive markets is critical. This is particularly the case when vertically integrated monopolies are giving way to markets, and when sectors are undergoing restructuring that could lead to concentration. Continuing efforts are required to minimise the risk of the potential abuse of dominant position by firms in these sectors. A number of sectors in Spain exhibit these characteristics.

Telecoms show how the law about abuse of dominance applies to deregulated industries.

The telecommunications sector has produced several important decisions about abuse of dominance. As noted in Chapter 6, full liberalisation in the telecommunications sector came in December 1998. The new telecoms regulator, CMT, has some merger and competition policy responsibility over firms in the sector, but these responsibilities do not interfere with the powers of the competition bodies or the Council of Ministers. Competition law provisions on abuse of dominance were applied several times to support reforms, beginning with an early case against Telefónica, the historic legal monopoly, for interfering with a new competitor's plans to provide enhanced services. On several occasions, the *Tribunal* took enforcement actions that included substantial fines – in early 1999, two cases demanded fines of

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Ptas 580 million and 750 million – against Telefónica's efforts to resist or delay market liberalisation.

Despite reforms, electric power supply is highly concentrated.

In the generation and distribution of electric power, as discussed in Chapter 5, two companies, the recently privatised Endesa group and Iberdrola, have 80% of the national market. Reform legislation, passed in 1997, promises full price liberalisation in 2007. Regulatory oversight is provided principally by the ministry and a new independent regulator, CSEN. Several competition cases have already arisen in this sector, including reviews of proposed joint ventures in transmission and in fuel supply. Complaints about access are being filed with the *Servicio* and reviewed by the *Tribunal*. Despite the reforms, the consolidation that accompanied reform has left a highly concentrated industry with limited possibilities for entry.

Some sectoral monopolies are only slowly giving way to competition principles.

The natural gas industry and the state rail company operate essentially as monopolies. In the gas industry, the long-term reform plan calls for prices to be liberalised over a 10 year period, beginning with the largest customers. The concession system would be changed to a system of licenses, and competition would be authorised in several functions. But cross-subsidisation is controlled only by accounting separation. The state company rail RENFE barely covers half of its running costs. Plans are underway to separate track construction and management from rail transport services. Though infrastructure has been separated out, and commuter and long-run operations have been managerially separated, there are as yet no new operators.

Air transport liberalisation appears generally successful, but competition problems should be carefully watched.

Competition problems may linger in the air transport sector. Two private companies compete with the state-run group, Iberia. There has been a significant reduction in prices, accompanied by a wider range of fares, more frequent flights and improved service quality, but there have been accusations that airlines are colluding to share markets or keep prices up. In a recent case, the airlines claimed, unsuccessfully, that their price fixing was covered by an EU block exemption.

EU requirements have led to competition in trucking, while buses remain regulated.

The framework law for road transport acknowledges the importance of competition and market forces. Still, some restrictions or non-competitive conditions persist, as in the bus industry. In the road freight sector, by contrast, licensing standards have been relaxed and a program of progressive fare liberalisation has been adopted. The EU has effectively opened up this sector by requiring nations to permit cabotage.

Financial services appear competitive, but competition oversight may need to be stronger.

Though business banking appears generally competitive and interest rates for mortgages in Spain are the lowest in Europe, some consumer rates, such as credit card and overdraft fees, are relatively high. After small businesses complained that two firms controlling 80% of the payment systems market refused to discount from their (common) merchant charges, an agreement was recently reached to progressively reduce those charges. Some of the *Tribunal*'s recommendations to strengthen competition oversight have been adopted, notably submitting major bank mergers for competition policy review. But some others, such as to increase consumer protec-

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tions and to put commercial banks and savings banks on a more equal competitive footing, have been rejected.

Formal exemptions from competition policy are narrow, due in part to actions by the competition authorities.

Conduct authorised by other law is excluded from the Competition Act.

There are few explicit sectoral or functional exemptions from competition policy, but the law includes a potentially broad exemption for officially authorised conduct. The *Tribunal* interprets that exemption narrowly. Only national government laws can support this immunity for private conduct. Examples of explicit laws are those that exempt the postal service and authorise margin or price fixing for tobacco products, books, and pharmaceuticals. More imaginative claims have lost. Cosmetics makers unsuccessfully argued that the pharmaceuticals law authorised them to limit distribution of their own products to drug stores, for example.

Retail distribution of tobacco products is a monopoly.

The retail monopoly for tobacco is run by a concession system. Profit margins at retail are set by law. The requirements for a retail license are very demanding, and no competitor has entered as of early 1999. The *Tribunal* objected, unsuccessfully, to the exclusionary effect of these license requirements. The new regulatory agency should promote competition in this sector through means such as separating regulatory functions from operating interests.

Ocean shipping may be exempt from the competition law.

Ocean shipping conferences are exempted from the prohibition of restrictive agreements, if they face effective competition. In port services, there has been some limited liberalisation. *Puertos del Estado*

Box 3.1. **Professional services and competition law**

Professional services illustrate the difficulties of eliminating exemptions from the competition law. The *Tribunal*'s first report about competition issues, in 1992, was about professional groups organised into *Colegios Profesionales*: doctors, dentists, pharmacists, lawyers, engineers, architects, surveyors, and others. Constraints in these fields were beyond the reach of the Competition Act, because they were imposed pursuant to regulation, not merely by agreement within professional associations.

The *Tribunal* recommended in 1992 that controls on prices should be eliminated. In addition, it recommended eliminating special rules about advertising, since professional advertising would still be subject to the generally applicable rules against deception in the Unfair Competition Act. And it recommended that territorial restrictions and restraints on business structures of professional practices should be abolished, as archaic and even harmful to Spanish professionals competing in the European community. The *Tribunal* did not object to the basic legal requirement of association membership, though, because it did not appear to be used to exclude competition, as essentially everyone who met the qualifications was admitted to association membership.

The major reform was a 1996 decree (afterwards enacted as the Law 7/97) making clear that the competition law applies to professionals. It provided for free setting of fees, by preventing associations from prescribing minimum fees, and it permitted professionals to practice anywhere in Spain based on joining a single professional association. A 1999 decree has extended the Competition Act's coverage to notaries, registrars, and commercial brokers. The associations' powers to compel payment through the association have also been eliminated. But these steps have not yet succeeded in fully opening up the markets. Some problems remain in practice, as associations recommend fees, try to control fee advertising, and hamper professionals' ability to practice freely anywhere in Spain upon joining a single professional association. Competition cases and fines against such practices are gradually opening up professional services to market competition.

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is 100% state-owned. The government has promised to increase port autonomy in management and tariff matters. Ports now have authority to set their own prices.

Pharmaceutical prices and margins are fixed, but there have been some reforms.

For pharmacies, the Ministry of Public Health sets the selling prices, profit margins at retail and wholesale are fixed, and geographical restrictions dampen competition. A 1997 law took control over opening new pharmacies away from the collegium of pharmacists and gave it to regional administrations. But in some regions, the result is rules that are more restrictive than before. Other reforms in this sector reduced the mark-ups, rationalised the list of drugs financed by the Social Security system, introduced generic medicines, and established reference prices.

Postal services are moving toward liberalisation, in response to EU requirements.

Competition in postal services is allowed, for inter-urban and international mailing, but private operators must charge prices five times greater than the basic price charged by the public, universal service operator. The universal service system is to be financed out of the budget and revenues from new entrants, whose contribution is limited to about 20% of the public system's needs. That limitation responds to a recommendation of the *Tribunal*.

Resale price fixing for books is permitted.

Resale price maintenance for books is authorised and discounts are regulated. The *Tribunal* has recommended phased elimination of this exemption, to permit wholesale and retail level prices to be set by the market. The *Tribunal* has predicted that the effect of permitting greater discounts for books would be an annual consumer saving of Ptas 50 billion (in a total market of about Ptas 400 billion).

At the sub-national level, regulations are sometimes invoked to avoid competition policy.

Reform is complicated by new local and regional powers.

Pro-competitive reform must deal with the constitutional devolution of powers to local and regional governments, the *comunidades autónomas*. Too much variation could lead to fragmentation of the internal market. And local and regional governments might be taking actions that run counter to the national efforts to conform to EU liberalising directives, in cable television and electric power. Spanish law includes principles to control how much regional governments can obstruct national economic markets. But there are also strong interests in permitting regional autonomy.

Anti-competitive local government aids may get more attention.

State aids from local or regional governments are also an increasing concern. The *Tribunal's* powers here are limited to providing non-binding opinions in response to specific requests. The ministry has proposed giving the *Tribunal* the power to initiate cases about state aids, although not the power to regulate them. The analysis by the *Tribunal* and the resulting transparency may help ensure that decisions about state aids take account of their competitive effects.

Regional governments may resist pro-competitive policies about retail distribution.

Though the aim in distribution is to free up opening hours by the year 2001, autonomous communities may curtail hours over the transition period, and even after 2001, the national government will still have to reach agreements about opening hours with each of these regional governments. Opening new large-scale stores is controlled by the regional governments. There is a mild form of competition policy

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oversight, in that they must obtain a non-binding report from the *Tribunal* before approving or denying an application. The *Tribunal* virtually always recommends approval. One control against abuse is that consumers are represented on the local commissions that make the decisions about permitting new stores. But the net effect of the process is to postpone entry. The latest controversy is over high-volume, single-theme "category-killer" outlets, through proposals for profile rules that would prevent specialisation and high volume operations.

Distortions in the market for urban land are a serious concern.

Land deals and land use control are a major source of funds for municipal budgets, and this aspect not only impedes reform, but it complicates decisions, increases costs and delays, and invites corruption. The latest reform effort, from 1998, included some of the *Tribunal*'s recommendations, but not others. In principle, this reform reverses the old presumption against development, but it still permits local authorities to deny development rights.

Local controls stall market reforms in funeral services.

The national government has tried to permit competition by removing the municipalities' power to authorise local monopolies in funeral services. Some companies have been privatised, and competition has increased since the 1996 liberalisation, but some monopolies remain in practice.

The Tribunal *and the* Servicio *are increasingly active, but need more resources to do their jobs effectively.*

Caseloads have grown, ...

As competition policy has become more prominent, the workload has increased markedly. From 1990 to 1995, the *Servicio* received an average of about 90 complaints per year; in 1996, it received 120, and in 1997, over 200. And the sanctions imposed in 1997 soared, amounting to five times more than the record set just the year before. A number of recent cases have targeted restraints in industries that have recently been liberalised, such as professional services and petroleum products, or that have some degree of exemption from the competition law, such as tobacco and pharmaceuticals.

... but resources have not.

Yet resources assigned to competition policy have been basically unchanged for several years. Although the *Tribunal* now has about 15% more human resources than it did six years ago, its budget has not increased commensurately. The *Servicio* still has basically the same resources as some years ago, despite the fact that compulsory merger notification, among other reforms, will increase the workload further.

Merger oversight is becoming more vigorous.

Authority on mergers rests in the government, not the Tribunal.

Mergers that exceed certain thresholds based on market share or firm's turnover must be notified to the Service for the Defence of Competition. Notification was made mandatory in 1999. The *Servicio* reports to the Minister of Economy whether a notified transaction raises issues that call for further investigation; if so, the Minister refers the case to the Tribunal. The Tribunal sends its advisory report to the Government, who can decide not to oppose the concentration, to approve it under conditions or to block the merger. The Tribunal, in its report, and the government, in its decision, may take into account both principles of competition and the general interest.

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Merger control has been reinforced since 1999.

Merger control was strengthened in 1999. In April of that year, merger control provisions included in Law 16/1989 were amended and since then enforcement has been stressed. Until 1999, the government had never blocked a merger. Some have been permitted, in order to encourage competition in the course of deregulation. For example, a new telecoms operator was allowed to acquire two Internet services firms so it could compete more efficiently with the dominant incumbent. Concern about interlocked control resulted in the referral of a major bank merger to the *Tribunal* in 1999; the result was that the government demanded divestiture in those cases where the bank participated directly or indirectly in two or more operators of the same oligopolistic market

Analysis and advocacy activity have declined, which reduces the level and quality of the public debate over regulatory reform.

The competition bodies have statutory roles in administrative and legislative processes.

Policy analysis and advocacy by the competition authorities can be the most effective kind of action against problems that are created by regulation or shielded by government sanction. As a part of the government, the *Servicio* provides advice in developing the government's program and priorities. The *Tribunal* can be more effective as a voice in public debate analysing and criticising current policies, because of its independent position.

The Tribunal's advocacy actions have dropped in recent years.

Since 1992, the *Tribunal* has made more than 150 recommendations for revising or repealing anti-competitive laws and regulations. About two-thirds of its recommendations were accepted, in whole or in part. The *Tribunal* has continued to issue some reports and studies, but the pace and focus have changed. Some of the early *Tribunal* reports addressed very broad subjects or issues, while recent ones are more narrowly targeted to specific situations and rules. In 1996 and 1997, the *Tribunal* issued about 10 reports per year; in the two years before, it had issued about 60 per year.

The decline is due in part to resource constraints.

The reduced rate of these reports, and their narrower focus, are explained by staff changes, and by a management decision that workload constraints meant other matters were higher priority. Another reason may be that the early reports addressed the most important issues, and appeared when public acceptance of competitive, market approaches was still unclear. Now, persuading the public is less important, and many of the major subjects have been addressed. Still, it would be unfortunate if the problem of resource constraints were met by reducing the *Tribunal's* advocacy role. Already, that role is less public than before, as some of the *Tribunal's* reports to the government about legislative proposals have not been published. Thus, this work is not available in public debate.

A new competition law has been put in place.

To demonstrate the high priority it has assigned to competition policy, a new competition law was passed by the Parliament in December 1999 and the government announced that it is committed to increasing available tools and resources. The government has provided for greater resources for the competition institutions, more transparent assessment of state aids, compulsory notification for mergers, improved co-ordination with EU competition enforcement processes, and consent settlement of sanctions proceedings.

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Chapter 4

ENHANCING MARKET OPENNESS THROUGH REGULATORY REFORM

Market openness further increases the benefits of regulatory reform for consumers and national economic performance. Reducing regulatory barriers to trade and investment enables countries in a global economy to benefit more from comparative advantage and innovation. This also means that the costs to Spain of poor regulations increase in global markets. As traditional barriers to trade have been progressively dismantled, "behind the border" measures have become more relevant to effective market access, and national regulations are exposed to unprecedented international scrutiny by trade and investment partners. Regulatory quality is no longer (if ever it was) a purely "domestic" affair.

Until Spain joined the EU, its economic strategy had long been based on the promotion of domestic exporting industries, sheltered from international competition.

Accession of Spain to the European Communities in 1986 and its subsequent participation in EU integration initiatives fundamentally changed the Spanish trade and investment environment…

The accession of Spain to the European Communities (now the European Union) in 1986 and its subsequent participation in EU integration initiatives fundamentally changed the Spanish trade and investment environment. Spain has abandoned a managed approach to foreign competition and embraced full participation in the EU Single Market and more open trade relationships with non-EU countries. Single Market directives, aimed at eliminating intra-European obstacles to trade, have acted as strong policy anchors for liberalisation processes.

Prior to its accession, Spanish authorities estimated that the average rate of duty applied on industrial products from non-EU member countries was 11.3% in 1985. In 2001, once all EU tariff reduction commitments undertaken during the Uruguay Round are fully implemented, the average unweighted tariff rate on industrial products is scheduled to be 3.7% (3.0% taking account of tariff elimination commitments of the recent WTO Information Technology Agreement).[32] In addition to customs tariffs, Spain had over 4 500 quantitative restrictions (QRs) in application in 1986, which affected a whole range of imports from both EU and non-EU countries. In the context of the implementation of the European Single Market in 1993, these were dismantled along with QRs maintained by other EU member states.

Likewise, the Spanish foreign investment regulatory framework was radically modified through removal of most restrictions on capital flows and adoption of EU compatible technical regulations. In

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1992, exchange controls were repealed to implement the EU directive on the deregulation of capital flows. In April 1999, a new investment regime eliminated remaining obstacles with respect to the clearance system, registration through Spanish notaries and prior authorisation for non-EU residents for investment in the special sectors, except in the defence sector. There are some remaining barriers. For example, since January 1997, any individual or corporation, whether national or foreign, could be required to obtain government authorisation to gain control of 10% or more of the capital of Telefonica. This procedure could only be applied in the case of hostile takeovers by foreign public monopolies.

Trade and investment liberalisation commitments have stimulated economic growth and injected competition.

... and, as a result, trade and investment have become economic motors for Spain.

Trade and investment have become economic motors for Spain. Reflecting trade liberalisation measures, the goods and services propensity ratios (import plus export as a percent of GDP) for Spain, measured in both current and constant pesetas, increased significantly particularly after 1990. The goods and services propensity ratios (the sum of import and export as a percentage of GDP) increased steadily from the accession onwards, moving from 37.6% in 1986 to 58.4% in 1998. The composition of exports also changed with a higher percentage of value-added goods in total exports (see Table 4.1). The share of manufactured goods in total exports increased from 59.9 to 65.2% between 1988 and 1997, with simultaneous slight reductions in the shares of other categories, *i.e.* agriculture and food, oil and mineral products, and semi-manufactured goods. Between 1988 and 1997, the share of textiles, clothing and footwear exports declined from 9.1 to 7.4% and the share of electric and electronic goods in total exports jumped from 4.2 to 7.2%.

Due to its investment liberalisation, Spain attracted sizeable levels of foreign direct investment (FDI) in physical assets (Table 4.2) and portfolio investment. Due to a combination of market factors, the

Table 4.1. **Product composition of Spanish trade**
US$ million and percentages

	1988	1990	1995	1997
Total exports of goods	40 221	55 517	91 043	106 241
Agriculture and food	17.8%	15.5%	15.9%	16.3%
Oil and mineral products	5.5%	5.6%	2.9%	3.4%
Semi-manufactured goods	16.7%	15.2%	15.8%	15.1%
Manufactured goods	59.9%	63.7%	65.4%	65.2%
Total imports of goods	60 144	87 551	113 316	124 418
Agriculture and food	11.8%	11.3%	14.5%	12.3%
Oil and mineral products	13.0%	13.4%	9.8%	10.4%
Semi-manufactured goods	16.6%	16.7%	19.8%	18.8%
Manufactured goods	58.5%	58.6%	55.9%	58.5%
Commercial services				
Exports of services	12 600	27 600	39 700	43 700
Imports of services	4 200	15 200	21 700	24 200

Source: OECD Trade Statistics and World Trade Organisation, Annual Reports.

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Table 4.2. **Inflows and outflows of foreign direct investment in Spain**
Euro billion

	1992	1993	1994	1995	1996	1997	1998
Inflows	15.8	48.3	–9.1	20.4	7.5	16.7	25.6
Direct FDI	8.2	6.2	7.6	4.7	5.1	5.6	10.2
Portfolio	7.6	42.1	–16.7	15.7	2.4	11.1	15.4
Outflows	3.0	7.3	4.7	3.1	7.0	25.3	55.1
Direct FDI	1.3	2.0	3.1	2.7	4.2	11.0	16.5
Portfolio	1.7	5.3	1.6	0.4	2.8	14.3	38.6

Source: Banco de España, *Boletín Económico*, December 1999.

level of direct investment marked a pause between 1995 and 1997 but resumed in 1998. The market-based approach to Spain's large privatisation programme contributed to these inflows, as the sales yielded significant opportunities for foreign investors. For example, foreign competitors are now effectively established in the Spanish telecommunications market, including France Telecom, Telecom Italia and British Telecom, enhancing competitive conditions.[33]

The rapid openness and internationalization of the Spanish economy has resulted in a strong growth of FDI outflows. In the last few years those outflows have dramatically increased, surpassing the considerable inflows.

Spain performs well in implementation of the OECD efficient regulation principles; attention to remaining regulatory barriers can boost the benefits of market liberalisation.

Important progress has been made in applying principles of non-discrimination, use of international standards, and recognition of equivalence.

An important step in ensuring that regulations do not unnecessarily reduce market openness is to build on the OECD "efficient regulation" principles (see Box 4.1) into domestic regulatory process for social and economic regulations, and administrative practices. The evidence suggests that Spain has amply embedded the principles of non-discrimination, use of international standards, and recognition of equivalence into its domestic regulatory regimes, in part through EU-level legislation. Some problems could arise in the areas of transparency and use of least-restrictive regulatory approaches, though, in practice, the trade advocacy role of the *Secretaria de Estado de Comercio* has helped to prevent problems. Continued advances in these areas would boost the benefits of Spain's comprehensive liberalisation initiatives and market-based approaches.

Transparency in the development of Spanish regulations has improved from a market openness perspective...

Regulatory transparency in Spain is acceptable and improving...

Regulatory transparency in Spain is acceptable and improving. Elaboration of voluntary technical standards in particular is subject to rigorous criteria in terms of transparency and public consultation. Chapter 2 discusses the transparency of the Spanish regulatory regimes, and notes that although consultation procedures have been significantly reinforced in the last few years, regulators have undue discretionary power in deciding who are the interested parties that will be included in the consultation process and what information will

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be made public. From the perspective of market openness, "notice and comment" strategies for public consultation on domestic regulations would improve access for foreign participants. Access through the Internet is another approach that Spain is using more frequently; this further strengthens international transparency.

... as could more careful assessment of the market openness impacts of proposed regulations.

... but more attention to regulatory impacts could improve regulatory effectiveness while reducing the risk of trade problems.

Earlier and explicit attention to potential impacts on market openness within the analysis of the benefits and costs of regulation could avoid potential trade problems. The Spanish procedures for developing new laws and other regulations lack application of modern policy evaluation tolls, such as cost and benefit analysis. Regulators are not explicitly asked to assess the quantitative impact of the draft regulations on society nor to do a cost and benefit analysis, nor are they asked to verify that the regulation meets the OECD efficient regulation principles. Such an assessment would be particularly valuable with respect to the non-discrimination and least trade restrictiveness principles. The criteria of non-discrimination and least trade restrictiveness should be specifically added in the regulatory impact assessment process.

Box 4.1. **The OECD efficient regulation principles for market openness**

To ensure that regulations do not unnecessarily reduce market openness, "efficient regulation" principles should be built into domestic regulatory processes for social and economic regulations, and for administrative formalities. These principles, described in *The* OECD *Report on Regulatory Reform* and developed in the OECD's Trade Committee, have been identified by trade policy makers as key to market-oriented, trade and investment-friendly regulation. This review does not judge the extent to which Spain has complied with international commitments, but assesses whether and how domestic regulations and procedures are consistent with these substantive principles.

- ***Transparency and openness of decision-making.*** Foreign firms, individuals, and investors seeking access to a market must have adequate information on new or revised regulations so they can base decisions on accurate assessments of potential costs, risks, and market opportunities.
- ***Non-discrimination***. Non-discrimination means equality of competitive opportunities between like products and services irrespective of country of origin.
- ***Avoidance of unnecessary trade restrictiveness.*** Governments should use regulations that are not more trade restrictive than necessary to fulfil legitimate objectives. Performance-based rather than design standards should be used as the basis of technical regulation; taxes or tradable permits should be used in lieu of regulations.
- ***Use of internationally harmonised measures.*** Compliance with different standards and regulations for like products can burden firms engaged in international trade with significant costs. When appropriate and feasible, internationally harmonised measures should be used as the basis of domestic regulations.
- ***Recognition of equivalence of other countries' regulatory measures.*** When internationally harmonised measures are not possible, necessary or desirable, the negative trade effects of cross-country disparities in regulation and duplicative conformity assessment systems can be reduced by recognising the equivalence of trading partners' regulatory measures or the results of conformity assessment performed in other countries.
- ***Application of competition principles.*** Market access can be reduced by regulatory action condoning anticompetitive conduct or by failure to correct anticompetitive private actions. Competition institutions should enable domestic and foreign firms affected by anti-competitive practices to present their positions.

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Spain is among the leading OECD countries in the efficiency of its customs procedures…

As customs tariffs are generally low within OECD countries, cumbersome customs procedures are increasingly perceived by traders as major trade obstacles and are often assimilated as non-tariff barriers. Greater efficiency in customs procedures, through transparent and even application (non-discrimination) of procedures, is a necessary complement to trade liberalisation initiatives.

Spain is among the leading EU member states in its implementation of an electronic-based (EDI) customs system.

Spain is among the leading EU member states in its implementation of an electronic-based (EDI) customs system. Spanish authorities estimate that EDI declaration forms are used on about 70% of import declarations and 95% of export declarations. With the proper use of EDI-based declaration forms, goods can be customs cleared within a few seconds. Before the implementation of the computerised EDI-based system for imports, Spanish authorities estimated that the average customs clearance time was four hours per transaction. The Spanish experience provides strong support for more intense efforts to implement EDI through the entire EU membership.

… and has built into its legal and institutional structures an obligation to use international standards wherever possible.

Spanish standards increasingly result from the transposition of European standards…

National efforts to encourage the adoption of regulations based on harmonised measures, procedures for monitoring progress in the development and adoption of international standards, and incentives for regulatory authorities to apply appropriate international standards are important indicators of a country's commitment to efficient regulation. As an EU member, Spain takes part in the Single Market harmonisation process for technical regulations and standards.

The Spanish standardisation body, AENOR, is required by its founding law to use international standards as a basis for national standards. In line with this objective, AENOR signed the Code of Good Practice for the Preparation, Adoption and Application of Standards of the WTO Agreement on Technical Barriers to Trade. Spanish legislation also requires that national standardisation bodies be a member of European and international organisations for standardisation and actively participate in their work.[34] AENOR is active in regional and international standardisation organisations and takes part in the development and diffusion of international standards.

Spanish standards increasingly result from the transposition of European standards. In recent years the number of standards in AENOR's catalogue has expanded significantly due to a growing number of European standards. The number of standards rose by 50% between 1996 and 1998, while the share of purely national standards in the catalogue of standards declined. Purely national standards account for less than 10% of standards currently under preparation.

… though, in a few important policy fields, national standards are still dominant.

However, Spain still produces a significant number of national rules each year. Over the period 1995-1997, Spain notified the EU of 79 technical regulations, which were purely national regulations. Over 75% of these notifications concentrated in four sectors: building and construction, machinery, telecommunications, and foodstuffs

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and agricultural products. These policy areas should be the priorities for more rigorous assessment of regulatory impacts on trade, and consultation with stakeholders in the development process.

Spain also supports the recognition of equivalence of other countries' regulatory measures.

As an EU member, Spain is involved in the Mutual Recognition Agreements (MRAs) negotiated by the European Commission with non-EU countries. These agreements intend to promote efficient, transparent and compatible regulatory systems, reduce costs and delays associated with obtaining product approvals in third country markets, and avoid duplication of testing procedures and unpredictability incurred in obtaining approvals.

The Spanish accreditation body (ENAC) has signed multilateral agreements (MLAs) sponsored by the European co-operation for Accreditation (EA) in the field of calibration, testing, certification, and environmental management systems. Under these agreements, bodies accept each other's accreditation systems, recognise and promote the equivalence of each others' certificates and reports issued by bodies accredited under these systems. A supplier will need only one certificate or report to satisfy several markets. EA-sponsored MLAs include EU countries, and also non-EU European countries and non-European countries such as Australia, New Zealand, South Africa, or Hong Kong.

ENAC participates in international fora that aim to enhance confidence in the accreditation and certification systems, for example, the International Laboratory Accreditation Co-operation (ILAC) and the International Accreditation Forum (IAF). These fora promote confidence in the accreditation systems and at reducing obstacles to trade by supporting the development and implementation of ISO/IEC standards and guides, exchanging information and establishing multilateral agreements on the equivalence of accreditation programmes operated by their members. A MLA has thus been signed at the international level on quality system accreditation, of which ENAC is a party.

Application of competition principles is sound from an international perspective, but continued vigilance by competition authorities is needed to maintain open access for foreign partners as markets restructure.

Competition law and institutions are strong in Spain. Vigilance will ensure that foreign and domestic firms continue to receive equivalent treatment under competition principles.

The benefits of market access may be reduced by regulatory action condoning anti-competitive conduct or by failure to correct anti-competitive private actions that have the same effect. As Chapter 3 explains, competition law and institutions are strong in Spain, and in general protect market entry by domestic and foreign firms alike. However, Spain should continue to be vigilant to ensure that foreign and domestic firms receive equivalent treatment in procedural and practical terms. It also needs to remain vigilant in applying competition policy to newly deregulated sectors and privatised enterprises to ensure that access and entry are not impeded. In this respect, competition filings against Spanish companies on behalf of foreign companies have occurred (i.e. British Telecom vs. Telefonica, which ended with sanctions against the Spanish telecom operator).

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It is important that regulatory institutions make it possible for both domestic and foreign firms affected by anti-competitive practices to present their positions effectively. In Spain, national treatment is applied in procedures for complaining about competition problems, so foreign firms have effective means of seeking redress for perceived anti-competitive problems.

For mergers, decision making relies on the Ministry of Economy or the Government, after the Tribunal's report, applying mainly competition principles, but other considerations could be taken into account, such as social and industrial policy. The generality and flexibility of these other considerations could call for care in application to ensure against discriminatory treatment, though takeover activity by foreign firms in Spain evidently shows that foreign firms are not deterred by such concerns.

Exemptions from the competition law may create market access problems.

For example, a general exemption from Spanish competition law for regulated conduct may inhibit market access.

Regulation in the distribution market may have the effect of inhibiting market access by foreign and domestic firms. For instance, there is a general exemption from Spanish competition law for regulated conduct that may inhibit market access by foreign firms (as well as new entry by domestic firms). This may be a particular problem with regard to restraints on commercial activities authorised by local or regional regulation. For instance, regional governments' limitations on the establishment of new large scale stores and regulation of opening hours may impede new entrants' access to the retail distribution system.

"Regulatory abuse" by Spanish firms has been addressed by the competition authorities.

A particular setting for concern is the exertion or extension of market power by a regulated or protected monopolist into another market. The substantive problem, sometimes called "regulatory abuse", is not always reachable by laws about abuse of dominance or monopolisation, or by regulatory laws applied to particular markets. Foreign firms and trade could be implicated in two ways. First, an incumbent domestic regulated monopolist might gain an unfair advantage over foreign products or firms in an unregulated domestic market. Or, an incumbent foreign regulated monopolist might use the resources afforded by its protection at home to gain an unfair advantage in another country.

The incumbent firms resulting from recent privatisation and deregulation initiatives might be able to impose strategic barriers that raise the cost of entry to foreign and domestic rivals. Furthermore, the advantage so gained in the domestic market may afford an unfair advantage in foreign markets where such firms compete against their foreign rivals. This might be a concern in network industries, such as telecommunications and electricity. However, recent decisions by the *Tribunal* against Telefonica for abusing its dominant position and the success of foreign operators in gaining sizeable market shares in the Spanish telecommunications market help to alleviate this concern.

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Chapter 5

REGULATORY REFORM IN THE ELECTRICITY INDUSTRY

The government of Spain has been engaged in a long process of reforming the electricity sector through a combination of regulation, privatisation, and liberalisation. A series of actions in recent years has broadened and quickened original reform plans. Today, Spain has exceeded minimum European directives in providing choice to more consumers and in restructuring the sector to increase potential consumer benefits, though more steps are needed to establish the framework for effective competition.

Regulatory reform in the electricity sector must account for a range of economic and social policy objectives.

In this complex area, the regulatory challenges are formidable: the regulatory framework must provide for the development of a competitive market that benefits consumers, but must also find efficient ways to meet environmental, safety, social and consumer protection objectives. The framework must support long term security and reliability of supply for electricity and deal with converging interests between electricity and gas regulation, and electricity and competition regulation. These various tasks require both deregulation in some cases, and construction of new regulatory regimes and institutions in others. Spain is doing both.

Spanish policy objectives include industry support, energy self-sufficiency, and universal service.

Current Spanish electricity reforms are developing from a policy environment that has promoted industrial policies, energy self-sufficiency and public service objectives. The policies that aim at supporting domestic coal mining and nuclear power could complicate the transition path to a competitive market. The main public service objective, highly reliable universal service at a uniform price throughout the country, continues to be a basic principle.

Introducing consumer choice and market competition are the major strategies of current reforms…

Compared with EU directives, liberalisation of consumer choice in Spain is wider and quicker and vertical separation is deeper.

Compared with the minimum requirements of the European Union Directive on the single market in electricity, liberalisation of consumer choice in Spain is wider and quicker and the vertical separation of activities is deeper. The Spanish electricity reform law adopted in December 1997, in response to liberalisation in the EU, built on reform efforts of the past decade. The law aims to lower Spanish electricity prices and improve the quality of service by increasing market freedom in a manner compatible with security of supply and environmental protection. The government also sold its shares in the country's largest utility, Endesa. In an attempt to further strengthen the

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competition conditions, the government has reduced its shareholding in Red Eléctrica, the national transmission company, from 60% to 25%, and capped the individual shareholdings so that power companies may hold no more than a combined 40% of Red Eléctrica's capital.

The 1997 law created an open wholesale market, introduced choice for the largest electricity customers, and required separation of the incumbent firm into distinct corporations, with common ownership and management, for generation, distribution and retail supply. It was accompanied by a commitment to price reductions for those customers remaining under regulated tariffs. The main elements of the reforms are:

- Phased liberalisation of electricity customers, starting with the largest customers in 1998 and extending to household consumers in 2007.
- Generation open to competition and subject to free entry.
- Non-discriminatory access to transmission and distribution networks.
- Separation of network businesses (transmission and distribution) into legally distinct, operationally separate companies from commercial businesses of generation and retail supply by 31 December 2000.
- Creation of an independent advisory commission (CNSE).
- Regulation by the government of network and end-user tariffs; CNSE settles disputes over the terms of network access.
- Payment of CTCs (costs of transition to competition) to the utilities by consumers.

Amendments in December 1998 and a Royal Decree in April 1999 widened choice for medium-sized consumers, cut regulated prices more deeply than originally planned, and encouraged greater activity in the wholesale market by lowering access tariffs. The Minister has indicated that the liberalisation of all customers, now scheduled for 2007, could be advanced to 2004.

… and the industry is now beginning to respond in ways that should improve efficiency in the sector.

Market liberalisation should lead to much lower electricity prices for both liberalised and captive customers.

With significant overcapacity and falling costs, market liberalisation should lead to much lower electricity prices for both liberalised and captive customers. There are positive early signs that the reforms are encouraging responses that will improve efficiency in the sector. Incumbent utilities are implementing plans to trim staff. Foreign companies are already building new generating stations in Spain. Regulated end-user tariffs have been falling. For instance domestic consumers have seen their tariffs drop by 11% in nominal terms in the period 1997-2000. Despite a slow start, increasing numbers of liberalised customers are opting to buy from the wholesale market rather than remain under regulated tariffs.

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With further steps to create a neutral environment and complete the regulatory framework, the market could drive major efficiency improvements.

To generate these consumer benefits, more progress is needed in several areas.

There remain four main areas where further reform is needed:

- Due to a legacy of concentration in the sector, effective competition among generators, which would promote lower prices to consumers and economic efficiency, may be slow to emerge.
- Regulation of the Spanish electricity sector should be more independent and transparent.
- Regulated prices do not fully reflect costs, so distort consumption.
- The transition payments (CTCs and capacity payments) and energy policy costs, particularly to support the coal industry, generation by renewable sources of energy and CHP (combined heat and power), as well as the power guarantee charges, are a substantial burden on the electricity consumer.

A vigorous market will be slow to emerge, however, because the structure of the sector is not conducive to effective competition.

Putting into place a competitive structure in a concentrated industry…

A fundamental element of effective reform is putting into place a competitive structure of the industry. In generation, this means that there must be an adequate number of independent competitive firms

Box 5.1. **The Spanish electricity sector at a glance**

The industry is relatively concentrated. Two private firms, Grupo Endesa and Iberdrola, account for 80% of the generation and distribution-supply in Spain. Most of the remainder is accounted for by two other utilities. The transmission company – Red Eléctrica – is largely separately owned, but 40% (the legal maximum) is owned by the four utilities. Imports are relatively small. While competitors are entering the Spanish market, they will not attain significant size for at least several years. The natural gas industry in Spain is *de facto* monopolised by Gas Natural: It owns the transportation systems and controls, under long-term supply contracts, nearly all pipeline capacity and a significant fraction of LNG capacity. The 1998 Hydrocarbons Law liberalised supply to large customers and power generators, provided for regulated third-party access to pipelines and LNG terminals, and required accounting separation of functions.

Excess capacity. Spain has a sizeable surplus capacity, with a maximum reserve margin of over 40%, whereas normal planning requirements are 20-25%, even taking into account for fluctuations in available hydroelectric power. Most of the nuclear plants are jointly owned by the utilities in varying shares, but the utilities are considering options for separating the ownership of each plant.

Market operation: The *Compañía Operadora del Mercado Español de Electricidad*, S.A. has been created to operate the national electricity market. It functions under the monitoring and control of a committee composed of market participants. Market operation is based on a day-ahead market, and an intraday market. Ancillary services are acquired by bidding and auction mechanisms managed by the system operator.

Fuel mix (1998): coal (35%), nuclear (31%) hydroelectric (20%), oil (6%), gas (7%), and renewables (1%). Over 80% of coal used for power generation comes from domestic sources of hard coal or black lignite (*lignito negro*) and brown coal (*lignito pardo*).

Emissions: Emissions of SO_2 and NO_x per kilowatt-hour produced are very high compared to other OECD countries. This is primarily due to the combination of the lack of emissions control on most plants and the poor quality and high sulphur content of domestic coal. SO_2 emissions fell by 20% and NO_x by 9% since 1990. While SO_2 emissions are well below regulatory limits, NO_x emissions are not. However, large investments in low-NO_x emission burners for the coal-fired power plants mean that the large combustion plant limits set out by the EU directive are likely to be met.

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exceeding minimum efficient scale. The current structure of the Spanish electricity industry makes the development of competition in generation difficult. In particular, the substantial market shares of two privately-owned utilities, Grupo Endesa and Iberdrola, raise concerns that the two utilities could raise prices above competitive levels.

These two utilities dominate electricity production and distribution in Spain. Together, they generate 76% and sell 81% of electricity. In 1998, Endesa and Iberdrola provided marginal capacity 59.2% and 23.7% of the time, respectively. Endesa, with the fourth largest generating capacity in the European Union at 23 GW, supplies over half of fossil-fired generation, which is important for mid- and peaking-load. Iberdrola has the largest share of hydroelectric output, also critical for peaking load. Between them, the utilities control about 85% of the hydroelectric output on mainland Spain and 100% of the oil/gas capacity that is used for peaking as well.

Analyses prepared for[35] or by[36] the CNSE suggest that Endesa or Iberdrola operating individually or collusively could exercise their market power and, that such behaviour could lead to an average price markup of 39% above marginal costs Currently, prices in the electricity market are well above marginal fuel costs. Studies of actual Spanish market operation[37] reached similar conclusions.

Other sources for potential competition are likely to be weak.

The other two utilities, Union Fenosa and Hidrocantábrico, generate 10% and 4% of the total, respectively. Independent power production accounts for 13% of energy generated. But IPPs sell to the utilities at regulated premium prices under a "special regime" rather than directly to consumers, and hence are not in a position to influence market prices.

Competition from new entrants will be limited for the foreseeable future. Even if all proposed new gas fired power plants were completed, Endesa and Iberdrola would still have a combined market share in excess of two-thirds. Likewise, potential competition from imports is limited, since total import capacity is small, about 6% of peak load (1700 MW), and for environmental reasons. Existing contracts further reduce the available capacity for competitors, *e.g.*, a contract between Electricité de France and REE for 550 MW ends only in 2010.

Resolving the problem of concentration, at least in the medium-term, may require reversing the consolidation of the past decade.

... could be done through divestiture of generating assets to several independent generating companies.

The most effective means of addressing the problem of a concentrated generating sector is the divestiture of generating assets to several independent generating companies. This has been done in some countries where publicly-owned electricity systems were reformed, as well as in some countries with privately-owned utilities, where the firms were offered incentives for the divestitures. Considerations about divestiture are very much influenced by the situation of neighbour countries.

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With stronger competition policy, the current problem may have been avoidable. The Spanish electricity sector greatly consolidated over the past decade, from a dozen independent firms to four. The electricity regulator published a report in 1996, warning of potential anticompetitive effects from the then-proposed acquisitions. While the acquiring company, Endesa, already owned large stakes in the two acquisitions, Sevillana and Fecsa, an opportunity was missed at the time of privatisation in 1996 to reduce concentration in the sector.

Other competition problems could emerge from current restructuring, and the Spanish government is taking steps that reduce the risk.

In addition to consolidation within the Spanish electricity sector, there is diversification of the two large companies into energy markets in Portugal and elsewhere and other Spanish network industries particularly natural gas and telecommunications. There are commercial agreements between major players in the natural gas and electricity sectors. These raise two concerns: the elimination of possible competitors in electricity generation and the potential for discrimination in access to gas. Natural gas is expected to be the predominant fuel for new power plants, and additional natural gas capacity could be needed.

The competition authority has characterised the extensive cross ownership between the different network firms as a common "web of interests" and is concerned that this web may dampen entry. The government has recently implemented new rules to limit cross shareholding by financial institutions amongst others in the utility sector.

Further liberalisation of the gas market is essential to improving performance in the electricity sector.

Development of the natural gas market will need to be monitored carefully to ensure that competition develops...

Development of the natural gas market will need to be monitored carefully to ensure that all entrants utilising gas-fired generation have equal access to gas supply. The decision of the government to create a single regulator, CNE (previously called CNSE), to monitor electricity and hydrocarbons is a positive development in this regard. Further liberalising the gas sector is a key to improving the electricity sector's performance since gas will become a critical input to power generation. The gas sector is currently dominated by a *de facto* integrated monopoly. The private company Gas Natural, which is almost the sole natural gas importer, commands 90% of distribution, and owns the operator of the high-pressure transmission system. To increase competition and transparency, measures similar to those applied to Red Electrica would constitute a significant step forward.

Competition in distribution is also weak, and regulation that induces efficiency should be strengthened.

... and the role for competition in the distribution sector should be re-examined.

The role for competition in the distribution sector should be re-examined. There appears to be limited scope for franchise competition between the two large distributors. The use of regulation that induces efficiency has therefore been imperative. Given the remaining scope for further efficiencies in both generation and distribution (Endesa estimates it can cut operating costs by half between 1996

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and 2006), there is scope for improved regulation in this sector. Although greater use of international competitive benchmarks in comparing costs would encourage distributors to improve the efficiency and cut the prices they charge, specific climatic and geographic conditions should be taken into account. Other means of increasing the use of benchmarks could also be explored.

Further vigilance by the regulator will be required to determine if corporate separation of retailing activity from distribution activity is effective in preventing discriminatory advantages by the retailing businesses, such as cost shifting and information sharing. More transparency in the distribution company's activities and well-defined rules on its relationships with all retail suppliers, such as a code of conduct, would help the regulator.

Regulatory institutions for the electricity sector are not sufficiently transparent and independent to meet good international practices.

Regulatory institutions are needed whose decisions are competitively neutral, transparent, and independent.

A market environment requires regulatory institutions whose decisions are competitively neutral, transparent, and independent from day-to-day political pressures. The market environment increases the responsibilities of the regulator, particularly to ensure non-discriminatory access and economically rational pricing for system services. The competition authority and the regulator will need to prevent anti-competitive behaviour. In many OECD countries, independent regulators perform these tasks. Arrangements differ in each country, but the main features of independent regulators are: independence from the regulated companies, separation from political control, a degree of organisational autonomy, and well defined obligations for transparency and accountability.

Market institutions in Spain include an effective competition law and enforcement agency, and an independent advisory commission (CNE) with few regulatory powers. Regulation of the Spanish electricity sector is mostly done at the national level by the Ministry of Industry and Energy, though important functions are carried out by the autonomous communities and by the European Commission (see Box 5.2). Allocating to the ministry most of the significant regulatory powers, leaves the government with considerable flexibility in adjusting tariffs, the rate of liberalisation, or transition cost compensation in a manner consistent with overall government policy.

In Spain, more transparency and regulatory independence would intensify competition.

In the short run, market participants would benefit from greater transparency in the ministry's regulatory activities, such as publishing detailed explanations for tariff decisions. Though the ministry reviews advice from the CNSE on tariffs, the ministry does not publish a detailed explanation of its tariff decisions. Also, the September 1999 agreement with utilities that led to securitisation of CTCs was criticised by the CNSE for being conducted without consultation.

As the transition to competition proceeds, however, there is less to be gained from leaving primary regulatory responsibilities within the ministry. Moving regulatory activities such as tariff setting from the ministry to the newly created CNE would boost confidence in the independence of decisions and improve the effectiveness of regula-

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tion. The CNE already has most of the necessary tools to be seen as independent but has few regulatory powers.

Prices of electricity are still highly distorted in Spain.

Price distortions in the Spanish electricity system increase costs for consumers.

There are a number of price distortions in the Spanish electricity system. Prices are distorted between large and other customers, and between those liberalised customers who purchase through the market and those who purchase under regulated tariffs. Other distortions arise because regulated tariffs do not reflect differences in the cost of service by time of use and geographic location. Regulated electricity tariffs, both for the end-user and for the use of the network, are the same throughout Spain including the islands.

Cross-subsidies to some large consumers under regulated tariffs benefit industrial competitiveness at the expense of smaller businesses and residential consumers. These price distortions meant that, even after liberalisation, large customers preferred regulated tariffs to market prices.

In 1998, only about 1% of all energy sold was sold through the market, though 26.5% was liberalised. The principal reason, according to CNSE analysis, was that regulated tariffs for many liberalised consumers are lower than market prices. Subsequently, the government cut the capacity payment by 1 Pta/kWh (which effectively cut the price of generation by 25%) and the network charges by 25% for those customers who buy through the market. These changes shifted

Box 5.2. **Institutions supervising the regulatory regime for electricity in Spain**

Ministry of Industry and Energy is the principal regulator. It has overall policy responsibility and regulates network access and regulated end-user tariffs, allocates revenues among utilities for various costs, and issues licenses for power market participants and authorisations for new generation.

Spanish Tribunal for the Defence of Competition has the power to apply antitrust rules to the electricity sector.

Autonomous community governments have specific regulatory functions with respect to distribution, quality of service and development of independent generation, for which support they may fund through a surcharge on the electricity bills of customers in their region.

European Commission's competition and energy directorates can intervene on certain issues. The Competition Directorate can, *e.g.*, determine whether transition costs constitute state aid and as such whether they are consistent with Community rules.

The *Comisión Nacional del Sistema Eléctrico* (CNSE, National Electricity Regulation Commission) is an independent body whose principal functions are advisory, such as producing proposals and reports, except for those related to dispute resolution and some mergers. Decisions of the CNSE other than requests for information and dispute resolution rulings can be appealed to the ministry. The CNSE is governed by a Board appointed by the government after review by Parliament. Once appointed, board members cannot be removed by the ministry. CNSE is financed through a levy on electricity and gas tariffs set by the government. The CNSE has significant powers to require information from market participants. It has several mechanisms to ensure the transparency of its activities, such as a Consultative Council with widespread membership, and publication of its decisions.

Comisión Nacional de Energía (CNE) is a new energy advisory body that has jurisdiction over electricity and natural gas and hydrocarbons, and has superseded CNSE in 2000. The CNE has much the same legal capability as CNSE; accordingly, the government must seek the CNE's views on proposed energy laws and regulations though it is not obliged to follow this advice.

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Ptas 141 billion annually of energy policy costs from customers purchasing through the market onto those purchasing under regulated tariffs. Differentiation on the basis of market *vs.* regulated tariffs, for example, is unsustainable as more and more customers become liberalised and captive customers must carry the additional cost burden. From 1 July 2000, 54% of total demand will be eligible to access the wholesale market.

Pricing that is not reflective of costs of supply distorts investment and consumption decisions, thus raising costs.

Transmission tariffs do not vary by location, thus inducing generation investments that do not minimise cost.

The absence of geographic differentiation of transmission tariffs can seriously distort investment decisions and thus demand for new transmission capacity. For example, a large part of new generating capacity is proposed for Southwest Spain, close to both a natural gas pipeline and an LNG facility. While this may reduce the transportation costs of gas, it may impose excessive costs on the electricity system because of the need to construct additional transmission capacity.

Time-of-use regulated prices would induce more efficient use of electricity.

Costs vary by time of use, and market prices fully reflect this variation but, except for night tariffs, standard retail end-user tariffs do not. Changing standard tariffs to reflect time-of-use would lead to more efficient use of electricity by consumers.

Benefits of competition in reducing prices will be complemented by lower-cost means of attaining energy policies.

Energy policy-related costs also add significantly to the cost of electricity in Spain.

Energy policy-related costs add significantly to the cost of electricity in Spain (Table 5.1). For example, the Spanish coal industry receives one of the largest subsidies per tonne of coal among OECD

Table 5.1. **Components of projected 1999 electricity costs for Spain**

Items	Costs (Ptas billion)	Share (%)
Production and related	**1 113**	**56.5**
Production and imports	695	35.5
Special regime production (payments to independent producers)	222	11
Capacity payments	196	10
Transmission and related	**117**	**6**
Ancillary services	30	1.5
Transmission	87	4.5
Distribution and related	**473**	**24**
Distribution	418	21
Retailing	40	2
Quality of service enhancement	10	0.5
Demand management	5	0.25
"Permanent costs"	**169**	**9**
System and market operators, CNSE	3	0.15
Costs of the transition to competition (coal related see Section 4.9 in background report to chapter 5)	58	3
Costs of the transition to competition (technology related see Section 4.9 in background report to chapter 5)	88	4.5
Extrapeninsular system	20	1
Diversification and security of supply costs	**87**	**4.5**
Nuclear moratorium (see Section 4.6 in background report to chapter 5))	69	3.5
Nuclear fuel cycle	17	1
Other	1	0.1
Total	1 960	100

Source: Ministry of Industry and Energy.

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countries. These factors together constitute one-fourth to one-third of total power costs in Spain. While some costs are justifiable to meet important policy objectives, in other cases policy objectives may be attainable at lower costs.

An example is the subsidies for special regime production. Spanish premiums for renewable energy are among the highest in the EU. "Special regime" power is generated by cogeneration and renewable sources and sold to utilities at regulated prices above normal power prices. Many projects have also received subsidies from the national government, the European Union, and autonomous communities. Some autonomous communities levy surcharges on the electricity bill to pay for their subsidies to independent generators. Because the government does not limit the quantity of power to be accepted, there has been a boom in "special regime" generation: from 2% of generation in 1990 to 13% in 1999. Special regime generation capacity continues to grow despite substantial overcapacity.

Re-examination of the plan to recover transition costs may identify ways to further reduce costs and speed up restructuring in the industry.

To quicken liberalisation, as has been done in many countries, the 1996 Protocol between government and utilities included an agreement on the "*costes de transición a la competencia*" ("Costs of the Transition to Competition" or CTC). The government permitted their recovery through inclusion in the regulated tariff for a maximum of 10 years. The actual CTC to be paid to the utilities depends upon actual prices in the market. Thus if market prices were higher than expected, the CTC would be reduced and vice versa. Thus, the CTCs insured consumers against the risk that they would face high prices, and utilities that they would face low prices. In September 1998, the government and the utilities negotiated a new agreement, ratified by the Spanish Parliament in December 1998, that changed both the maximum to be recovered and the procedure for recovery. If, by 2007, it is determined that the utilities have received more compensation than the total CTCs, the government will establish a procedure to ensure customers are compensated. The new legislation is under review by the European Commission competition directorate under state aid rules.

The CNSE issued a highly critical report, calling the process leading to the new agreement secretive and the amount agreed under the guarantee excessive. In addition to excess costs to consumers, the CNSE noted that excess payments might damage the prospects for competition by providing a financial weapon to the utilities to defend themselves against new entrants. The CNSE also argued that the government did not get sufficient compensating benefits for electricity consumers, and suggested that the government should have used the offer of the guarantee to induce the two large utilities to take steps to reduce their market power. The report points to some U.S. states where this leverage has been used.

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The decision to securitise the CTCs, currently under review by the European Commission, is not unprecedented and can have substantial benefits A revised plan would provide an opportunity to assess whether the current scheme maximises consumer benefits by promoting pro-competition restructuring and by ensuring that there are sufficient incentives to minimise overall costs to the consumer.

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Chapter 6

REGULATORY REFORM IN THE TELECOMMUNICATIONS INDUSTRY

The telecommunications industry is extraordinarily dynamic. Rapid technological evolution is shaking up industries and regulatory regimes that had long been based on older technologies and market theories. Twenty-four OECD countries now have unrestricted market access to all forms of telecommunications, including voice telephony, infrastructure investment and investment by foreign enterprises, compared to only a handful a few years ago. The industry's very definition is blurring and merging with other industries such as broadcasting and information services.

Regulatory regimes must simultaneously promote competition and protect other social policies in dynamic markets.

Strong competition policies and efficiency-promoting regulatory regimes are crucial to the performance and future development of the industry.

The role of regulatory reform in launching and shaping the rapid evolution of the industry has been described by some as pivotal, and by others as at best supportive. It is nonetheless clear that strong competition policies and efficiency-promoting regulatory regimes that work well in dynamic and global markets are crucial to the industry's performance and future development.

The central regulatory task is to enable the development of competition in local markets, while protecting other public interests such as reliability, universal service and consumer interests. Entry must be actively promoted in markets where formerly regulated monopolists remain dominant, and consideration must be given to convergence of separate regulatory frameworks applicable to telecommunications and broadcasting infrastructures and services.

Regulatory reform is well advanced in Spain, and the regulatory framework compares well to those in other countries.

The Spanish government has made significant progress in adopting pro-competition regulatory principles in the telecommunications sector.

The Spanish government has made significant progress in adopting the regulatory principles prescribed by the EU and WTO, and the April 1998 General Telecommunications Law provides a solid foundation for further progress. In December 1998, Spain officially opened to competition its telecommunications market that Telefonica had monopolised for 74 years. Although this occurred 11 months after most other EU countries, in important respects, the basic regulatory framework now in place in Spain stands up well to a comparison with other OECD countries.

The most important driver of Spain's market and regulatory reform was the requirement to meet European Commission Directives[38] and WTO commitments.[39] Notably, Spain (and four other

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EU members[40]) obtained a derogation to delay full liberalisation. In the case of Spain, although the derogation went to 2003, the period was shortened to 11 months By the end of 1998, Spain was assessed to have largely incorporated into national law the obligations set out in EU directives.

Another driver of regulatory reform is concerns within Spain that the country lags in "teledensity" and network modernisation. As Table 6.1 indicates, the penetration rate in Spain has increased from 24.3 mainlines per 100 inhabitants in 1985 to 32.1 in 1990 and to about 40 in 1997. This was one of the lowest rates of telephone connection in Western Europe and is still significantly lower than the OECD average of about 59. When mobile subscribers are included, "teledensity" in Spain was about 51% in 1997 (compared to the OECD average of 64) with some 92% of households connected to the telephone network. According to the latest data, the global teledensity in Spain including fixed and mobile telephony reached 83 lines per cent inhabitants by January 2000, corresponding to 45.4% inhabitants in fixed telephony and 37.6% inhabitants in mobile.

Table 6.1. **Access lines per 100 inhabitants in the OECD area during 1985-1997***

	Access lines per 100 inhabitants					Residential access lines per 100 households 1997	Telecom access paths per 100 inhabitants
	1985	1990	1995	1996	1997		
Australia	41.6	46.1	50.8	50.8	51.2	96.47	77.3
Austria	36.1	41.8	46.8	46.6	45.7	#N/A	59.9
Belgium	31.1	39.3	45.7	46.5	48.5	#N/A	58.0
Canada	45.5	55.0	59.7	60.8	61.6	104.89	69.7
Czech Republic	12.9	15.8	23.4	27.5	32.0	46.86	37.1
Denmark	49.7	56.6	61.3	62.1	63.6	#N/A	93.5
Finland	44.7	53.5	55.0	55.4	55.6	87.98	101.2
France	41.7	49.5	56.1	56.9	57.6	107.88	67.4
Germany	32.9	40.3	51.5	54.0	55.0	98.18	64.9
Greece	31.4	38.6	49.4	40.8	51.6	98.06	60.2
Hungary	7.0	9.6	21.3	26.4	31.9	55.43	38.9
Iceland	42.6	51.4	55.3	56.7	56.7	121.50	80.7
Ireland	19.8	28.1	37.0	39.1	42.1		56.5
Italy	30.6	39.2	43.4	44.1	44.9	91.89	65.4
Japan	37.5	44.1	48.9	49.1	47.9	96.75	78.4
Korea	18.5	35.7	48.3	50.3	52.0	115.38	67.1
Luxembourg	42.0	48.2	57.5	62.7	67.1	116.91	83.2
Mexico	4.6	6.2	9.7	9.5	9.8	33.96	11.7
Netherlands	40.2	46.4	51.7	54.1	56.6	#N/A	67.4
New Zealand	38.8	43.9	46.6	49.5	50.5	#N/A	63.6
Norway	42.3	50.3	56.1	58.6	62.6	97.09	101.1
Poland	6.7	8.6	14.9	16.9	19.4	41.55	21.0
Portugal	14.1	24.1	36.5	38.0	39.0	90.50	54.3
Spain	**24.3**	**32.1**	**38.1**	**38.8**	**39.9**	**91.90**	**50.8**
Sweden	62.8	68.3	68.4	68.4	68.0	114.08	103.8
Switzerland	50.1	57.7	61.5	63.3	64.5	96.25	78.8
Turkey	4.5	12.3	23.3	25.6	28.0	79.06	30.6
United Kingdom	37.0	44.1	50.6	52.8	54.0	95.98	68.3
United States	48.9	53.9	61.6	63.3	66.0	108.94	86.3
OECD[1]	32.9	39.2	46.1	47.4	58.9	#N/A	64.3

* Telecommunication access paths include the total of fixed access lines and cellular mobile subscribers.
1. OECD average is a weighted average rather than a simple average.
Source: OECD, *Communications Outlook* 1999, Paris, p. 74.

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Regulatory reform is beginning to reduce prices, boost investment, and improve service quality...

There are signs that regulatory reform is producing benefits, and a growing number of new entrants in fixed telephony and in the fast growing Spanish mobile telecommunications market.

There are early signs that regulatory reform is producing benefits. Since full liberalisation of the market in December 1998, there has been a growing number of new entrants, particularly in fixed telephony. In the fast growing Spanish mobile telecommunications market, new entrants are deploying infrastructure and services based on state-of-the-art technology. The number of subscribers to mobile service in Spain grew by 113% between January 1999 and January 2000 to 15 million and is forecast to increase strongly over the next few years. Customer choice and quality of service are improving. Telefonica has performed well, with a marked improvement in its quality of service between 1990 and 1999.

Prices have been falling sharply.

Long distance prices have been falling in Spain since 1995 in anticipation of competition. The tariffs of regulated basic services provided by Telefonica have been reduced significantly. From June 1996 till January 2000, the tariffs fell for provincial calls (15%), interprovincial (42.7%), international (37.6%), fixed to mobile (29.5%) and mobile analogue telephony (42.3%). Circuit rental tariffs also fell in the same period by 26% in national and 56.9% in international circuits. But the standard "list" prices of long distance calls do not fully reflect the reduction effect of discount schemes. Competition has resulted in price discount schemes with varying discounts and eligibility conditions. From the customers' perspective, reduced prices for newly competitive long distance services are not equal to changes in prices for less competitive basic carriage local services, so gains to customers have not been homogeneous. Customers who make significant long distance and international calls are more likely to be better off.

Other decisions were taken that are expected to have important implications in the mid-term for competition: these decisions included the timetable to facilitate operator pre-selection in long distance calls, the guarantee of number portability between mobile service operators, the award of a new mobile operator licence and the schedule to complete tariff re-balancing of Telefonica prices (increasing fixed monthly rental charges) and for changing the regulatory prices system toward a more flexible price cap scheme before 1 August 2000.

These reforms helped position the telecommunications sector as an important contributor to Spain's economic growth and employment gains.

These effects will reinforce the position of the telecommunications sector as an important contributor to Spain's economic growth and net gains in employment. In terms of revenue, the Spanish telecommunications market is projected to grow from about US$16.5 billion in 1996 to about US$25 billion in the year 2000, making the Spanish market of some 40 million people the fifth largest in Europe.

... which will help remedy some continuing performance problems.

Yet price comparisons indicate that Spain's long distance prices still are among the highest in OECD countries, due in part to delays in market opening,...

According to OECD data, price comparisons indicate that Spain's long distance prices have been and still are among the highest in OECD countries. The onset of competition has led to recent price falls, though falls in prices in other countries were greater than Spain's. Figures 6.1 and 6.2 indicate that prices in Spain as at

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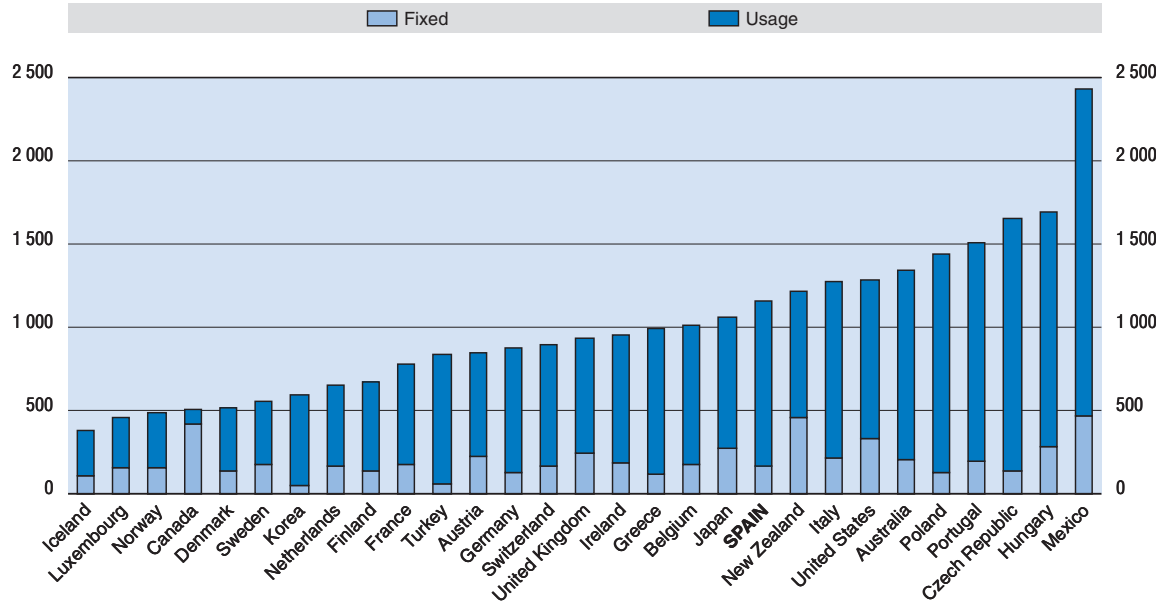
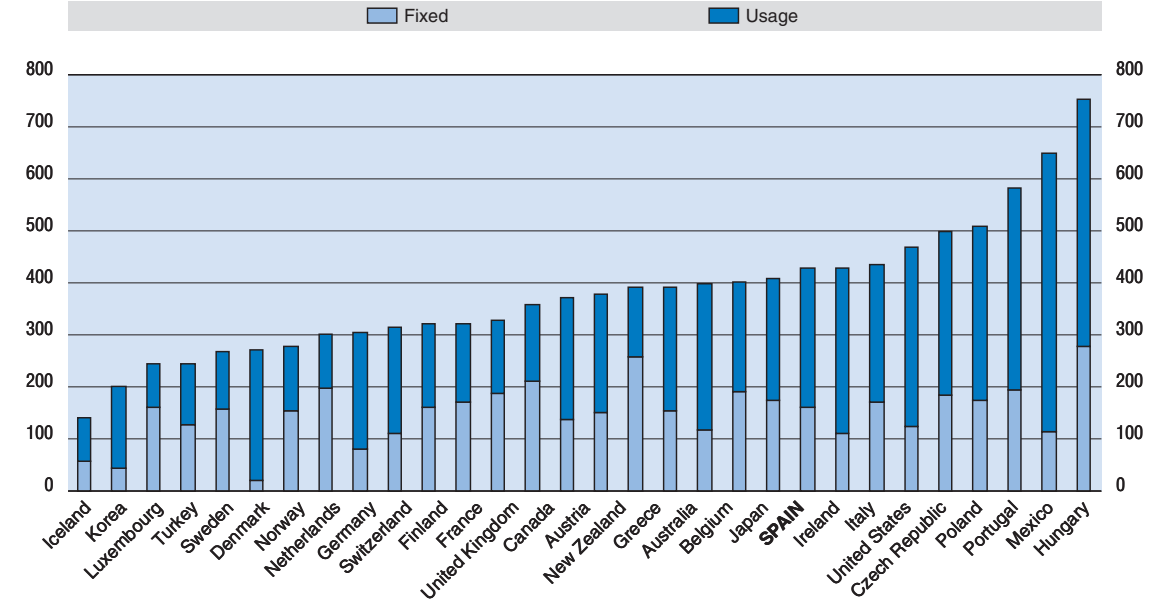
Figure 6.1. **OECD national business basket as at November 1999**
In US$ PPPs



Source: OECD, Eurodata.

Figure 6.2. **OECD national residential basket as at November 1999**
In US$ PPPs



Source: OECD, Eurodata.

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November 1998 were relatively high for business and residential customers. Spain's prices for leased lines were also relatively high. Since Spain's market was fully opened to competition in December 1998, 11 months later than most other EU countries, Spain's relatively poor performance reflects this delay. The experience of other OECD countries that have liberalised their telecommunications markets sooner indicates that there is potential for considerable further price falls in Spain.

... and there is room for substantial further gains from reform.

The growth in telecommunications access lines in Spain is less than the average rate for OECD countries during 1992-1997, and in Spain, public telecommunications investment fell significantly over the past ten years. Network digitalisation grew between 1991 to 1998 to cover 86% of the network, behind that of many other OECD countries. New entrants on network are boosting investment and increasing the range of products and services, such as prepaid cards, telephone translation services, and Internet usage.

CMT has had important successes in regulating the industry in consumer interest, but its independence and responsibilities should be increased.

The independent regulator is gaining respect and has had early successes, but clarity about the division of responsibilities could be improved.

The *Comisión del Mercado de las Telecomunicaciones* (CMT) began operating in 1997 as the independent national regulatory authority provided for in EC Directives. CMT is gaining respect as a well empowered and resourced agency, with early successes, such as significantly lowering Telefonica's interconnection price. However, problems have been identified. On the institutional side, there is a lack of clarity about the division of responsibility between the Ministry for Development, the traditional telecommunications regulator, and CMT. Uncertainty over the division of responsibility ("competency") between CMT and the competition law authorities about control of anti-competitive behaviour was addressed by the competition law reform.

The *Secretaría General de Comunicaciones*, located within the Ministry for Development (the ministry), has traditionally regulated the telecommunications sector. The ministry retains a major role in the new regulatory regime, raising concerns about a lack of clarity in the division of regulatory responsibilities. To clarify the division of responsibilities, the ministry released an unofficial circular in January 1999. Notably, the Ministry is responsible for awarding individual licences where radio spectrum frequency is considered to be limited.[41]

Several areas of the ministry's responsibility, such as control of the quality of services, development of new administrative regulations, and application of penalty procedures, are in many other OECD countries the responsibility of the independent regulator. The policy aspects of these issues (justifiably within the ministry's jurisdiction) should be clearly demarcated from operational aspects (CMT's responsibility). On its part, CMT can enhance its reputation for independent decisions by moving toward more open hearings, establishing a formal process for receiving submissions, and consulting widely. New entrants have called for CMT to issue clear guidance on its filing requirements. These are useful practices to create a

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transparent system, as demonstrated by the UK's OFTEL and the US's FCC.

The current division of competency between the CMT and the Competition Authority (*Tribunal* and *Servicio*) in regard to the regulation of anti-competitive behaviour has been clarified in the new Competition Law, where it reserves to the Competition Authorities all the prerogatives in relation with the prosecution and sanctioning of the anticompetitive practices in the telecommunications sector. Cross-ownership of different competing telecommunications operators and the effect of such cross-ownership on competition should be closely monitored.

Such efforts will be useful in enhancing transparency and market entry procedures.

Institutional clarity is important to help resolve a general impression that it is hard to enter the Spanish market. Though there have been improvements over the last year, further efforts will be useful in enhancing transparency and market entry procedures.

Interconnection prices are properly based on Long Run Average Incremental Costs.

Interconnection charges are critical in the development of effective competition. For example, they can account for some 50% of the costs incurred by new operators. In Spain, interconnection charges are a matter for commercial agreement between operators, though the dominant operator is obliged to publish an unbundled Reference Interconnection Offer (RIO) as a standard rate for other service providers. Where necessary, the CMT is empowered to arbitrate and is required to issue, within six months, a binding resolution open to challenge in the courts.

Spain's interconnection rates are among the lowest in Europe…

The terms of Spain's derogation with the EC stipulated that Telefonica publish a standard interconnection offer by 1 August 1998. Telefonica's initial RIO was rejected by CMT and after protracted negotiations, a binding resolution was put forward by CMT and the ministry[42] in October 1998. This RIO reduced Telefonica's interconnection charges by 30% to 50%,[43] becoming the second lowest among EU member countries (only rates in the UK are lower). Telefonica has taken legal action to prevent CMT from using the so-called Long Run Average Incremental Cost (LRAIC) approach, but the efficient price is clear: to encourage only efficient investment in local service competition, interconnection charges should reflect long-run incremental costs including a reasonable profit margin.

… and interconnection agreements are becoming easier to obtain.

Interconnection agreements are still problematic for new entrants.[44] While the RIO was concluded, Telefonica has allegedly been reluctant to provide interconnection on these terms to some operators. By July 1999, it appeared that CMT had successfully steered several interconnection agreements with several new entrants.

Spectrum frequency should be awarded by auctions, and tradable rights could be considered.

In awarding spectrum, auctions are preferable in terms of efficient use of a scarce resource.

Spectrum frequency is an important scarce resource in the Information Age. Awarding of spectrum licenses presents an important regulatory issue, since the broadband capacity it would offer could

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present the alternative infrastructure for bypassing the access bottleneck. A basic issue is whether UMTS licences should be awarded by "beauty contest" or by auctions.[45] The net benefits of each system are difficult to generalise. French authorities prefer awarding UMTS licences by beauty contest.[46] In March 2000, the Spanish government awarded four UMTS licenses by a competition that was not an auction. By contrast, the UK will conduct an auction, and Germany also favours the auction model. In the Spanish case, from the legal point of view, both options can be used.

In important respects, auctions are preferable because they permit licensees, not regulators, to formulate business and marketing plans. Further, spectrum is more likely to be allocated efficiently among telecommunications firms and telecommunications services if trading in spectrum is allowed. Spain should consider establishing auctions for allocating spectrum and tradable rights in spectrum. To increase market confidence in neutrality, the responsibility for awarding licences for use of spectrum frequency should be shifted from the Ministry for Development to the CMT.

Rules pertaining to the accounting separation of costs have not been enforced, but are important to reduce the risk of anti-competitive behaviour.

An effective regime is still needed to separate monopoly and competitive activities of Telefonica.

Although the interconnection regulation establishes the principle of non-price discrimination,[47] some problems have appeared in practice.[48] The scope to act anti-competitively in regard to non-price terms of access is amplified by the absence of an effective regime to separate monopoly and competitive activities of Telefonica. There is provision for accounting separation in the law but this has not yet been enforced. Accounting separation is admittedly a weak measure since the problems of "information asymmetry" concerning an incumbent's costs, as well as the ingeniousness of "creative accounting" are well known. Nevertheless, data provided on the basis of accounting separation will help restrict the potential for Telefonica to cross-subsidise activities. At minimum, the CMT should require immediate accounting separation by Telefonica with accounts subject to scrutiny by an independent accounting firm.

Local competition should be promoted through resale and unbundling.

Measures to foster competition in the last mile are essential to significantly reduce the price of access, including for internet users.

There has been little development of local competition in Spain. In March 2000 six licenses were awarded for the provision of radio access networks with national coverage. However, further measures to foster real competition in the last mile are essential to significantly reduce the price of access, including for internet users. To facilitate market entry and promote local competition, the various pathways to competition should be kept open, including facilities-based competition, resale, and unbundled network elements.

In Spain, simple resale is permitted. However, simple resellers must pay a higher interconnection charge to Telefonica than operators with infrastructure. Also, customers of resellers must dial an access code before each call. Resellers should not be handicapped

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since resale can promote competition by (1) allowing retail-stage competition to emerge more rapidly and widely; (2) yielding substantial net benefits to customers through lower prices and increased customer choice; and (3) facilitating more rapid rate of facilities-based entry as the number of retail customers increases.

The market power of incumbents should be reduced where necessary through restructuring or divestiture. The OECD warned in its 1997 report on regulatory reform that ownership of cable television networks by incumbent telecommunication companies, with their control of the public switched telecommunication networks, could give them an extremely powerful bottleneck in the local loop. Effective competition is likely to develop only by the emergence of alternative access networks. Reducing the market power of existing dominant operator(s) over alternative infrastructures, such as cable television networks, is crucial.

In Spain, a two-year moratorium has been imposed on Telefonica's entry into cable telephony to give new cable companies time to establish themselves before Telefonica enters the industry. The Spanish government should also consider requiring divestiture of Telefonica's cable interests. This would remove the danger that Telefonica's cable networks with its dominance over the fixed network would foreclose the potential for cable operators to provide effective competition in the local service market.[49] Alternatively, in view of the delays in installing their networks, the government could extend the moratorium period to five years.

Spain has no policy to allow access to unbundled network elements that are essential facilities. The decision over UNE pricing is critical since if UNEs are priced either too high or too low, competition in local service will suffer. In general, resale and unbundling should be used as a temporary measure subject to review over time. Spain has created a mandated unbundling of Telefonica's xDSL network to allow access by other operators, currently a very topical issue in Spain and of close concern to Spain's rapidly growing number of Internet users. Nevertheless, similar measures to guarantee direct access to unbundled network elements do not exist.

Several key regulatory issues should be resolved to establish the conditions for consumer choice and competition…

Number portability takes effect in 2000, a good step to encourage entry…

Number portability refers to the ability of customers to change their location, service provider, or service without being required to change their number. An absence of provisions to allow for number portability acts as an artificial disincentive for customers to switch from the incumbent to a new entrant. In the Spanish case, the 1998 Telecommunications Law prescribes that fixed network operators must ensure customers' number portability, and it is guaranteed since January, 2000. Number portability between mobile service operators will be compulsory from 1st July, 2000.

… and rights of way merit more attention.

The problem of obtaining rights of way for new entrants can be formidable. In Spain the ability of powerful local governments to delay the construction of telecommunications networks received considerable prominence recently in regard to the construction of

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cable network infrastructure. Since concerns relating to the protection of private property and the environment,[50] as well as the scarcity of suitable sites, appear to be growing, the regulatory authority should act to encourage negotiated arrangements and as a last resort impose facility-sharing arrangements. In Spain, CMT has the power to oblige sharing but only for new ducts. The government should consider legislating further powers to enable the mandated sharing – on reasonable terms – of the facilities of all telecommunications operators as well as other public utilities.

... such as improving the timeliness and efficiency basis of pricing regulation.

Price-distorted markets are impeding competition, and more price rebalancing is needed.

Price re-balancing towards costs has occurred, but more might be required once the cost accounting of the dominant operator is in place. Pricing decisions are taken by the ministerial-level Delegated Commission of the Government for Economic Affairs (*Comisión Delegada del Gobierno para Asuntos Económicos*).

Such delays support the shifting of responsibility for price regulation to CMT, whose primary focus is the impact of price changes on competition. Price regulation on the basis of a price cap scheme offers the best prospect to move away from decisions based on political considerations towards "arm's length" price regulation.[51] Price regulation should be applied only to those market segments where there is insufficient competition. If the liberalisation experience in Spain follows that of other OECD countries, price regulation should not be required for international long distance prices or national long distance prices.

The question of whether a transparent, competitively and technologically neutral universal service costing and funding mechanism should be established has not been resolved.

An important public policy goal is universal service, and a costing methodology would assist in meeting this objective efficiently, without unnecessary costs on consumers.

The 1998 Telecommunications Law requires that several services be guaranteed in regulation, including connection for all citizens to the fixed telephone network. The government may revise and extend the list of services, the quality of service, and criteria for determining prices. Telefonica is designated the dominant operator required to provide universal service until the end of 2005. There is compensation for any "competitive disadvantage" caused by the provision of universal service on the basis of net cost of the obligation to the operator concerned. Other operators are obliged to contribute to the universal service financing fund in proportion to their share of the market.

CMT is responsible for specifying the costing methodology to be used. But this has not yet been done leaving unresolved the issue of whether the net costs are significant enough to warrant contribution by other operators through the establishment of a universal service fund. This delay is generating considerable uncertainty and concern[52] since new entrants are unsure of whether they will be required to pay any contributions over the next few years, and if so, what their payment obligations are to be.

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The legislation's reference to the ambiguous concept of "real costs" and its provision that surcharges may be made to the interconnection price to offset "access deficits" and universal service costs has been problematical. Such a surcharge included in the actual interconnection charge reduces the transparency of the interconnection price and is a distorting and inefficient way to raise funds.

Consumer protection should be strengthened to ensure that abuses do not occur in competitive markets.

To avoid victimisation of consumers by unscrupulous operators…

In countries where competition has been introduced, some customers have been victims of unscrupulous operators. Such infringements are likely to occur in Spain as competition intensifies unless action is taken to contain them.

… more consumer protection measures would be useful, such as the Ministry of Development's quality standards and information disclosures

A remedy for dealing with slamming and other billing issues is the provision of clear and timely information to subscribers. The government should consider requiring the establishment of an industry *Code of Conduct* backed up by a *Customer Service Guarantee* scheme to help maintain standards by prescribing financial compensation for customers when operators fail to meet minimum service levels, including billing accuracy. CMT should determine – after broad consultation with customers – information to be made publicly available that will enable customers to make comparisons (such as of quality of service) delivered by operators. CMT should define performance indicators that enable evaluation of the effectiveness of competition and should ensure such data is available on a timely and regular basis. In this context, the Ministry for Development has regulated quality conditions for telecommunications services, including standards for billing accuracy and obligations of information that will be remitted to the CMT In addition, the Minister for Development will supervise and make public an annual general report with information regarding the quality of the services provided by the different operators, so that all users can compare alternatives.

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Chapter 7

CONCLUSIONS AND POLICY OPTIONS FOR REGULATORY REFORM

Market liberalisation and opening; democratisation and modernisation of the public sector; and devolution to the autonomous communities transformed Spain's economy and its governance system.

In 15 years, Spain has experienced an historic process of social, political, and economic change. In the process, Spain has moved considerably closer to the mainstream of regulatory practices in the OECD, and in some areas is moving ahead. Market liberalisation and opening, particularly in the network sectors; democratisation and modernisation of the public sector; and devolution to the autonomous communities transformed Spain's economy and its governance system. The pace of change toward market-oriented policies and government institutions has accelerated in recent years. These economic reforms are working their way through the regulatory system, deepening and widening the scope of regulatory reform.

EMU membership and associated constraints on macroeconomic policy will require that Spanish authorities continue to be vigorous in their approach to structural and supply-side reforms,

As noted in Chapter 1, regulatory reform within an overall mix of economic policies is assisting Spain in completing the process of catching-up with Europe that began over 15 years ago, and in addressing structural problems such as high unemployment levels. Chapter 1 identified important problems related to continuing supply side rigidities: high unemployment and low employment rates, relatively high service sector inflation, and a lack of innovation. EMU membership and associated constraints on macroeconomic policy will require that Spanish authorities continue to be vigorous in their approach to structural and supply-side reforms, both deregulation and quality regulation. Attention will be needed to completing the institutional and legal framework to improve economic performance so as to reinforce market mechanisms and competition throughout the economy. As the Spanish experience shows, competition policy, market openness principles, and improved transparency of the public administration are important elements of that framework.

The Spanish experience supports that of other OECD countries in showing that domestic structural reform can enhance economic performance.

The Spanish experience supports that of other OECD countries in showing that domestic structural reform can enhance economic performance across the board, helping stimulate the virtuous circle of higher growth, lower unemployment and inflation, improved competitiveness, and fiscal and external balance. Market liberalisation has contributed to bringing Spanish GDP per capita closer to the European average, and continued reform that boosts non-inflationary growth will be important to sustain strong growth.

The experience of Spain also shows the importance of a supportive external policy environment for domestic reforms. Important drivers of Spain's market and regulatory reform were the European Single Market and WTO commitments. In fact, Spain implemented the single market framework in less than six years. Exposure to com-

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petition within the European community helped spur Spanish industry to greater efficiency.

Spain's broad programme of structural and regulatory reform has produced major benefits by:

Such a programme has reduced prices, and boosted consumer income and demand…

– Boosting consumer demand, income, and welfare through lower prices, better service quality, and a greater variety of goods and services. Price declines have been seen in Spain's telecommunications, electricity, transport, and financial services. There is potential for large cost reductions in several sectors in Spain through steps to intensify competition. For some services in the telecommunications and electricity sectors, prices are still relatively high, though are still adjusting, and Spanish consumers would enjoy substantial benefits from further reforms as suggested below.

…will reduce costs in exporting sectors;

– Reducing the domestic cost structure of exporting sectors to improve their competitiveness in European and global markets, while reducing the risk of trade tensions due to possible regulatory barriers. Since 1995, though, Spain has experienced a slow down in aggregate measured labour productivity growth, for which there are many possible explanations, including the nature of employment as new workers are brought into the labour force.[53]

… improve innovation and flexibility, raising the long-term potential growth rate;

– Improving the flexibility of the supply-side of the economy by stimulating investment, by increasing the efficiency of the allocation of capital and by lowering barriers to the creation of new firms, products and services, which boosted non-inflationary growth in Spain. Business investment has accelerated in Spain, while the economy showed remarkable resilience in the wake of the Asian crisis, in part due to the easing of regulatory constraints on business activity.

… has increased employment through new job opportunities…

– Helping to increase employment by creating new job opportunities. Spain enjoyed one of the highest rates of employment growth in the OECD in the latter 1990s, as reforms in product and labour markets more than offset employment declines in individual sectors by stimulating overall growth. Though most new jobs were in the labour-intensive tourism and construction sectors, the new economic opportunities created through structural and regulatory reforms lay the groundwork for economy-wide investment. For example, while Telefonica's employees are at about the same level as 1985, the entry of new operators in the telecommunications sector suggests that the telecommunications industry is poised to grow. Business plans announced by new concession holders estimate that a substantial number of new jobs will be created over the next few years. Further labour market reforms will be needed to maximise the benefits of a more competitive market and further reduce the structural rate of unemployment.

… and maintained high levels of regulatory protections.

– Maintaining and increasing high levels of regulatory protections in areas such as health and safety, the environment, and consumer interests by introducing more flexible and efficient

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regulatory and non-regulatory instruments, such as market approaches.

Regulatory reform is supported by high quality competition law and institutions.

A renewed competition policy set the stage for reform...

Launching of modern competition policy in 1989 was virtually a blueprint for reform, both in content and in model of analysis and advocacy for the policy process. Much of the program has been followed in efforts to introduce competition in telecoms, airlines and other transport sectors, electric power, and the professions.

... and continued attention to consumer welfare is needed during the multi-year adjustment of the markets.

Continued vigilance is needed, notably while markets adjust to competition. In view of sectoral competition issues such as the post-reform monopoly in tobacco and a highly concentrated electric power sector it remains necessary to stress the priority of competition policy in reform..

A sustained effort to improve the institutions and implementation of reform policies will boost the benefits of reforms...

Good regulatory governance is moving Spain in the right direction.

Aspects of good regulatory governance are folded into multiple reform policies, and together these are moving Spain in the right direction. In particular, recent Spanish reforms to regulatory production processes and administrative simplification policy are improving the capacity of the administration to produce higher quality regulations and formalities.

The next phase of reform should focus on capacities for enforcing regulatory quality and improving accountability for regulatory performance.

The next phase of reform should focus on capacities for enforcing the new disciplines and improving accountability for regulatory performance. Spain's well-developed policies to improve market functioning will become more effective as the institutional infrastructure to put them into effect is developed. Here, Spain has taken a number of positive steps. New institutions to oversee sectoral regulatory regimes are promising, though their performance is not yet demonstrated and this review has identified some gaps in authority and independence. 1997 reforms to the Government Law moved Spain toward more transparent and less discretionary regulatory practices. Regulatory transparency, in particular, is much improved. Today, the Spanish public administration has a clear mandate and the elements of a sound policy framework to use regulation more carefully and consistently with market-led growth.

As one important step, the government strengthened administrative simplification efforts that should reduce burdensome formalities that inhibit entrepreneurs throughout the economy. As other countries' experiences show, reduction of barriers to entry and costs of doing business could stimulate SME growth, and strengthen the constituency for further reforms.

... as will improving regulatory protections for social policies.

A second challenge is improving regulatory effectiveness in meeting social policy goals such as environmental protection, consumer protection, and labour standards.

A second challenge is improving regulatory effectiveness in meeting key social policy goals such as environmental protection, safety, and health, consumer protection, and labour standards. The government has acknowledged some problems in these areas, including regulatory gaps, problems with unrealistic laws and

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enforcement. There could be substantial gains from more focus on social policy regulations. Estimates from the United States indicate that, in that country, social regulations impose costs 3-4 times higher than do economic regulations and that administrative regulations have a disproportionate impact on SMEs.

This requires a multi-faceted approach to regulatory quality.

Such an expansion of the programme means a new approach. Social regulations will continue to be crucial instruments to carry out government policies. Administrative regulations are necessary for modern governments needing extensive information. Deregulation cannot be the guiding philosophy for reform in social and administrative areas. The approach should be based on a case by case analysis of trade-offs between different forms of government action and no action at all. The OECD recommendations are based on the belief that this will be possible only with a permanent, transparent, and empirical decision-making process based on adoption of regulatory quality standards, regulatory impact analysis, public consultation, a wider assessment of alternatives to regulation, and constant review and updating of regulation. To this end, progress in several areas would be beneficial:

- Spain's 1997 policy on regulatory improvement does not provide a policy framework for quality regulation that is sufficiently clear to guide a government-wide and multi-year reform programme.
- Opposition to change inside the public administration weakens disciplines on regulatory quality. The number and overlapping mandates of inter-ministerial commissions and various programmes reduce the impact of the regulatory reform policy as whole. A rationalised and more centralised reform structure might be needed.
- It will be important to reduce excessive regulatory discretion by tightening controls on quality of regulatory decisions. The evaluation questionnaire for draft laws and decrees has not achieved its potential because it is not mandatory, is implemented late in the process, and is not public. Public consultation, too, would be more useful if there were clearer rules about who is consulted, when, and what material is shared. Ministerial orders, which can contain costly requirements, avoid scrutiny and consultation altogether.
- Transparency has improved significantly across the government, but further steps may be needed. The proliferation of regulations at multiple levels adds to the complexity of the legal and regulatory environment, makes it difficult for administrations to enforce the rules, and fosters non-compliance by citizens and firms.
- Administrative simplification policy and competition policy should be more closely integrated with the policy to improve the quality of new regulations. It is more efficient to redress anti-competitive effects and paperwork burdens before regulations are adopted than afterward.
- Regulatory impact analysis has not yet become a useful tool for good decision-making. Lack of attention to cost-effective-

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ness and benefit-cost ratios is one reason for the reliance on control and command regulations instead of market-based or other approaches.

Further improvements will require a broad and co-ordinated approach.

The challenges for the government in regulatory quality are formidable. Co-ordination of regulatory policies and reform between levels of government is improving, but regulatory layering is growing. Problems with regulatory compliance may be larger than suspected. Innovation and use of other policy instruments such as economic incentives are rare, and the focus on procedures rather than results will slow the introduction of new methods. These problems, if left unchecked, can significantly reduce the potential benefits of economic structural reforms.

Other structural reforms are needed in parallel to strengthening competition.

In other areas, structural reforms are needed in parallel to strengthening of competition. For example, Spain's bankruptcy and temporary receivership laws are in need of change so that competition among market institutions can do its job of allocating resources. And reform of the rules governing civil law procedures is necessary to the effectiveness of law-based enforcement and privately-initiated actions. Now, civil law proceedings are often too complex and drawn out, so parties seeking the aid or protection of the courts are often disappointed. A bill about civil procedureshas been recently enacted. The most important innovations undertaken, will speed up court cases by cutting out procedural stages, streamline administrative requirements, and improve the notification system for hearings, as well as measures to improve processes for collecting debts.

POLICY OPTIONS FOR REGULATORY REFORM

This report is not a comprehensive review of regulation in Spain, but the areas reviewed show where Spain is lagging behind OECD good practices in some areas. This section identifies actions that, based on international consensus on good regulatory practices and on concrete experiences in OECD countries, are likely to be beneficial to improving regulation in Spain. The summary recommendations presented here are discussed in more detail in the background reports to Chapters 2-6, published in this volume. They are based on the recommendations and policy framework in the OECD Report on Regulatory Reform.

Sustained strong political support will be needed at the highest levels to continue reform in the next several years.

Sustained political support for market-oriented and quality regulation will be necessary to meet the regulatory challenges.

The reform agenda is becoming more complex as Spain converges with Europe in policy frameworks. Sustained political support for market-oriented and quality regulation will be necessary to meet challenges in institutional development, co-ordination among multiple layers of government, careful oversight of restructuring markets,

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and meeting the demands of citizens for high levels of regulatory protections.

Adopt at the political level a broad policy on regulatory reform that establishes clear objectives, accountability principles, and frameworks for implementation.

The 1997 OECD *Report to Ministers on Regulatory Reform* reads, "Regulatory reform should be guided by coherent and transparent policy frameworks that establish concrete objectives and the path for reaching them... Such programmes will enhance the credibility of reform, and reduce the costs of reform by signalling to the wide range of affected interests what is to come. The emphasis on broad programmes is deliberate, since the likelihood of success is increased by including at the outset the full mix of policies needed to gain full benefits of reform."[54]

Establishment of an explicit policy could integrate the various reform efforts now underway.

Spain's 1997 legal reforms moved toward a clearer policy based on principles of good regulation. Establishment now of an explicit policy could help integrate the various reform efforts now underway, and establish a uniform set of quality standards. Competition principles should be strengthened in the overall policy framework, perhaps through incorporation of the "competition test" advocated by the Tribunal for the Defence of Competition.[55] For the success of the policy, political accountability and targets should be clarified, with a clear relationship with competition policy, market openness, and public management reform.

- *As part of the policy, adopt principles of good regulation based on those accepted by Ministers in the* OECD *Report on Regulatory Reform, including the principle that regulation will not be made or retained unless the benefits justify the costs.* Some gaps remain in defining the dimensions of regulatory quality, such as the principle that regulations shall be adopted only if costs are justified by benefits. Development and adoption of a more complete set of quality principles, able to provide a consistent framework for regulatory actions throughout the public administration, would be useful as reform moves into its next phase.
- *Establish an oversight unit connected to the Prime Minister or Council of Ministers with (i) capacities to co-ordinate a government-wide reform programme, and (ii) a secretariat with resources and analytical expertise to provide independent expertise on regulatory matters.* Its ambitious structural reforms demonstrate that Spain has the political will and administrative machinery to change quickly. Successful mechanisms for monitoring progress and achieving results, such as liberalising product and service markets and adopting European directives, provide precedents for further regulatory reform. To attain government objectives for regulatory reform, an institution to promote, steer, and co-ordinate the reform programme is needed, with economic and public management skills to complement the *Consejo de Estado*.[56] The central unit should have responsibility for regulatory quality control across the administration, and, to ensure that it has a broad policy view, should be close to the Prime Minister or

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Council of Ministers. The unit would need a well-resourced secretariat with cross-governmental views, and would assist in designing cross-cutting reforms, co-ordinated across relevant policy areas. Working with the regulatory ministries, the unit would develop performance targets, timelines, and evaluations, and would advise the centre of government on the quality of regulatory and reform proposals from ministries. The central unit could also monitor regulatory quality by reviewing new regulations, perhaps under a "notice and comment" process (see below). An interim approach may be for a secretariat on regulatory reform to report to the Council of Ministers, or *Comisión Delegada*. In the longer-term, the government should consider creating a permanent advisory and analysis central unit on regulatory reform responsible to the Prime Minister.

Strengthen the capacities of the public administration to make high quality regulatory decisions and to prevent regulatory problems early in the policy process.

More rigor and quality controls are needed to enable regulators to consistently judge if a regulation is necessary or if there are better alternatives.

– *Revise the evaluation questionnaire on the basis of* OECD *best practices, make it mandatory for proposed regulations, including ministerial orders, and make the responses publicly available as part of public consultation procedures*. The current regulatory process, where drafts are negotiated and discussed, has advantages. The possibility of checking with all government agencies, through collegial membership of the CGSYS, can strengthen the quality of proposals, as can the legal check by the *Consejo de Estado*. The evaluation questionnaire is an important tool supporting more transparent analysis of the impacts of a proposal. However, the current process lacks the explicit disciplines and uniform parameters needed to enable regulators to consistently judge if a regulation is necessary or if there are better alternatives.

– *Implement across the administration a step-by-step programme for improving regulatory impact assessment, based on* OECD *best practice recommendations, for all new and revised regulations*. A key step to improve regulatory quality is to improve the analysis of social and economic impacts. Three-quarters of OECD countries now use RIA and the direction of change is universally toward refining, strengthening and extending the use of RIA disciplines. RIA can be a powerful tool, especially if integrated with notice and comment procedures, to boost regulatory quality by giving policy officials better information on the impacts of regulation on the economy. The analysis should begin with feasible steps such as costing of direct impacts and qualitative assessment of benefits, and move progressively over a multi-year period to more rigorous and quantitative forms of analysis as skills are built in the administration. Creation of a training programme would help instil the necessary skills in the public administration.

– *Include assessment of the "efficient regulation principles in the regulatory impact analysis*. Although some of the efficient regulation principles, such non-discrimination, the use of international stan-

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dards and the recognition of equivalence are fairly extensively applied in practice, the six principles could more rigorously be applied in respect to elaborating regulations.

Build on current reforms to improve regulatory transparency and simplicity to improve the environment for business investment and growth.

More transparency will improve market certainty, and more dialogue with stakeholders will help maintain support for the reforms.

Clear, public objectives for regulation and reform, taking consumer interests into account, and independent monitoring are important elements for ensuring that the reform process is open and inclusive. Particularly as reform involves social policies more deeply, dialogue with all important stakeholders will be needed to maintain legitimacy and support.

– F*urther strengthen public consultation processes*. Spanish regulators typically consult affected parties, and consultation is increasing. However, the consultation does not always produce higher quality outcomes. A useful improvement would be a further clarification of the consultation rules established in the Government Law. Consulted parties should, for example, have direct access to the evaluation questionnaire. The government could experiment with new methods like the Danish Business Panels and focus groups to identify the costs of a proposed regulation and more effective and efficient alternatives. Legal requirement for notice and comment, already required for technical standards, should be extended to all proposals. Adoption of a general consultation requirement covering all substantive new laws and subordinate regulations (including ministerial order) would promote both the technical values of policy effectiveness and the democratic values of openness and accountability. Making draft regulations available on the Internet is particularly valuable for foreign firms.

– E*stablish a centralised registry of all regulatory requirements with positive security*. A single authoritative source for regulations would significantly improve transparency for users in terms of the content and form of permissible regulatory actions, and encourage a rationalisation of ministry rules. "Positive security" means that regulations must be included in the registry to have legal effect, which ensures against any non-compliance by ministries. Spain is among the few OECD countries that have adopted an indicative registry for administrative procedures. Based on this experience, the government should pursue its effort into two directions. First, it should seek to give positive security to the registry. Additionally, the government could implement a certification process consistent with good quality standards to be renewed every five years, together with a logo delivered on completion, for all formats. Such a process could be inspired on the French CERFA (*Centre d'Enregistrement et de Révision des Formulaires Administratifs*) model. More ambitious, Spain could adapt the 1980s Swedish initiative, where after establishing a central registry of regulations and giving time to ministries to register individual regulations,

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the government, through delegated powers of the Parliament, nullified – through the well-known "guillotine" mechanism – all the hundreds of regulations that were not individually enlisted.

Administrative simplification will reduce the cost of government and improve the business environment, particularly for SMEs.

– *Strengthen administrative simplification by (i) assuring that regulatory quality principles and criteria are used to revise existing formalities, (ii) by boosting the Simplification Commission's secretariat with analytical expertise and resources, and (iii) by reducing authorisations, licences and permits.* The establishment of the interministerial Simplification Commission was an important step toward making the administration more slim and efficient. To improve the ministries' accountability in the process, the Commission should develop criteria to assist the ministries in justifying objectively and publicly the need for each procedure. Another important element is a capable secretariat reporting to the Commission. To maintain political support, early and visible results are needed. The 9-10 month limit to eliminate unnecessary formalities is a useful target. The Commission may wish to concentrate its resources on eliminating or improving permits and licenses, which are among the most damaging of government formalities with respect to business start-ups and among the most costly to administer. The government should also assist the Commission in clarifying and simplifying the institutional network for administrative simplification, particularly in ensuring communication and co-ordination among the various bodies at work. Strengthening of linkages between the Commission's work and the government's SME policy and initiatives stirred by the Ministry of Economic and Finance is an important step. The work of the Commission should also be clearly linked to the regulatory reform and competition policies.

Involve regional and local governments, which have an increasing role in regulatory matters, in regulatory reform to ensure that gains are extended throughout the national regulatory system.

Safeguarding the gains made at the national level through regulatory reform will require intensive efforts to promote regulatory quality at sub-national levels.

– *Encourage regulatory reform by co-ordinating initiatives with the autonomous communities and municipalities, and by assisting them to develop management capacities for quality regulation.* Progress in devolving regulatory powers to bring them closer to citizens and business has been impressive. The orderly way that this has been done in Spain could be considered a lesson for many countries. Yet safeguarding the gains made at the national level through regulatory reform will require intensive efforts to promote regulatory quality at sub-national levels. Adoption by autonomous communities and municipalities of programmes of reform based on consistent principles should form the basis for more formal co-operation measures. Consideration should be given to establishing fora for such purposes and to resolve issues arising from regulatory conflicts. A complementary strategy should also be developed to help autonomous communities encourage municipalities to launch regulatory reform programmes. Continued leadership from the centre to encour-

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age and learn from experimentation at the sub-national level will speed up efforts.

– *Heighten awareness of and encourage respect for the efficient regulation principles by the autonomous regions and large cities in their regulatory activities*. Through the co-operation institutions between the central government and autonomous communities, the central government should promote the awareness and encourage respect of the efficient regulation principles.

Build on the effective competition policy and authorities are relatively effective, take further steps to increase the application of competition principles to economic regulations and structural decisions.

Competition policy could be more transparent…

– *Make competition policy in merger review and privatisation more transparent*. In these important functions, the *Tribunal*'s role is advisory If assignment of decision power to the independent Tribunal is considered inappropriate in the structure of Spain's government, then the Tribunal's analysis and recommendations in such matters should be publicly available before a final decision is reached.

… and its scope broadened.

– *Remove remaining exemptions and unnecessary constraints on competition*. In most sectors, some reform steps have already been taken and plans are in place to remove constraints. For others, though, more deliberate action is needed. The special rule for permitting price fixing for books should be changed, given that consumers would benefit substantially from lower prices. Competition among pharmacies remains limited.

– *Limit the anti-competitive effects of special laws about retailing*. Before 1996, Spain's retail environment was subject to relatively few competitive constraints. Now, regional governments have powers to control new locations and operating hours. Control over entry risks affording unfair advantages to firms that were in place before the controls were adopted, and may permit them to exercise some market power. And the 1996 legislation also set special rules about unfair competition in this sector. It is unclear why general principles of competition law, and of unfair competition, would be inadequate in this sector. This legislation will be reviewed in 2001.

– *Increase resources for competition policy*. The *Tribunal* has virtually no professional staff to support the members. It is unlikely that the *Tribunal* could effectively conduct an independent or supplementary investigation without the assistance of the *Servicio* or of parties to a controversy. One proposal to increase resources would involve adding members to the *Tribunal*. But with nine members, the *Tribunal* is already a fairly large decision-making body. More staff, rather than more members, would probably have a greater impact on its output and efficiency. The *Servicio* remains with approximately the same resources as in the past, though it is handling twice as many complaints and may now review a larger number of proposed mergers, under tighter time constraints.

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– *Consider consolidating decision processes*. Originally, the *Tribunal* and the *Servicio* were separated because one was a quasi-judicial body and the other was administrative. But now that both are clearly administrative, and a further appeal to the judiciary is possible, that formal reason for separation no longer obtains. The *Tribunal* in 1989 suggested that the *Servicio* become a component of the *Tribunal*, so that the *Tribunal* would in effect have the power to open and conduct proceedings. The *Tribunal* already has some control over its agenda, when it responds to complaints about the *Servicio*'s actions and its failures to act. But as a practical matter, it appears that the *Tribunal* does not manage the development of competition policy. One way to strengthen its role could be to give other parties, such as sectoral regulators and even private complainants, greater powers to bring matters to the *Tribunal* directly. That could require a substantial increase in the *Tribunal*'s resources.

– *Maintain the Tribunal's independent advocacy function*. Over the years, the Tribunal's public studies and reports have played a central role in the reform process. That process is not over. To be sure, the major subjects have been identified and many of the reform recommendations have been implemented. For others, the tasks are now to work out details and to resist backsliding. But even if the level of reform is the details, continued study, analysis, and public debate will be important. The *Tribunal*, from its position of independence from the government, can be a particularly powerful and credible voice in that debate. The latest proposals would give the *Tribunal* a valuable new advocacy role, in making the anti-competitive impacts of government aid transparent.

Improve the policy foundation for the efficiency, independence, and accountability of new independent regulators by developing guidelines for their systems of governance, policy coherence, working methods, and relations with the competition authority. A high-level and independent review of these issues would be a useful step.

Increased attention in Spain to the creation of market-oriented regulatory institutions will improve the environment for competition and business growth.

Increased attention in Spain to the creation of market-oriented regulatory institutions will improve the legal and administrative environment for competition and business growth. This is even more consequential when new markets are opened in areas formerly reserved to monopolies. However, as in most countries, Spanish institutions are being developed on an *ad hoc* basis. It may be useful to evaluate the feasibility in Spain of a multi-sectoral regulatory institution to share resources, facilitate learning across industries, reduce the risk of industry or political capture, and deal with blurring industry boundaries. An independent expert group could review the institutional architecture for market-oriented regulation in order to determine if a new harmonised framework would improve efficiency and competition in regulated areas of the economy. Experiences in the United Kingdom, where a *Green Paper* was recently prepared,[57] could be a model.

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Take further steps to integrate market openness principles into national regulatory and administrative regimes.

Faster implementation of an EU-wide electronic-based system will benefit Spain as well as other OECD countries.

- *Enhance the transparency and the uniform application of customs procedures by assigning higher priority to faster implementation of an* EU-wide *electronic-based system that responds more efficiently to the requirements of* the EU Single Market, *including transit operations; prepare a new consolidation of the* EU Customs Code; *and create a comprehensive* Internet *site providing access to the* EU Customs Code, *all its amendments, formulas and official communiqués.* Pursuing greater simplification and harmonisation of customs procedures is a necessary complement to trade liberalisation initiatives as cumbersome procedures can hinder trade and translate into high transaction costs for traders. Significant efficiency gains can be realised for both users and customs authorities through enhanced use of electronic-based systems.
- *Continue to encourage the use of international standards as a basis for national standardisation activities and to promote international harmonisation in the European and international fora*. A strong commitment to an efficient and reliable standardisation system not only enhances market opportunities for Spanish firms but also greatly contributes to the consolidation world-wide of efficient and transparent markets for industry and consumers.

In the electricity sector, a number of steps are needed to establish a regulatory regime supportive of market entry and competition that benefits energy consumers.

Electricity sector reforms should open more opportunities for competition, strengthen the independent energy body, and make prices more cost-reflective.

In the electricity sector, reforms should aim to open more opportunities for competition, to strengthen the role of the independent energy body, and to make prices more cost-reflective. Each of these reforms will contribute to the efficiency and innovativeness of the sector.

- *Take steps to improve competition in generation*, including divestiture of generating assets, leasing/operating agreements, and caps on capacity expansion by dominant firms.
- *Eliminate the capacity payment and review electricity market trading arrangements in light of experience with current market prices.* Provide retail supply monopolies with incentives to procure least cost supplies.
- *Carefully monitor developments in the natural gas market* and, if necessary, intervene to ensure that all potential competitors including co-generators have equal access to natural gas supply at cost-reflective prices.
- *Continue efforts to strengthen electricity interconnections to neighboring countries.*
- *Introduce full retail competition sooner than currently targeted*. In the interim, the Spanish authorities should consider allowing groups of low voltage customers to become eligible for the market through aggregation.
- *Strengthen the ability of the regulator to monitor the effectiveness of the legal separation of distribution activities from the unregulated activities of*

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generation and retailing. Be ready to use stronger options for separation if monitoring indicates a need.

- *Shift essential regulatory responsibilities from the* Ministry of Industry *and* Energy *to an independent, accountable regulator.* In particular, Spain should examine the potential for making the CNE responsible for regulation of the network, including transmission tariffs, terms and conditions and the calculation of the re-balancing payments between utilities, regulating captive consumers' tariffs and new plant licensing.
- For matters under the final responsibility of the ministry, *ensure that the ministry consults the* CNE *on all major policy issues* and that all published ministry decisions include explanations of the reasons for the decisions.
- *Strengthen the independence of* CNE. To this end, procedures for selecting commissioners should be reviewed to ensure that they may act without undue concern for political pressures.
- *Strengthen competition law enforcement in the energy sector,* particularly with respect to market access and anti-competitive conduct and the effects of cross ownership on the electricity and natural gas markets.
- *Ensure that network and end-user tariffs and discounts for interruptibility are cost reflective and do not discriminate between suppliers or between customers remaining on tariffs or opting to use the market.* Standard end-user tariffs should reflect costs by time of use.
- *Consider the progressive introduction of geographic differentiation of tariffs according to cost of supply, taking into account social cohesion principles.*
- *Review the existing arrangements and calculations for apportioning costs due to policy actions*. Make sure that they do not discriminate between customers remaining on regulated tariffs or choosing to enter the market.
- *Reduce the size of subsidies to the coal industry* by providing incentive mechanisms for the coal companies to minimise restructuring costs and improve productivity.
- *Phase out price subsidies to all co-generation regardless of size.*
- *For renewable energy generation, examine cost-effective approaches* of meeting renewable energy objectives such as competitive tendering.
- *Increase efficiency of environmental regulation* by using feasible market-based approaches for controlling emissions of NOx to ensure that control is achieved in the most cost-effective way.

Much progress is seen in telecommunications. Further reforms will stimulate competition and promote a dynamic market that serves Spain's communication needs.

In telecommunications, too, substantial progress will yield optimum results only with further reforms.

- *Reduce barriers to entry by minimising the requirement to obtain a license and the range of conditions attached to a licence.* Broad discretion is available to the Ministry for Development and CMT in the decision to grant a licence and attach terms. Licensing procedures need to be simplified. This could best occur through

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implementing a general class licensing framework rather than require individual licences for entry.

– *Amend the legislation providing for the use of "real costs" as a basis for setting the price of interconnection so that it explicitly refers to long-run average incremental cost* (LRAIC) *as the appropriate cost basis for pricing*. The concept of "real" or historical costs is not meaningful as Telefonica is in the process of price adjustments by eliminating cross-subsidies and operating inefficiencies developed as a result of its former monopoly position. Efficient pricing needs to be based on forward-looking LRAIC costs, including a reasonable profit margin.

– *Refrain from collecting funds to offset any "access deficit" or fund universal service as a surcharge on the interconnection price. Any access deficit should be addressed through appropriate price re-balancing*. Assuring interconnection to the incumbent's public switched telephone network is a key competitive safeguard. Such safeguards are particularly important where, as in Spain, the incumbent carrier is vertically integrated into local, long distance and other services and therefore with strong incentives to hinder equal access. Progress in establishing an effective interconnection regime is important to assuring that the benefits generated from competitive market structures are fully realised. Recent steps have reduced the economic distortions generated by Spain's interconnection regime. To help ensure effective competition, the price of interconnection to the incumbent's public switched network should be based on long-run average incremental costs. Interconnection rates based on "real costs", interpreted as historical accounting costs, will maintain high rates and restrict new entrants from offering lower rates to customers. Further, any access deficit contributions should be addressed through price re-balancing, and transparently separated from interconnection charges.

– *Require Telefonica to provide direct unbundled access to its network by other operators on reasonable terms, including any* ADSL *enhanced segments, for a limited period of five years*. Forward-looking LRAIC-based pricing is also the appropriate cost basis for pricing unbundled network elements. To maintain incentives on new entrants to deploy their own infrastructure rather than depend indefinitely on the incumbent's, the requirement on Telefonica to provide unbundled elements of its network should be restricted to a specific specified period.

– *Take steps to assure new entrants appropriate access to rights-of-way*. An arbitration procedure to be used when carriers and local governments cannot reach agreement on the use of public land should be established. In addition, improved arrangements should be made for facility sharing between operators insofar as this would not impose an unreasonable economic burden or technical difficulties on the incumbents and facility-based carriers.

– *Continue to ensure that numbering allocation and number portability policies for both mobile and wireline carriers are competitively neutral. Policies should allow for call over-ride to enable carrier selection on a call-by-call basis*.

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An absence of provisions to allow for number portability acts as a strong disincentive for customers to switch from the incumbent to a new entrant because such switching imposes transaction costs, such as the burden of informing others of their new number. Moving forward toward full implementation of a permanent form of number portability would be an important step in ensuring that subscribers do not face artificial disincentives in deciding whether to switch between carriers in response to price competition. It is also important that Telefonica comply with carrier pre-selection obligations by January 2000.

– *Introduce policies to promote infrastructure competition in the local loop. Amongst other measures, by promoting radio access network, by establishing that Telefonica is legally obliged to provide direct access to its network, or by divesting Telefonica cable television business.* Future local competition will depend importantly on the ability of alternative infrastructure to offer both voice telephony services and newly developing information services. Divesting Telefonica's cable operations would help stimulate local competition as well as competition in the CATV market. At minimum, there should be a moratorium on Telefonica's entry into cable telephony for five years or until Telefonica is no longer considered dominant in the local service market. To promote competition in the local market, various entry options should be maintained, including facilities-based competition. The regulator needs to ensure that access to unbundled elements of Telefonica's network is made available at reasonable prices.

– *Abandon the duopoly policy in the* CATV *market in each of* 43 *demarcated regions to permit other entrants.* CATV infrastructure provides one of the most rapid and efficient means to stimulate entry into the local loop. Maintaining a duopoly only retards the build-up of competition in this area.

– *Move price regulation from government authorisation to become the responsibility of* CMT. The regulation of prices through government authorisation – a practice with a history of long delays being experienced before approval is granted – was one which may have been appropriate during the era of government owned monopoly provision of telecommunications. It is unsuitable for current competitive circumstances particularly since it depends on a process which lacks transparency and is driven more by political considerations rather than the pro-competitive need for price flexibility in the dynamic, converging, telecommunications industry. If price regulation is considered necessary, it should be on the basis of an "arm's length" price cap regulation scheme designed and monitored by CMT.

– *Base price regulation on a simple transparent price cap approach. Incorporate an appropriate "sunset clause" to ensure that streamlining/abandonment of price regulation occurs as soon as effective competition permits.* The price cap formula should be designed to allow continued price re-balancing of prices to reflect costs. Price re-balancing should be conducted as rapidly once the cost accounting is in place, since price-distorted markets impede competition. But

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Telefonica should be required to substantiate its claim of the substantial "access deficits" it incurs by making available for public examination the data upon which it bases its calculations. The benefits ownership of the local loop confers should not be overlooked. To enable the pricing flexibility that "convergent" technologies, markets and services require, price cap regulation should be clearly installed as a temporary measure to be streamlined and withdrawn as soon as (competitive) conditions permit. To help ensure price caps are withdrawn promptly from competitive markets, a price cap scheme should incorporate a "forbearance provision" to oblige withdrawal of price caps in any market that the regulated operator could prove had become competitive.

– *Proceed without further delay with the introduction of cost accounting principles for Telefonica and then define and estimate the net cost of Telefonica's universal service obligation and, if considered necessary, promptly establish an explicit, portable, competitively and technologically neutral universal service fund.* There should be no further delay in deciding whether the significance of the net costs of Telefonica's universal service obligations constitutes a competitive disadvantage thereby warranting the establishment of a separate Universal Service Financing Fund to which all operators would contribute. Such a fund would make the delivery of universal service more transparent. In an era of rapid technological change, it is important that it be designed to be technologically neutral. A preliminary step in the process is the definition of the nature, extent and speed with which universal service objectives are to be addressed. Since (as noted earlier) the Ministry for Development is responsible for specifying universal service coverage, it should complete this task as soon as possible to enable CMT to proceed with the determination of the net costs of the universal service obligations identified.

– *Review regulations in all areas of telecommunications regularly and systematically with a view to streamlining and where appropriate abandoning them.* The government should require that a systematic regular review of all regulations be conducted (say every three years) to ascertain whether the regulations are still in the public interest and whether such regulation should be abandoned or modified. "Forbearance" procedures (or "sunset clauses") should be incorporated to ensure that regulations no longer necessary are eliminated.

MANAGING REGULATORY REFORM

Communication and consultation strategies are key to sustaining a balanced reform programme.

An important determinant of the scope and pace of further reform is the attitude of the general public. Communication and consultation strategies are key. Evaluation of the impacts of reforms and communication with the public and all major stakeholders with respect to the short and long-term effects of action and non-action, and on the distribution of costs and benefits, will be increasingly important for further progress.

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NOTES

1. Reino de España (1992), *Programa de Convergencia*, Madrid, March.
2. Kingdom of Spain (1998), 1998-2002 *Stability Programme*, p. 3 and p. 43.
3. From Spain to EC countries and these were paralleled by large internal migration flows from rural to urban areas
4. De La Dehesa (1994), p. 131.
5. FDI inflows averaged over 2% of GDP from 1986-92, accounting for over 10% of total investment and a much higher percentage of investment in manufacturing, and was largely concentrated in the areas around Barcelona and Madrid. FDI brought with it not only investment capital but also a substantial technology transfer, increased product innovation integration into European-wide marketing networks, and perhaps most importantly a deepening of managerial skills: many of today's younger business leaders began their careers in foreign multinationals.
6. See OECD (1998), OECD *Survey of Spain*, p. 86-7 and Table 15 for a more complete listing.
7. Subsidies declined from an average level of 1.5% of GDP between 1987 and 1996 to 0.6% in 1998. OECD (1998*a*), Table 17, p. 91.
8. After ten years of liberalisation local and regional authorities tightened regulations on shop hours and large stores in order to protect small shops and prevent urban shopping and traffic patterns from becoming suburbanised.
9. As of 1998, Spain's employment to population ratio was 51.2% compared to EU and OECD averages of 61.1 and 65.1%, respectively. This is a combined result of the high unemployment rate and the fact that Spain has one of the lowest labour force participation rates in the OECD. See OECD (1999), *Employment Outlook*, June, Table B.
10. Population ageing, which is already beginning to slow down growth in other OECD countries, will not affect Spain until 2020.
11. The major exception has been prices in rail transport which have been artificially suppressed and supported by large budgetary subsidies.
12. Some of this is also due to administrative increases in the price of services which were previoiusly below cost, such as residential telephony.
13. OECD (1997), Table A7.1, p. 170, estimated the effect on output of reforms in electricity, air and road transport, telecommunications and distribution at 2.24%, and the OECD *Economic Survey* (1998) added to this list additional benefits from reforms in gas and petrol – Table 22, p. 125.
14. Backward and forward linkages describe the relative importance of individual sectors in the economy as a whole. As the names imply, backward linkages refer to the role of a sector as a source of demand for the services of other sectors, forward linkages refer to the role of a sector as an input into other sectors. A sector's relative importance can be measured both in terms of its share of the economy and the size of its coefficient or multiplier in an Input-Output (I-O) table; *i.e.* a one unit increase in final demand for all sectors generates how much of an increase in demand for that sector.
15. Data are based on the 1995 Input-Output table, the most recent available. Including distribution, this figure rises to 35.7%. This information was kindly provided by the Spanish Ministry of Finance.
16. Again, the most obvious case was in financial services, where high margins constrained overall levels of investment and particularly small and medium-sized enterprises (SMEs) who lacked access to wholesale or international capital markets. The liberalisation of this sector has been key in improving the business climate for SMEs.
17. In fact widespread claims of intense competition resulting in low prices and margins in Spanish financial services appear on closer inspection to be more mixed. The CPI component for financial services rose sharply between 1994 and 1999, by a cumulative 49.2%, as compared to overall inflation of approximately 15.2%. It appears that part of the explanation for these conflicting stories is that competition is less intense in consumer areas like credit cards and overdrafts, and that decreases in margins may have been offset by increased commissions. The described trend in prices has nonetheless receded in the last few months.

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18. Prices have also risen in rail transport or postal service as subsidies have been cut in an attempt to reduce losses and the fiscal burden. Prior to the subsidy cuts prices in these sectors were the lowest in Europe and way below costs; despite such cuts these sectors prices remain low and well below cost, they still operate at a loss.
19. Spanish subsidy levels have come down substantially in recent years and are now quite low by EU standards. A number remain and still contribute to the deficit or serve as implicit taxes on the rest of the economy creating distortions at the microeconomic level, such as in rail transportation or coal mining (electric power generators are required to purchase domestic coal at prices well above world levels.
20. Consejo de Estado (1993), *De Cara a la Union Europea*, Memoria del Consejo de Estado, Madrid, p. 175.
21. In October 1998, with only 2.7% not yet implemented of the 156 Single Market Directives, Spain was ranked the 6th country among the EU State Members, European Commission (1998), *Single Market Scoreboard*, No. 3, DG XV October, p. 4.
22. Consejo de Estado (1992), *La Recepción del Derecho Communitario*, Memoria del Consejo de Estado, Madrid, p. 140 and Consejo de Estado (1993), *De Cara a la Union Europea*, Memoria del Consejo de Estado, Madrid, p. 178-184.
23. OECD (1998), *Economic Surveys: Spain*, p. 136.
24. This in part is linked to rigidities in the enrolment and management of the civil service. Alba, Carlos (1995), "L'administration publique espagnole: réforme ou modernisation", *Revue Française d'Administration Publique*, No. 75, July-September, p. 389. Sanchez, Antonio Ramiro (1997), "Más reformas en la Administración, Para qué?" *Gestión y Análisis de Políticas Públicas*, No. 9, May-August, p. 63.
25. OECD (1997), *The* OECD *Report on Regulatory Reform: Synthesis*, Paris, p. 37.
26. The Legal Service of the State, *Servicio Jurídico del Estado*, provides also advice on improving the legal quality of draft laws and regulations from ministries that required its assistance (Ley de Asistencia Jurídica al Estado e Instituciones Públicas (52/1997)).
27. Deighton-Smith, Rex (1997), p. 221.
28. Fundación Entorno (1998), *Libro Blanco de la Gestion Medioambiental en la Industria Española*, Madrid.
29. In 1998, a regulatory commission for the tobacco sector – *Comisión del Mercado de Tabaco* – with widespread regulatory powers was established.
30. José Luis Palma (1997), *La Seguridad Jurídica ante la Abundancia de Normas*, Centro de Estudios Politiccos y Constitutionales, Cuadernos y Debates, No. 68, Madrid.
31. OECD (1998), *Economic Surveys: Spain*, pp. 130-133.
32. In 1997, the EU simple average tariff rate across all products stood at 10%. The average rate for agricultural products (HS 1-24) stood at 20.8% in 1997. See, Trade Policy Review, European Union, 1997, World Trade Organisation, page 44-45.
33. In 1999, the major operators in the Spanish telecommunications fixed line are:

    Telefonica (*Telefónica de España*): Spain's largest telecommunications company. **Retevision**: it is a former TV and radio transmission company and is building its own network. Retevision is free to set prices lower than those stipulated for Telefonica. **Lince**: is the third telephony operator with France Télécom and Cableuropa as main shareholders. **Euskatel**: it is the first regional phone company operating in the Basque region since January 1998 and is associated with Telecom Italia. **Jazztel**: it is investing heavily in deploying a broadband network, as well as the installation of a submarine cable between Bilbao and United Kingdom. **BT Tel**: it is a subsidiary of British Telecom and it has for several years operated Spain's second largest data communication network.

    In mobile services, the main companies are:

    Telefonica: it has about 70% of the Spanish mobile phone market with its two subsidiaries Movistar and Moviline. **Airtel**: a private consortium using GSM 900 technology, has been competing with Telefonica since 1995. In March 1999, it had about 30% of the Spanish mobile market. **Retevision Movil**: it was awarded Spain's third mobile phone license in May 1998.
34. This obligation is provided by the Royal Decree 2200/1995, which set up the conditions for recognition as a national standardisation body.
35. Frankena, Mark (1997), *Market Power in the Spanish Electric Power Industry*, Report prepared for the Comisión del Sistema Eléctrico Nacional, Madrid, March.
36. Ocaña, Carlos, and Romero, Arturo (1998), A simulation of the Spanish electricity pool, CNSE, Madrid, June.
37. London Economics (1999), *El sector eléctrico español, Análisis del poder de mercado*, Madrid, February. CNSE (1999), *Análisis de la participación de Endesa en ciertos episodios anómalos en los mercados de energía eléctrica gestionados por el operador del sistema* and *Análisis de la participación de Iberdrola en ciertos episodios anómalos en los mercados de energía eléctrica gestionados por el operador del sistema*, Madrid, 28 July.
38. The EC Directives include: Terminal Equipment Directive (88/301/EEC of 16th May, 1988); Services Directive (90/388/EEC of 28th June 1990); ONP Framework Directive (90/387/EEC of 28th June, 1990); ONP Leased Lines

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Directive (92/44/EEC of 5th June 1992); Satellite Directive (94/46/EC of 13th October, 1994); Cable Directive (95/51/EC of 18th October, 1995); Mobile Directive (96/2/EC of 16 January 1996); Full Competition Directive (96/19/EC of March, 1996); Licensing Directive (97/13/EC of 10th April, 1997); ONP Interconnection Directive (97/33/EC of 30 June 197); ONP Amending Directive (97/51/EC of 6th October, 1997); Telecoms Data Protection Directive (97/66/EC of 15th December, 1997); ONP Voice Telephony Directive (98/10/EC of 26th February, 1998).

39. Spain made international commitments for regulatory reform through its acceptance of the regulatory principles in the "Reference Paper" attached to the February 1997 WTO agreement on basic telecommunications services.

40. Extensions were to 1 July 1998 in the case of Luxembourg, 1 January 2000 in the case of Ireland and Portugal, and 31 December 2000 in the case of Greece. The Irish government subsequently announced its intention to liberalise the Irish market by the end of 1998, one year ahead of its extended deadline.

41. Under the terms of the 1998 General Telecommunications Act, the Ministry for Development shall exercise such powers in respect of general authorisations or individual licences as are not assigned to the CMT under the Telecommunications (Liberalisation) Act of 24 April 1997.

42. "Spanish Regulator Passes First Test", *Eurocom*, 13 November 1998, p. 3.

43. Telefonica claimed that revenue would fall by 20 billion pesetas (US$13.8 million) a year. "Spain's Telefonica Says Lower Fees Will Cut Revenue", Andrew Davis at Bloomberg News, *Total Telecom*, 23 November 1998.

44. David Molony, "Spain's Regulatory Delay Deters New Entrants", *Communications Week International*, No. 201, 980316, p.13.

45. It has been contended that the initial spectrum availability constrains the number of licenses that can be awarded for national coverage to four (Government of France (1998), *The Introduction of* UMTS *in France*, December.

46. Basing judgement on criteria such as the bidder's coverage plans', views on roaming onto rival second or third-generation networks; the subsidisation of networks in areas of low-population density (government of France, *The Introduction of* UMTS *in France*, December 1998).

47. The access provider can discriminate in providing access in various and subtle ways that are difficult for regulators to detect and monitor: by providing poor interconnections, slowly and/or ineffectively repairing and maintaining leased network facilities, and delaying or denying the use of local network innovations to their competitors. The access provider who is also a down stream competitor, has strong incentives to behave in this way, leading customers to reject alternative providers thereby preserving their position.

48. In March 1999, Airtel asked CMT to act as mediator in efforts to persuade Telefonica to "unblock negotiations on interconnection charges". (*El Pais*, 26/03/1999, p.67). Notably, CMT has shown some determination to address such problems. On 18 March 1999, it made a provisional ruling under which Telefonica must make its network more accessible to RSLCom. The ruling was made in response to RSLCom's complaint that Telefonica has made the technical requirements for interconnection more complicated in order to deliberately delay a new competitor's entry into the market. ("RSLCom complains about access to Telefonica's networks", *El Pais*, 25/03/1999 p. 63).

49. Technically, the cable telecommunications service would not be provided directly by Telefonica but by one of its subsidiaries called Telefonica Cable.

50. A cost of market liberalisation perceived by the community has been in regard to environmental degradation as companies dig up streets to deploy cable networks in ground, or above ground through installation of antennas or overhead cable. Spain's 1998 Telecommunications Act contains specific penalties for operators who act in a manner that degrades the environment.

51. OECD (1995), "*Price Cap Regulation – Policies and Experiences*", Paris. Also OECD (1999), *Communications Outlook* 1999, Paris.

52. Gartner group, "Liberalisation Milestones: One year on". Issue 2, January 1999. At http://www.bt.com/liberalisation.

53. See OECD (2000), OECD *Economic Survey of Spain*, January.

54. OECD (1997), OECD *Report on Regulatory Reform: Synthesis*, p. 38.

55. Tribunal de Defensa de la Competencia (1993), *Policies to Boost Free Competition in the Service Sector and Put an End to the Damage Done by Monopolies*, p. 26.

56. The Consejo de Estado, acknowledged this situation when a few years ago, it recommended to the government delegating to a dedicated body the study of the regulatory inflation. Consejo de Estado (1992), *La Seguridad Jurídica*, Memoria del Consejo de Estado, Madrid, p. 113.

57. DTI (1998), A *Fair Deal for Consumers. Modernising the Framework for Utility Regulation*.

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Part II

BACKGROUND REPORTS

BACKGROUND REPORT ON GOVERNMENT CAPACITY TO ASSURE HIGH QUALITY REGULATION*

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Background Report on Government Capacity to Assure High Quality Regulation

Are national administrations able to produce social and economic regulations that are based on the core principles of good regulation? Regulatory reform requires the development of administrative capacities within the public sector to judge when and how to regulate in a highly complex world. Administrative transparency, flexibility, policy co-ordination, understanding of markets, and responsiveness to changing conditions are increasingly important to policy efficiency and effectiveness.

Over 20 years, Spain has experienced a process of social, political, and economic change of a magnitude seen in few other OECD countries. This has brought Spain considerably closer to the mainstream of regulatory practices in the OECD. In some areas, it is moving ahead. Democratisation, devolution to regions, and convergence with the rest of Europe have transformed the Spanish governance system, particularly its administrative and legal environments. The pace of change toward market-oriented policies and government institutions accelerated in recent years through a series of bold economic reforms, many linked to membership in the European Union. Policies of privatisation, market openness, competition enhancement, and regulatory reform substantially reduced the direct role of the state in the economy, strengthened competitive forces, and improved the efficiency of remaining state intervention in some policy areas and sectors.

In recent years, the government has broadened these structural reforms by improving the capacities of the national administration to ensure that regulation is transparent, efficient and necessary. Since 1997, each new law and regulation has had to be accompanied with a mandatory report justifying its necessity, together with a memorandum estimating its foreseen costs. Regulatory transparency has also improved through use of different consultation strategies by regulators. The government has also placed more emphasis on administrative simplification. In January 1999, a new inter-ministerial commission on simplification launched a review of existing formalities to eliminate those deemed unnecessary, and to simplify and reduce the response time of those remaining. The commission is also responsible for preparing and monitoring an annual simplification programme for the administration. The government recently announced that improving the regulatory environment is a major priority to improve the competitiveness of the Spanish business sector, as commitments to the European Monetary Union and the EU Stability Pact constrain monetary, exchange rate, and fiscal policy instruments.

These steps and commitments are necessary, but are not yet comprehensive enough to achieve the desired results in terms of an improved environment for business growth, in particular for small and medium-sized enterprises. For example, the efficiency of achieving social policy objectives such as environmental quality through regulations and administrative formalities has not received enough attention. Reform in these areas would produce large gains. Strengthening regulatory management, such as through a specialised unit, to supervise the use of regulatory powers throughout the administration is needed. Establishing regulatory quality standards will make bad regulatory decisions more transparent, and reduce the ample discretion by strong ministries to regulate as they wish. The interdependence of both elements – quality standards enforced by an effective oversight body – could improve regulatory quality and promote a cultural change in the administration. These reforms should also encourage the Spanish regulatory system to move from a control and command and legalistic approach towards a compliance-friendly and performance based approach. To support this move, the existing Evaluation Questionnaire should be turned into full-fledged regulatory impact analysis that is publicly accessible. "Notice and comment" should be required for all new proposals to strengthen consultation. Finally, regional and local governments, which have an increasing role in regulatory matters, need to be more involved to ensure that gains are preserved and extended throughout the Spanish regulatory system.

Potentially large gains could be realised if the government of Spain would:

– *Adopt at the political level a broad policy on regulatory reform that establishes clear objectives, accountability principles and frameworks for implementation.*

– *Establish an oversight unit with i) legal authority to make recommendations to the Council of Ministers, ii) adequate capacities to co-ordinate the programme through the administration, and iii) a secretariat with enough resources and analytical expertise to provide independent opinions on regulatory matters.*

– *Revise the existing evaluation questionnaire to conform with OECD best practices, make it mandatory for all proposed regulations, including ministerial orders, and make the responses publicly available as part of public consultation procedures. As part of this, implement across the administration a step-by-step programme for improving regulatory impact assessment, based on OECD best practice recommendations, for all new and revised regulations. The analysis should*

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Executive Summary (*cont.*)

begin with feasible steps such as costing of direct impacts and qualitative assessment of benefits, and move progressively over over a multi-year period to more rigorous and quantitative forms of analysis as skills are built in the administration. Implementation will be more rapid and successful if a training programme is established, managed by the regulatory oversight unit discussed above, to instil the necessary skills in the public administration.

- *Improve transparency by further strengthening the public consultation process, by adopting uniform notice and comment procedures, and by launching a programme of codification to reduce legal uncertainty.*
- *Establish a centralised registry of all regulatory requirements with positive security.*
- *Strengthen the administrative simplification policy by i) assuring that quality standards and principles are used in the revision of existing formalities, ii) by assigning to the Simplification Commission a dedicated secretariat with analytical expertise and resources, and iii) by concentrating as a high priority on reducing and simplifying authorisations, licences and permits.*
- *Encourage regulatory reform by co-ordinating initiatives with the autonomous communities and municipalities, and by assisting them to develop management capacities for quality regulation.*

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1. REGULATORY REFORM IN A NATIONAL CONTEXT

1.1. The administrative and legal environment in Spain

In the past quarter century, Spain has experienced a profound transformation of its governance structures that continues yet today. The Constitution of 1978 accelerated and consolidated a process of social and economic transformation toward market-oriented democracy. This process gained further impetus in 1985 with Spain's accession to the Europe Community.

Within this broad context of governance reform, regulatory regimes and institutions have been extensively reshaped. Three key policies have been particularly important in driving regulatory reform: the process of European convergence, particularly the harmonisation of Spanish legal frameworks with European policies in many areas; the accelerating devolution of regulatory and other governance capacities to the autonomous communities and other sub-national governments; and the modernisation of the national public administration. Spain's participation in the European Monetary Union will place even greater attention on the efficiency of its regulatory institutions, processes, and policies.

European convergence dramatically modified the general regulatory context. Spain has steadily integrated its national regulatory regimes within the European legal framework. Today, the European Commission considers Spain as one of the most advanced EU countries in transposing EU Directives.[1] Today, a large part of the Spanish legal framework is based on European law and judicial decisions. For instance, the *Consejo de Estado* estimates that even before the Maastricht and Amsterdam Treaties, more than 54% of the legal framework was related to EU directives, regulations, and decisions.[2] This has had far-reaching impacts on the regulatory administrative organisations, and legal traditions and doctrines, of Spain. For instance, according to the *Consejo de Estado*, the transposition has brought gradual but deep changes – from the terminology to the doctrine – to the Spanish legal system.[3]

A second major force remoulding Spain's legal and administrative framework is related to its remarkable experience in reconciling a highly centralised state with growing regional demands. The devolution has taken place through a long sequence of steps and phases that were begun by the approval of a new Constitution in 1978, and reinforced by crucial decisions of the Constitutional court. The speed and scope of decentralisation is different for the various autonomous communities, but today all 17 autonomous communities have developed a strong sense of regional and political identity. Each has established its institutions, administration, and legal and regulatory frameworks. Devolution has required that major administrative functions of the national government be reinvented, such as replacing service delivery with new policy co-ordination functions to guarantee basic conditions of equality for all Spaniards (Section 2.3).

The third major reform affecting regulation is the modernisation of the public sector. Like other OECD countries, the Spanish public sector grew significantly during the past 50 years. Public intervention multiplied through regulations, subsidies and investments, and as the public administration took on increasing responsibilities in social and environmental areas. Democratisation and devolution had immense impacts on the public sector: the administration was long considered a pillar of the previous regime and had to be recreated, while a constellation of public administrations emerged in the autonomous communities and municipalities. Since the early 1980s, the government has tried to lead and accelerate those changes, as well as to improve the efficiency of its public sector through professionalisation of the civil service, organisational restructuring, legal rationalisation, and privatisation (see Section 2.1).

Reforming key aspects of public sector organisations and cultures has proven to be an extended, multi-year process. The Spanish administration is compartmentalised into strong ministries. Horizontal oversight bodies and co-ordination mechanisms and institutions are often weak, slowing implementation of administration-wide reforms.[4] The civil service has suffered from rigidity in personnel and staffing, delaying needed reforms.[5] Though changes are noticeable, the civil service has not lost its interventionist habits. Reliance on command and control regulations and controls on market competition are prevalent. Corporatist attitudes and institutions have not disappeared, nor has a rent-seeking approach to regulation. These problems are also seen at regional and local levels.

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Other important features of Spanish administrative culture are a highly-developed legalism, reliance on precedent, and formalism in actions and procedures, which has made it difficult to move toward policy practices and tools that are results-oriented and responsive to citizens and businesses. This can be seen, for example, in the lack of economic impact assessments when preparing laws and regulations. The legalistic approach contributes to the practice of using regulations as the preferred instrument to solve problems, instead of alternative policy instruments (see Section 2).

The confluence of these three reforms – European integration, devolution to regional and local governments, and reform of the administration – has produced a period of legal activity and reform without precedent in Spain's history.[6] But the new legal framework has not realised its full promise in improving regulatory quality, the general business environment, and the market orientation of the public administration. A recent OECD Economic Survey stated:

> *Despite the strong macroeconomic performance and a number of recent structural reforms, the Spanish economy has not yet fully overcome the strong corporatist philosophy and heavy regulation of economic activity from its past. Even after recent reforms, the overall business environment and the prevailing web of regulations and other institutional factors combine to generate what could be significant impediments to entrepreneurial activity.*[7]

Indeed, there were suggestions by the Council of State in 1992 that the complexity and quality of Spanish regulation may have worsened at that time. First, the legal transformation generated regulatory inflation. The annual number of pages of the Official Gazette (*Boletín Oficial del Estado*) grew from 2 663 pages in 1970 to 9 498 pages by 1990. The regulatory stock in 1990 was estimated by the *Consejo* to include more than 12 488 norms and regulations in force.[8] More importantly, the Council of State indicated that regulatory inflation had been accompanied by a "degradation of laws", that is, a reduction in the rigour and overall quality of laws and regulations.[9] This could be seen in the use of fragmented legislation and the lack of a systematic and rigorous abrogation of old rules (Section 3.1.3). These developments had

Box 1. **Good practices for improving the capacities of national administrations to assure high quality regulation**

The OECD Report on Regulatory Reform, which was welcomed by ministers in May 1997, includes a co-ordinated set of strategies for improving regulatory quality, many of which were based on the 1995 Recommendation of the OECD Council on Improving the Quality of Government Regulation. These form the basis of the analysis undertaken in this report, and are reproduced below.

A. BUILDING A REGULATORY MANAGEMENT SYSTEM

1. Adopt regulatory reform policy at the highest political levels.
2. Establish explicit standards for regulatory quality and principles of regulatory decision-making.
3. Build regulatory management capacities.

B. IMPROVING THE QUALITY OF NEW REGULATIONS

1. Assess regulatory impacts.
2. Consult systematically with affected interests.
3. Use alternatives to regulation.
4. Improve regulatory co-ordination.

C. UPGRADING THE QUALITY OF EXISTING REGULATIONS
(*In addition to the strategies listed above*)

1. Review and update existing regulations.
2. Reduce red tape $and government formalities.

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consequences for legal security, particularly for a civil law system, which is based on an exhaustive and explicit set of rules.[10]

1.2. Recent regulatory reform initiatives to improve public administration capacities

Spain's approach to regulatory reform has been pragmatic and somewhat reactive, and its speed, scope, and success have differed among policy areas. For example, reforms to economic regulations have been taken much further than reforms to social and administrative regulations. In that sense, no comprehensive regulatory reform policy or strategy have yet been established. On the other hand, the government has separately pursued a number of important reforms that have had direct and indirect impacts on regulatory capacities in the public sector. Three particularly important policies launched in recent years were: structural economic reforms, modernisation of the national public administration, and reforms to the Administrative Procedure Law.

Structural economic reforms date from modernisation strategies launched in the late 1950s when the government began to move away from the autarky economic model. Convergence with Europe since 1985 gave new impetus and direction to structural reforms (see Box 2). As in many other countries, these reforms were a mix of market opening steps, large-scale privatisation, liberalisation of state control activities, sectoral re-regulation, and strengthening of competition policy.

Implementation of the European Single Market Programme from 1989 resulted in major deregulation. Almost all agricultural markets and most branches of industry were more or less opened to European trade and investment. A huge array of regulations and technical standards was eliminated. Spain implemented the single market framework in less than six years, when other countries needed decades.

Market openness was quickly followed by liberalisation of factor markets.[11] In 1992, as the domestic market was opening to international competition under the European Single Market, the government concentrated on reform of service sectors, privately and publicly owned.[12] Stimulated by a comprehensive report on structural reforms released in 1992 by the competition authority, reform of telecommunication, electricity, gas, oil product distribution, and air transport regulations got underway, with initial steps to strengthen competition policy, and improve regulations in land, retail distribution, professional services, postal services, and water. A Convergence Programme approved in 1992 to meet the requirements of the Treaty of Maastricht supplemented the microeconomic reforms with plans to reform macroeconomic policy. In 1996 the government approved an ambitious programme of structural reforms that included, among other reforms, the privatisation of almost all the remaining public enterprises. This programme, in just two years, sold practically all of Spain's biggest state-owned companies in a wide range of sectors, keeping a core of companies concentrated in mining, defence, and loss-making strategic companies (*i.e.* railways, shipbuilding, etc.). The programme also drastically reduced aids to state-owned enterprises. The second wave is not yet completely implemented, but the privatisation process is nearly over. By 2000, the only activities left within the public enterprise sector will be mining and certain defence companies.

With Spain a founding member of the EMU, a new and ambitious medium term policy was articulated in the 1998-2002 Stability Programme recently approved by the government. The programme stated that, to counter the weakening of demand-side instruments such as monetary and fiscal policy, further emphasis will be needed on supply-side policies and structural reforms of factor and product markets. The government will further open competition in protected sectors and take additional steps to improve regulatory quality in relation to both specific sectors and the general business environment. The programme lists sectors (telecommunications, electric utilities, water, retailing, land use, and finance) and other policy areas (privatisation, bankruptcy law, rules of civil law procedures, SMEs, competition policy, tax measures, and research and development policy) for specific reforms.[13]

Public management reforms. Reform of the central administration has been underway since the 1980s. Successive governments have proceeded with cautious and piecemeal changes to bring managerial and technical skills as well as flexibility to the civil service, to change a procedure-based administrative

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culture into a performance-based one, and to shift the focus on objectives rather than means in the delivery of public services.

Civil service reform, needed to achieve the flexibility and mobility needed for the devolution process, was launched in the early 1980s. In 1984 the traditional civil corps (*cuerpos de estado*) were restructured and many specialised corps were eliminated and replaced by more broad-based ones. However, the results of these reforms were not totally satisfactory and further transformations later stalled.[14] The government recently indicated its intent to enact a new law.

Other reforms focussed on improving the delivery of public services. The most ambitious initiative consisted of a detailed Plan to Modernise the Central Administration by the Ministry of Public Administration (MAP) in 1992. The plan was intended to improve (*i*) communication and information to citizens; (*ii*) service quality; (*iii*) simplicity of formalities; and (*iv*) efficiency of government-wide processes and procedures. The MAP co-ordinated hundreds of proposals prepared by ministries and agencies.

Box 2. **Structural regulatory reforms in Spain**

Late 1970s – end of 80s:	Reforms generated by accession to the European Union.
June 1985:	Spain's Accession to the European Community.
1987:	Signature of the Single European Act.
1987:	Price and quantitative restrictions on road haulage phased out (Law 16/1987).
1989:	A new Competition Law replaces the 1963 law.
1989:	Start of the public enterprises privatisation process.
Early 1990s –1996:	Reforms around the European Single Market Programme.
1983-1996:	Liberalisation of airport handling operations.
April 1992:	The Council of Ministers publishes the Convergence Plan.
January 1993:	Completion of the Single Market Programme.
October 1994:	Council of Ministers approves the full liberalisation of telephony by 1 January 1998.
1994:	Liberalisation of air transport.
1994:	Labour market reform (flexibility of temporal work contracts).
January 1995:	Bank of Spain becomes autonomous.
March 1995:	Creation of the electricity regulator, National Electricity System Commission.
1996-1999:	Reforms around Convergence to EMU.
June 1996:	The government launches the State Enterprise Modernisation Programme. First list of "Measures to Liberalise and Reactivate the Economy". The Law for the Defence of Competition is partially amended.
July 1996:	Pact of Toledo and new law on pension reforms.
February 1997:	Second list of "Measures to Liberalise and Reactivate the Economy".
April 1997:	Reforms of the labour market through agreement between employers and unions. Creation of the telecommunication regulator, *Comisión del Mercado de Telecomunicaciones*. Creation of a new public entity to manage the rail infrastructures.
September 1997:	Restructuring of controlling bodies of state-owned enterprises.
November 1997:	New Electricity Law.
April 1998:	New Basic Law on Land Regime and Valuation.
1998 -2002:	Stability Programme.
July 1998:	New Universal Postal Service Law.
October 1998:	New Hydrocarbon Law.
April 1999:	Urgent Measures to Liberalise and Increase Competition.

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Some 204 projects were published in 1992.[15] Commitments ranged from the elaboration of a *Manual of Administrative Language for the User* to the simplification of frequently used formalities, like social securities or passports formats. The results of these reforms were considered to be modest. Few innovations and changes were introduced to the organisation and work methods of the administrations.[16] This was in part due to a lack of political backing. According to commentators, MAP did not have enough power to mobilise other ministries for in-depth reforms, and after a few months the highest levels of the government lost interest.[17]

On the other hand, MAP was more successful in promoting targeted improvements to relationships between the public and the administration. Information technology initiatives have provided better and faster access to public services and products. An ambitious project to create one-stop-shops (*Ventanilla Unica*) was launched, and will soon be supported by citizens' assistance centres (*Centros de Atención al Ciudadano*). These initiatives are closely connected with the administrative simplification policy renovated at the beginning of 1999 (see Section 2.1). Other areas where the government has been active include transparency enhancement projects like creating national inventories of administrative procedures. Finally, the MAP has been working on establishing a performance management programme for civil servants and promoting implementation of total quality management programmes for street level offices.

Reform of the Administrative Procedure Law. In parallel with those initiatives, Spain reformed through a series of new laws and amendments the 1958 Administrative Procedure Law to increase accountability and transparency across the administration. This multi-year endeavour can be divided into four distinct elements (see Table 1):

The first reform in 1992 focussed on revamping the legal regime of common administrative procedures, that is, procedures connecting citizens with the administration. The rules include how the procedure begins, when it finishes, the format, and so forth.[18] The reforms set up minimum standards to be followed by all sub-national administrations. A key intent of the reform was to reduce the response time of the authorities by implementing the tacit authorisation rule across the whole administration (central, regional, and local). This rule means that, in case of non-response by the authority, the applicant can assume the request was authorised. In January 1999, the law was further reformed with stricter mechanisms and disciplines, and a new permanent Inter-ministerial Commission on Simplification was established to steer a review process (see Section 2.1 and Section 4).

– A second initiative reformed in 1997 the normative processes for producing laws and subordinate regulations. The new law added more requirements to the process and provided important clarifications, for instance to the consultation process (see Section 2.1 and Section 3).

– Through the same law, the powers of the central government organisation were redefined to separate the political from the administrative levels throughout the administration. The law also regulated the role of co-ordination bodies like the Delegated Commissions and the General Commission of Secretaries and Subsecretaries (CGSYS).

– Another 1997 law reorganised and modified the legal regime of the central administration.[19] First, a major reorganisation of the administrative services representing the central administration in the regions (the "peripheral administration") reduced duplication among levels of government. Second, the law clarified the right and duties of new public agencies and enterprises that had been established in the past decade. As other countries, Spain had set up many specialised bodies to improve flexibility and responsiveness of regulatory and other policies. In exchange for more accountability, these entities got more freedom in day-to-day operations (for instance, concerning human resources and spending controls) and the possibility to work under private law instead of administrative law. This trend, called *Huida del Derecho Administrativo* or flight from administrative law, needed extra care in a country like Spain because of its impact on the whole system of intricate administrative laws.[20]

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Table 1. **Evolution of the 1958 Administrative Procedure Law**

	1958	1992	1997		1999
	Administrative Procedure	Common Administrative Procedure (30/92)	Organisation and operation of the general administration of the State (6/97)	Government (50/97)	Reform of the Common Administrative Procedure (4/99)
Elements dealing with procedures between the administration and the public	"Tacit negation" and minimum criteria to be followed in every procedure established.	"Tacit authorisation" becomes a rule for all procedures, but ministerial exceptions. Mandate for 1st review of existing procedures.			"Tacit authorisation" becomes a rule for all procedures, but Parliament exceptions. Mandate for 2nd review of existing procedures. Simplification Commission established.
Elements dealing with procedures for creating a law or regulation	General steps for preparing a law or regulation, including public consultation to social partners.		Requirement of an authorisation from MAP in case of impacts to the distribution of competencies between levels of government, the creation of a new administrative procedure, and changes to civil service regime.	Clarification of types and levels of regulations. A justification report and economic memorandum become mandatory. Strengthening of consultation process.	
Elements dealing with procedures for organisation of the central administration	Rights and duties of central administration.		Civil Governors eliminated in the provinces and replaced by regional delegates.	Clarification of role of co-ordination commissions.	
Elements dealing with the organisation of regulatory bodies	Two types: autonomous organisms and public enterprises.		Clarification and reform of regulatory bodies (*i.e.* autonomous organism and public enterprises).		

Source: OECD Secretariat.

2. DRIVERS OF REGULATORY REFORM: NATIONAL POLICIES AND INSTITUTIONS

2.1. Regulatory reform policies and core principles

The 1997 OECD *Report on Regulatory Reform* recommends that countries adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.[21] The 1995 OECD *Council Recommendation on Improving the Quality of Government Regulation* contains a set of best practice principles against which reform policies can be measured.[22] In Spain, no explicit policy on regulatory reform or regulatory quality exists covering social, administrative, as well as economic regulations, unlike other countries as the Netherlands or the United States, and this absence has fragmented reform efforts (see Box 1.1 in Part I for the OECD definition of regulatory reform). However, aspects of regulatory reform are folded into other reform policies, and these are moving Spain in the right direction. In particular, recent Spanish reforms to regulatory production processes and administrative simplification policy are boosting the capacity of the administration to produce higher quality regulations and formalities.

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Spain has a long-standing policy, under the responsibility of the Council of State, to improve the *legal* quality of proposals of laws and regulations.[23] Through its annual reports and legal quality review, the Council provides overall analysis, proposals and guidance to the government on trends in quality, and gives formal opinions on the quality of specific proposals (see Box 6). Reforms in the Government Law of 1997 have the potential to also improve the *substantive policy content* of new regulations. Four reforms in the law were positive in terms of improving policy quality:

– The law lays down procedures for proposals of law and proposals for subordinated regulation (royal decrees and ministerial orders). With the above explicit definition of the set of different regulatory instruments available to the government, the law clarified the constitutionally mandated requirement to publish all regulations in the Official Bulletin.

– The law assigns an explicit supervision role to the Technical General Secretary of each ministry. These high officials play a key role in co-ordinating and managing budgetary and other resources inside each ministry.

Each draft law or regulation is to be accompanied by a justification report and an economic memorandum about its cost. MAP also needs to provide an authorisation in case a regulation has an impact on the distribution of competencies between the central and the regional and local governments.[24]

– The law mandates that, as a general rule, all proposals should be subjected to public consultation.

These reforms are consistent with the 1995 OECD *Recommendation on Improving the Quality of Government Regulations* in establishing additional requirements to improve the quality of proposed regulations. The new law provided welcome clarifications to key mechanisms, such as public consultation, that were still ruled by old and unclear practices.[25] It also laid the foundation for a uniform process of regulatory management stretching across the public administration.

However, the reform contains two weaknesses. First, there is little capacity to oversee compliance with its requirements. The law does not establish clear accountability or responsibility for regulatory quality assurance and compliance. In theory, the Technical General Secretary of each ministry is in charge of quality control, but his location in the ministry is not a line position, and is weaker than the Secretaries of State in charge of regulatory areas. Co-ordination and oversight are also absent from the rulemaking process established in the law. In practice, these tasks are assumed by the General Commission of General Secretaries and Sub-secretaries (CGSYS), before a final decision is made at the Council of Ministers. For some sectoral issues deemed to have a high economic impact, the draft law or regulation needs also to be discussed in the *Comisión Delegada* before going to the CGSYS. However, as the collegial CGSYS has other crucial responsibilities, its time to concentrate in providing critical and independent scrutiny of regulatory proposals is limited. Last, the CGSYS does not review ministerial orders, which often have important regulatory impacts. Best practice in other countries shows that a specific body or even a dedicated commission with a clear mandate and adequate resources are often needed to provide support in supervising the regulatory quality procedures. Such a body can also be a useful counter balance to powerful ministries in the regulatory management system.

The second weakness is that the law has not been reinforced by further principles, implementing regulations, definitions, or guidance to drafters that can help to prepare the reports and carry out consultation. Without clear standards or minimum parameters, regulators have few incentives to comply with the law and will tend to mechanically abide by the process and to inconsistently interpret the law's intent, especially if they are not cross-examined by an oversight body.

As other OECD Member countries' experiences show, quality standards and an effective regulatory management institution are interdependent requirements. Central oversight is more effective and accepted if objective quality standards for regulation are specified in detail. But quality standards and principles are often not enough to improve regulatory habits and counter incentives. An expert government-wide institution should be accountable for overseeing compliance. A concrete and market-oriented set of quality standards should be based in the OECD principles accepted by Ministers in 1997, which read:

Establish principles of "good regulation" to guide reform, drawing on the 1995 OECD *Recommendation on Improving the Quality of Government Regulation. Good regulation should: i) be needed to serve clearly identified policy goals and*

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effective in achieving those goals; ii) have a sound legal basis; iii) produce benefits that justify costs, considering the distribution of effects across society; iv) minimise costs and market distortions; v) promote innovation through market incentives and goal-based approaches; (vi) be clear, simple, and practical for users; vii) be consistent with other regulations and policies; and viii) be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.

Administrative simplification policy. Since the early 1990s, Spain has pursued administrative simplification. MAP had the main responsibility, though lately the Ministry of Economy and Finance, through its horizontal SME policy, has taken an increasingly prominent role. MAP's involvement has been broad in scope, encompassing both activities of central government administration and establishing basic administrative and managerial rules for regional and local administrations. Two main objectives have been pursued. The first aim has been to facilitate relationships between the administration and the citizens. Hence, MAP has focused on organisational aspects, implementing for instance, intermediary units (one-stop shops and start-up shops) or information technology tools. The second strategic objective has been to improve the efficiency of administrative procedures, and in particular to reduce the authorities' response time and promote implementation of the tacit authorisation rule.

The current policy can be traced to the legal reforms of the Common Administrative Procedure Law of January 1999. The law established clear accountability in a new inter-ministerial *Simplification Commission* chaired by the Minister of Public Administration who reports to the Council of Ministers.[26] The State Secretary of Public Administration, the State Secretary for Commerce, Tourism and Small and Medium Enterprises and the Secretary of State for Social Security act as its vice-presidents. The sub-secretaries from all the ministries are standing members. The Commission is supposed to meet at least twice a year, and be supported by an Executive Commission. The General Directorate for Inspection and Quality of Service of the MAP will provide a Secretariat.

The purpose of the Commission is to propose reforms to the Council of Ministers. It thus lacks binding powers and relies mainly on peer pressure and transparency, such as through an annual report on compliance by ministries. In the short run, and by legal mandate, the Commission will concentrate on two targets: (*i*) harmonisation and elimination by April 2001 of "unnecessary" formalities, and (*ii*) implementation by April 2001 of the tacit authorisation rule in some procedures that were exempted previously. In carrying out these tasks, the Commission is obliged to design, approve and monitor a *General Plan for the Simplification of the General Administration of the State*. This annual plan will be based on simplification proposals provided by ministries in accordance with general directives and criteria approved by the Commission. Among its other tasks, the Commission will also provide an opinion on all new administrative procedures contained in legal or regulatory proposals.

It is too soon to evaluate the effectiveness of the new policy: the first meeting on the first plan is not expected to happen before September 1999, and additional elements are still being crafted (in particular guidelines for the submissions of ministries). However, based on the 1995 OECD Recommendation and other OECD country experiences, some important issues can already be flagged. It is a strong point that an accountability mechanism has been clearly established. The existence of a permanent mission with time frames is also a radical change to the previous *ad hoc* initiatives. The creation of an inter-ministerial commission is another good step to build a crosscutting view of the central administration, improve consistency and transparency, and promote reforms at all levels of government. Controlling new as well as existing administrative procedures is also a good practice. A strategy controlling the stock will be self-defeating through time if the flow is not attended. Overall, the institutions and processes for this simplification initiative are more structured and operational than for previous endeavours.

Though the reform is still at an early stage, some potential weaknesses and gaps can be identified. First, concerning the authority of the members of the Commission, it is not clear that the participating sub-secretaries, who are two levels under the minister, have enough clout to commit to painful changes by their ministries. The Commission will also operate through self-assessment and peer review rather than through independent assessments. As in any country, it is likely that ministries will propose reforms that do not threaten their authority or require basic rethinking of their roles. This is even more important as the Commission has only a consultative role, and its Secretariat has no access to budgetary and human

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resources other than those currently assigned to the General Directorate for Inspection and Quality of Service, which are relatively limited.

Second, though general directives and criteria for the revision of new and existing administrative procedures have not yet been published, according to the MAP it is not intended to establish clear economic principles or methods for decisions on eliminating and simplifying procedures. Without objective standards and methods, accountability will not be maintained. Ministries will tend to generously interpret the benefits and minimise the costs of each formality to be eliminated. This is problematic, as the definition of administrative simplification is not clear in the law or elsewhere. The article of the law on the mandate says only that simplification includes "rationalisation and elimination of unnecessary formalities." The lack of a clear test of what is "necessary" and what is "unnecessary" makes it difficult for ministries to make the policy operational and may foster discrepancies and inconsistencies across the government. The same article emphasises the traditional thrust of administrative simplification; namely reducing response times and implementing the tacit authorisation rule. This could misdirect the initiative by giving priority to improving the speediness of current procedures, without considering the need to eliminate or reinvent them.

A related concern is the lack of transparency and open participation in the process. Except through publication of the General Plan and the annual assessment report, the working of the Commission is not exposed to citizens' inputs, nor is dialogue carried out with stakeholders. Again, this will tend to support administrative efforts to make incremental changes without truly resolving the problems of unnecessary controls and excessive intervention, nor weighing the costs and benefits of options. Public perceptions and experiences in following the procedures would help to assess true burdens and benefits. Additionally, because each ministry will consider its own administrative procedures, the lack of users' inputs will reduce the assessment on the duplication and aggregation of information requirements. Finally, lack of stakeholder participation will reduce the credibility and public support for the whole initiative.

2.2. Mechanisms to promote regulatory reform within the public administration

Reform mechanisms with explicit responsibilities and authorities for managing and tracking reform inside the administration are needed to keep reform on schedule. As in all OECD countries, Spain emphasises the responsibility of individual ministries for reform performance within their areas of responsibility. This is amplified by the tradition of strong and independent ministries and the principle of departmentalisation, which grants each minister broad autonomy and responsibility in the sphere of his or her competencies. Clearly, however, government-wide reforms requiring consistency and systematic approaches across the entire administration must depend on co-ordination mechanisms and strong institutional drivers. In Spain, inter-ministerial commissions and a few independent bodies relying on legalistic precedent and peer pressure have played such roles.

The most important co-ordinating body on regulatory affairs is the General Commission of General Secretaries and Sub-secretaries (CGSYS). It is chaired by the Vice-president of the Council, or in his absence the Minister of the Presidency. All General Secretaries and Sub-secretaries of the 14 ministries can participate. The Commission is responsible for preparing decisions to be taken to the Council of Ministers, and to this end it may revise proposed laws and royal decrees. A small secretariat from the Prime Minister's Office serves it.

The *Simplification Commission*, headed by the Minister of Public Administration, should soon have a higher profile in promoting reforms across the administration, though its mandate is only advisory and its function co-ordinative. A particular challenge will be to improve the co-ordination between the administrative simplification and the SME policies. In this sense, the nomination as one of three vice-presidents of the Commission of the State Secretary for SMEs of the Ministry of Economy and Finance is an important step forward. The government drawn up in July 1999 of the *Plan to Simplify the Regulatory Framework for SMEs Competitiveness* with the specific provision that it should be integrated into the *General Plan for the Simplification of the General Administration of the State* is also a positive signal of better co-operation between these two key ministries. Moreover, MAP's officials are now participating into SME bodies and initiatives such as in

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the working group on the simplification of the tax system of the SME Observatory, which is the government consultative body for SMEs policy.

In addition to servicing the Simplification Commission, the *Ministry of Public Administration* has two other important regulatory reform roles. First, it is in charge of relations with the autonomous communities and local administrations. In this role, it monitors the enactment of new laws and regulations by regional and local governments and facilitates the exchange of information between them. The MAP must authorise all proposed laws and regulations that may affect the distribution of competencies between the national administration and the autonomous communities.[27] MAP is also in charge of *ex post* evaluation, internal controls and auditing of central administrative functions through the General Directorate for Inspection, Simplification and Quality of the Services.[28] Specifically, the General Directorate reviews and scrutinises the satisfactory delivery of authorisations, the rationality of procedures, the reduction of red tape and all matters related to improving public services delivery.

Although not directly involved in improving the quality of regulations, the Delegated Commission of the Government for Economic Affairs (*Comision Delegada del Gobierno pasa Asuntos Económicos*) has power from the Council of Ministers to deal with economic issues of political relevance. As such, the *Comision Delegada* has discussed and influenced most structural reforms and economic liberalisation measures of the past decade, and is an initiator and supervisor of the implementation of reforms. This powerful commission is composed of all ministers directly involved in economic affairs. The Minister of Economy and Finance chairs it and the Secretary of State of Economy acts as its secretariat with the technical assistance of the Directorate General for Economic Policy and Defence of Competition.

The Ministry of Economy and Finance plays key roles in regulatory quality control through two other bodies. First, the Directorate General for Economic Policy and Defence of Competition hosts the prosecutors branch of the competition authority, *Servicio de Defensa de la Competencia*, which has promoted deregulation and regulatory improvements across many economic sectors (see background report to Chapter 3). The Ministry has also been responsible since 1996 for SME policy, and has been in charge of the *Plan to Simplify the Regulatory Framework for* SMEs *Competitiveness*. The General Directorate for SMEs Policy also provides the secretariat for the SME Observatory and has promoted significant reforms to tax formalities. As indicated above, closer co-ordination mechanisms between the SME State Secretary and the Simplification Commission have recently been established.

Two independent bodies need to be mentioned in connection with the regulatory quality management system. The *Tribunal for the Protection of Competition*, which acts as the decision-making body in competition policy, has been active in competition advocacy since the early 1990s, for instance through the publication of an influential analysis on the role of competition in 1993.[29] Second, the *Consejo de Estado*, which is by constitutional mandate the supreme counsellor of the government, assures the legal quality of the regulatory framework, including the transposition of European law (see Box 6).

2.3. Co-ordination between levels of government

Regulatory systems are composed of complex layers of regulation stemming from sub-national, national, and international levels of government. Complex and multi-layered regulatory systems have long been a subject of concern with respect to the efficiency of national economies and the effectiveness of government action. In Spain, sub-national and supranational levels are inextricable elements of the regulatory framework, and developments at one level affect developments at the others. The policies and mechanisms for co-ordinating regulations between the regions and municipalities on one hand, and the European level on the other, are essential to the establishment of a high quality regulatory environment in Spain.

Co-ordination with the autonomous communities and municipalities. The Constitution does not define Spain as a federation, though the system increasingly operates like one. Article 2 states that the Spanish nation "recognises and guarantees the right to self-government of the nationalities and regions of which it is composed". The legal realities of regional self-government are still evolving. From a highly centralised system in which there were two levels of government, the country has moved to a three-tier system composed of central, regional, and local governments. The regional level is made up of 17 self-governing or

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autonomous communities established between 1978 and 1983.[30] The local level is sub-divided into two tiers: fifty provinces and about 8 000 municipalities. Although provinces and municipalities are supposed to be "autonomous", in practice the former are often little more than administrative machines for the delivery of certain public services, and many of the latter lack the resources necessary to bring self-rule to full fruition.[31]

Two constitutional articles define the general distribution of competencies. Article 148 enumerates the powers that may be adopted by the regions, and article 149 lists powers that are the exclusive competence of the national government (see Table 2). All residual capacities not enumerated are left with the central level if the regions have not claimed the competence in their regional basic law, known as a "Stat-

Table 2. **Division of main regulatory powers**

Policy area/public service	European level	Central level	Regional level	Municipal level
Nationality, immigration, emigration	X	X		
Defence and armed forces		X		
International relations		X		
International trade, customs and import duties	X	X		
Monetary policy	X			
Competition policy	X	X		
Administration of justice	X	X	X	
Commercial, penal, penitentiary and procedural legislation	X	X		
Civil law, contract law		X	1	
Public administration, administrative procedure and expropriation		X	X	X
Public safety		X	X	X
Spanish cultural, artistic and monumental heritage			X	
Press, radio and television	X	X	X	
Industrial and intellectual property law	X	X		
Labour legislation	X	X		
Credit, banking and insurance activities	X	X	Mg	
Air transport and air traffic control	X	X		
Sea fishing	X	X		
Inland hunting and fishing			X	
Railways and inland transportation	X	X	mg	
Airports, ports		X	mg	
Merchant shipping		X		
Post Office		X		
Domestic trade and retail	X	X	X	X
Academic degrees and professional qualifications	X	X	(2)	
Telecommunication	X	X		
Industry and Agriculture	X	X	X	
Electricity	X	X		
Mining and energy (other than electricity)	X	X	X	
Environment	X	X	X	mn
Education		X	X	mn
Health care pharmaceutical products	X	X	X	
Social security		X		
Water resources		X	X	mn
Woodlands and forestry			X	
Urban and land use planning			X	X
Public works		X	x	X
Housing			X	X
Staple markets				X
Slaughterhouses			X	X
Waste disposal				X

Note: This is an indicative table identifying main regulatory policies according to levels of decision. In many cases a subsidiarity principle applies and many laws are applied concurrently by the different levels of government.
1. Except in those matters regulated by traditional regional legislation.
2. Important self-regulation from the private sector.
Mg: (Marginal): based on basic national regulation, often the implementation aspects.
r (Regional): only if one region is concerned.
mn: Municipal.
Source: Articles 148 and 149 of the Spanish Constitution and *Consejo de Estado* (1993), *De Cara a la Union Europea*, pp.175-187.

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ute of Autonomy" (E*statuto*). Although the lists are quite exhaustive, the actual distribution has needed interpretation and clarification by the Constitutional Court, in influential cases.[32]

The Constitution creates a continuing process to devolve powers, according to local capacities to exercise them. This has resulted in a multi-speed devolution, in which the degree of devolution varies from community to community. A community may assume full legislative and executive powers, or Parliament or the national government may explicitly delegate powers. The C*onsejo de* E*stado* is responsible for overseeing devolution. The Constitutional Court settles *ex post* any dispute.[33] Some autonomous communities (the Basque country, Catalonia, Galicia, Andalucia, and to some extent, Valencia, the Canaries, and Navarra) have claimed from the outset the fullest degree of self-government possible under the Constitution, leading the other communities.

In addition to this asymmetry among autonomous communities, two other features determine the distribution and the differences in regulatory frameworks at sub-national levels. First, the constitutional arrangement differentiates between policy and implementing powers in many areas. For central government competencies, policy making – often established on a "basic law" – is very often kept at the central level, while the implementation and administration of regulations is delegated to autonomous or local levels. Second, in many areas, the central government sets minimum standards to be met and leaves each autonomous community, or even municipality, the capacity to adapt them according to environmental, social, political and cultural situations. Such is the case, for instance, for environmental rules where Andalucia, Catalonia, and Galicia have enacted more stringent environmental laws and regulation than the national government (or what is required by European Directives).[34]

Expansion of regional and local regulatory power has stimulated the emergence of regulatory innovations and alternatives. Some autonomous communities are laboratories of new ideas on legal approaches. For instance, although the "tacit authorisation" rule for all administrative procedures was discussed in the central government since the late 1980s, the Catalan government was able to implement the measure a few years earlier. In terms of regulatory processes too, autonomous communities have moved faster to reform and, in some cases, more radically. In 1989, eight years before the national reforms, the government of Catalonia requested by law a cost-benefit analysis for legal and subordinate regulations which, on paper, put Catalan reforms ahead of those of most OECD countries. Catalonia also established a process for approving laws and subordinate regulations that was more structured than those existing at the national level. A well-designed programme, based on training seminars and a very complete guidebook, backed these rules.[35] In recent years, however, the Catalan benefit-cost test has been reduced to only an assessment of impacts on the government budget, which is not a useful test for regulation.

In some cases, autonomous communities have been innovating in regulatory administration. For instance, new ways to deliver health care have been tried in Catalonia through consortia, in Anadalucía through semi-private bodies, and in Galicia through public foundations. Such initiatives inspired and influenced the 1996 reforms of the national law, which permitted public hospitals to become financially autonomous based on private-sector management principles.[36]

Such innovations were the exception rather than the rule, however, and in many policy areas decentralisation requires more attention to ensure that the new regulatory functions are carried out consistently with principles of regulatory quality. The rapid transfer of regulatory powers has fostered a rapid increase in the number of new regulations, creating overlaps and even inconsistencies between the national government regulatory framework and those of the autonomous communities, and between those of the autonomous communities themselves. For instance, in 1991, the 17 autonomous communities enacted a total of 205 laws and 4 801 decrees.[37] Enactment and implementation of dissimilar and detailed regulations by regional and local governments has reduced legal security and made more complex the regulatory administration.

At a more fundamental level, the general discussion and negotiations in the past few years between the national and regional governments has concentrated on the question, "who regulates what?" instead of "is a regulation needed?" In allocating competencies, the *role* of government has barely been questioned, which may represent a valuable missed opportunity.

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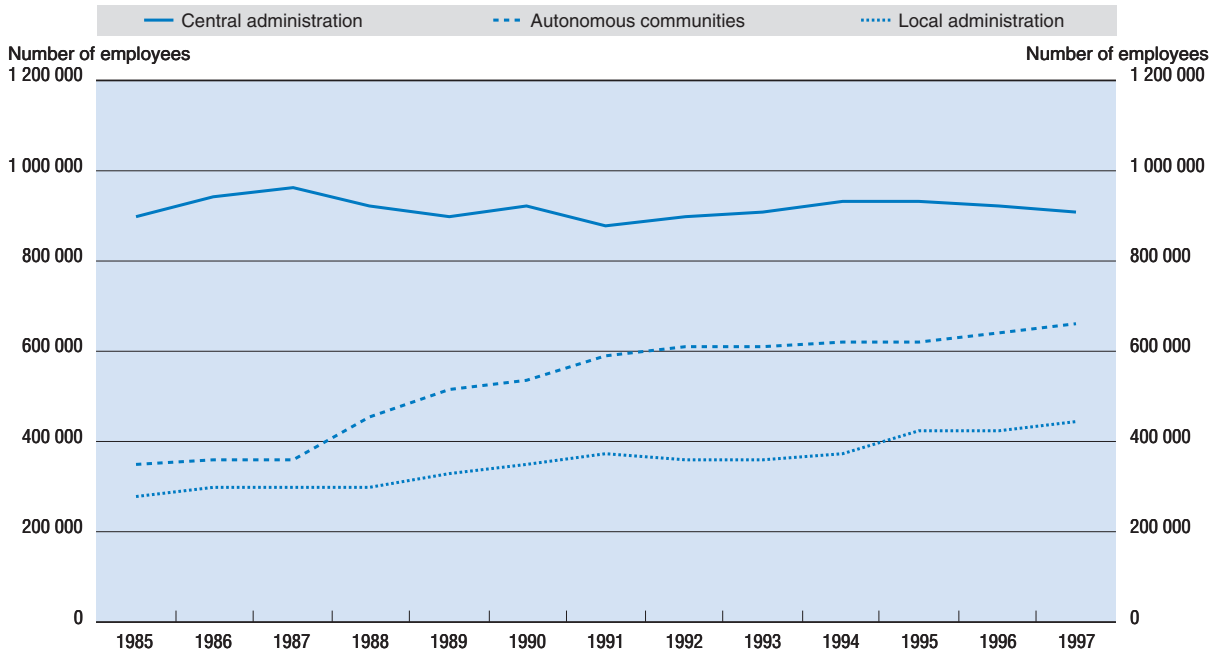
Other circumstances have affected the quality of the sub-national regulatory framework. Regional and local administrations have inherited the cultural and traditional rigidities of the national administration. An alarming re-emergence of interventionist policies and attitudes may be signalled by the acquisition by autonomous communities and municipalities of hundreds of public enterprises.[38] The benefits of bringing the administration closer to the people have partly offset by duplication and overlap of administrative services between different levels of government still remain in some areas. In the recent past, decentralisation has resulted in rapid growth in the civil service: the Spanish administrative structure grew 31.% between 1985 and 1997. Because the national administration has not changed, all the increase was attributed to growth in the public sectors of the autonomous communities (by 86%) and of the local governments (60% growth).[39]

The government has taken steps to correct some of these problems, for instance through reform of its administrative services at local levels. Given the political momentum toward devolution, it has concentrated its resources in reinforcing co-operation instruments. In the forefront of such initiatives, a web of intergovernmental boards or "sectoral conferences" has been created since the early 1980s to prevent conflict and improve communication between the national government and the autonomous regions. In mid-1999, 27 sectoral conferences are operating. Chaired by the responsible national minister, each conference specialises in policy areas (education, health, industry and energy, labour, etc.). The meetings cover the subjects of interest to both parties, though the national government decides whether a consultation is necessary.[40] It is through these fora that each national ministry consults with the autonomous communities on legal proposals and European Directives before they are submitted to Parliament.[41]

As a complement to the sectoral conferences, the government established in January 1999 new institutions and co-operation instruments.[42] The Bilateral Co-operation Commissions (*Comisiones Bilaterales de Cooperación*) between the national government and individual autonomous communities are intended to permit a more focused and prompt approach to problems. These new bodies reflect a successful model

Figure 1. **Public sector employment in Spain**



Source: OECD/PUMA (1999), Public Sector Pay and Employment Database.

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developed for environmental policy; the European Environmental Agency, for example, has considered as best practice the co-ordination tools developed in Spain to integrate environmental concerns with other policies at regional levels. *Agencias del Medio Ambiente* (AMA) or Environment Agencies have been established in four autonomous communities. They bring together sectoral ministries to develop environmental policy and regulations, thus spreading the "ownership" of environmental protection measures and facilitating their implementation.[43]

The 1999 reform also reinforced an important co-ordination tool, the "co-operative covenants", in order to strengthen the institutional framework to develop joint plans and programmes between the different governments on particular issues.

Co-ordination with European institutions. Since accession in 1985, Spain has been a front runner in implementing European legislation. This is largely due to the fact that the government established a closely-knit system of co-ordination mechanisms built around the Inter-ministerial Commission for European Affairs. This Commission monitors the transposition of European Directives and prepares Spain's positions in European negotiations (together with the *Comision Delegada*). It is also in charge of implementing, following up and solving European Union issues affecting more than one ministry. The commission is chaired by the State Secretary for External Policy and the European Union, with two vice-presidents, the Secretary of the *Comisión Delegada* and the General Secretary for External Policy and the European Union. The General Director for Co-ordination of the Internal Market and Other Community's Policies of the Ministry of Foreign Affairs acts as its secretariat.

Two other important bodies participate in co-ordination with Brussels. In Parliament, the Joint Commission for the European Community (*Comision Mixta para la Union Europea*) contributes to the elaboration and implementation of European law. This important commission formed by an equal number of members of the two Parliament's chambers actively takes part in the preparation, discussion and approval of European laws and regulations. Also, during the transposition of European Directives, the *Consejo de Estado* oversees constitutional and legal aspects. In particular, the *Consejo* focuses on restricting the propensity of ministers to use the transposition process to include additional requirements (a practice known elsewhere as "gold-plating" or "gilding the Brussels lily"). Further, the *Consejo de Estado*, with the MAP, is in charge of verifying and controlling the capacities of the autonomous communities to incorporate in their legal and regulatory frameworks the elements of European law. Some autonomous communities have established regional legal consultation councils equivalent to, and recognised by the *Consejo de Estado*. In such cases, the regional council is responsible for assessing the conformity of their legal and regulatory frameworks with EU legislation.

In the past decade, autonomous communities have increasingly participated directly in European regulatory processes, either through national channels and co-ordination institutions, or by establishing representation offices in Brussels. In the former case, the government set up a system where two representatives of autonomous communities participate on a rotating basis in the Spanish Delegation in Brussels.

3. ADMINISTRATIVE CAPACITIES FOR MAKING NEW REGULATION OF HIGH QUALITY

3.1. Administrative transparency and predictability

Transparency of the regulatory system is essential to establishing a stable and accessible regulatory environment that promotes competition, trade, and investment, and helps ensure against undue influence by special interests. Just as important is the role of transparency in reinforcing the legitimacy and fairness of regulatory processes. Transparency is a multi-faceted concept that is not easy to change in practice. It involves a wide range of practices, including standardised processes for making and changing regulations; consultation with interested parties; plain language in drafting; publication, codification, and other ways of making rules easy to find and understand; and implementation and appeals processes that are predictable and consistent. In the past two decades, Spain has taken steps to improve transparency in its regulatory and administrative activities. However, major challenges are not yet resolved.

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3.1.1. *Transparency of procedures: administrative procedure laws*

As explained above, the Government Law of 1997 sets requirements for the process to be followed in promulgating laws and subordinated regulations. Previously, a system existed under the 1958 Administrative Procedure Law. The 1997 reforms clarified the procedures to ensure that regulatory decisions are made appropriately, predictably, and openly.

The general scheme established in the new law consists of a sequence of steps starting with a General Directorate or administrative units preparing a legal text. This is followed by a negotiated process and the gathering of mandatory and explicatory reports and opinions, which form the dossier. The proposal is presented to the Council of Ministers for final approval or for subsequent discussion in Parliament. The process ends when the measure is published in the Official Gazette (*Boletín Oficial del Estado*). The procedure applies to all proposals of laws, royal decrees and ministerial orders produced by the national government (see Box 3). The autonomous communities and the municipalities have adopted similar processes, although in general with fewer constraints.

The scheme varies significantly according to the category of the proposals (laws or subordinate regulation), the nature of the task (transposition of an EU Directive, reform of an existing measure, etc.), and external circumstances (*e.g.* cases of emergencies). For instance, ministerial orders, which include by-

Box 3. **The standard procedure for producing laws and subordinate regulations**

1. A General Directorate prepares the proposal and establishes a report on the necessity of the measure and an economic memorandum on its potential costs. In some cases, the General Directorate is assisted by the legal service of its ministry, the Legal Service of the Ministry of Justice, or the Codification Commission, a legal counsellor to the Central Administration.
2. The Technical General Secretary of the proponent ministry prepares a mandatory validation report. From this moment, with the support of the General Directorate, the Technical General Secretary is entrusted with the responsibility of managing the next steps of the procedure, the further elaboration of the dossier and the managing of the consultation process.
3. The promoters organise the public consultation, known as *trámite de audiencia*, according to one or more modalities. They need to prepare a mandatory written statement summarising the consultation (see Section 3.1.3).
4. According to the regulatory area, some ministries or units need to present an opinion or an authorisation on the proposals. For instance, the MAP needs to authorise a draft regulation if the proposal has impacts on the distribution of competencies between levels of government, if a new administrative procedure is created, or if it has effects on the civil service management policy.
5. The proposal is sent to the *Consejo de Estado* for a legal opinion on its constitutionality, distribution of powers between levels of government, etc. This opinion is mandatory for royal decrees but voluntary for draft laws (see Box 6).
6. The proponent Technical General Secretary finalises the dossier. In particular, it gathers the economic memorandum prepared by the Ministry's Budgetary Office and approves the Questionnaire to Evaluate Regulations (see Section 3.3) and other documents prepared by the sponsoring General Directorate.
7. In parallel, the proposal and its preamble are distributed through an electronic network to all the members of the *Comision General de Secretarios y Subsecretarios* (CGSYS).
8. If the CGSYS approves the project, the Technical General Secretary transmits the dossier with the Questionnaire to the Council of Ministers for final authorisation. In the case of draft laws and regulations with substantial economic impacts, the *Comisión Delegada* also discusses and approves the draft.
9. In the case of laws, the Government Presidency sends the proposal to Parliament.
10. The approved law, royal decree or ministerial order is published in the Official Gazette (*Boletín Oficial del Estado*).

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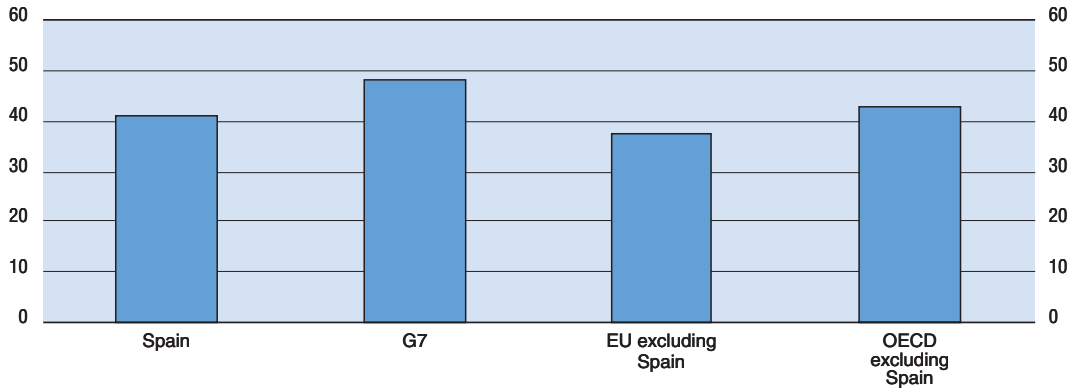
rules developed by sectoral regulators under a legal or regulatory mandate, do not reach the Council of Ministers and are not overseen by the Council of State. Some sectoral laws have particular procedures to establish by-laws. Although not as lengthy as in some other OECD countries, the process may take years to be completed for complex laws. For such regulations, it is not infrequent to have the proposal presented several times to the Council of Ministers.

For technical standards, a different procedure linked to the European system exists.[44] Basically, every standard is created in the 115 Technical Standardisation Committees (TSC) organised under the umbrella of the Spanish Association of Normalisation and Certification (AENOR). The scheme goes by the following main steps: (1) a working party prepares a standard project; (2) the TSC approves the project and publishes it in the Official Gazette for comments; (3) TSC examines the comments and prepares the final proposal, and (4) an AENOR authorised body approves it and publishes it in the Official Gazette (for further details see background report to Chapter 4).

Box 4. **Transparency of regulatory systems in selected OECD countries***

Based on self-assessment, this broad synthetic indicator is a relative measure of the openness of the regulation-making and regulatory review system. It ranks more highly national regulatory systems that provide for unrestricted public access to consultation processes, access to regulation through electronic and other publication requirements, access to RIAs, and participation in reviews of existing regulation. Spain scores above the EU average, but lower than the OECD and G7 averages. It loses points, in particular, due to the absence of public consultation for the evaluation questionnaire and lack of an annual report on regulatory reform.



Source: Public Management Service, OECD, 1999.

* The indicators used here are part of a dataset under construction as a contribution to the OECD Secretariat's horizontal work programme on regulatory reform. They are based in part on a survey of all OECD countries carried out in March-April 1998.

3.1.2. *Transparency in decision criteria: proportionality*

Consistent with the OECD recommendation that "governments establish principles of 'good regulation' to guide reform," explicit standards for regulatory quality have been adopted, as have principles of regulatory decision-making. As noted above, the Spanish principles cover both economic and legal quality concepts.

However, a notable gap should be identified. The OECD has recommended as a key principle that regulations should "produce benefits that justify costs, considering the distribution of effects across society." This principle is referred to in various countries as the "proportionality" principle or, in a more rigorous and quantitative form, as the benefit-cost test. These criteria ask whether the size of the policy

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problem is sufficient to justify action and, if so, if the action proposed is the least cost option. Such a test is the preferred method for considering regulatory impacts because it aims to produce public policy that meets the criterion of being "socially optimal" (*i.e.* maximising welfare).[45] Some governments have adopted strict analytical standards that benefits should justify costs, while others have adopted more general proportionality criteria. This key principle of proportionality is insufficiently developed in Spain.

Spain's Government Law calls for all proposals of law and subordinate regulation to be accompanied by a "report or studies justifying the necessity and opportunity of the proposal, together with an economic memorandum containing an estimate of the foreseen costs" (Articles 22.2 and 24.1*a*). However, the Spanish framework for regulatory impact assessment includes neither consideration of proportionality nor a benefit-cost test. In practice, regulators have tended to comply through legalistic and descriptive assessments which are often too vague and lack sufficient detail to support good decisions (see further analysis in Section 3.3). Very often, the preamble of the measure or a brief note is considered to be sufficient. Some commentators have indicated that the end result is that public debates on regulation are still mainly based on political arguments with little economic foundation.

3.1.3. *Transparency as dialogue with affected groups: use of public consultation*

A strong trend toward expanding public consultation in regulatory development is underway in OECD countries. A well-designed process gives stakeholders the opportunity to have active input in regulatory decisions. Consultation can contribute to higher-quality regulations, identification of more effective alternatives, elimination of duplication across levels of government and ministries, lower costs to business and administration, better compliance, and faster regulatory responses to changing conditions. Properly constructed, it can also reduce the risk of capture and undue influence by special interests. In Spain, consultation mechanisms have been improved in regulatory matters. The Constitution of 1978 elevated a procedure called *tramite de audiencia* to a constitutional obligation, strengthening transparency and accountability as well as reducing corporatist elements of the 1958 Administrative Procedure Law system.

In November 1997, as part of the clarification and re-organisation of the rule-making process, the Government Law took further steps that brought Spain closer to international best practices. For subordinate regulations, it specified that consultation should take place within a reasonable time frame not less than 15 working days. Regulators are required to prepare a written statement summarising comments and justifying the consultation mechanism used. In addition, many sectoral laws have established advisory and consultative bodies with explicit mandates to review proposals of laws and subordinate regulations in their areas. At the end of the process for subordinate regulations, the Council of State assesses the extent and results of the consultation. After entering into force, laws and regulations may be annulled due to a lack of adequate consultation through legal appeal. Box 5 has the important features of the current process.

Several consulting methods are used for regulations:

– A*udiencia a los interesados* (consultation with interested parties). The regulator usually sends the proposed regulation to selected groups or individuals believed to be affected. For instance, the Ministry of Environment organised a complex system to identify and inform lumberjacks in the north of Spain when preparing a new forestry law. This approach can be useful, but risks limiting the consultation to only those groups known to the ministry or excluding those groups that may be hostile. New electronic procedures hold the promise of opening up these consultations to a wider range of interests. The Ministry of Justice is experimenting with a new consultation procedure based on the Internet.

– A*udiencia corporativa* (consultation with organised groups). This form of consultation is the most structured and frequent. Two mechanisms exist that may be used separately or jointly. First, the proponent consults bilaterally or multilaterally with representative groups deemed to be stakeholders in the regulated issues. In addition, and depending on the subject or if a previous law mandated it, a consultation is organised with some of the 473 official consultative bodies currently in existence. The size, influence and scope of each consultative council vary greatly. Some have permanent staff, while others are *ad hoc*. A number are partially or totally subsidised by the government or autonomous communities. It is not infrequent that a law creates a consultative council with a mandate to review future subordinate regulations. Very often, Chambers of Commerce and Indus-

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try or unions appoint members to these bodies. Increasingly, other organised interest groups, such as environmental NGOs, are involved. Unless otherwise specified, the councils are subject to internal procedures regulated by the Administrative Procedure Law.

– In economic, social, and labour matters, the most important consultative council is the Economic and Social Council (*Consejo Economico y Social*), founded in 1991 as the main forum for social partners. Its 60 members represent in equal proportions employers, unions, and other representatives from consumers and agrarian organisations. Through a strict procedure, specialised committees and working bodies prepare reports on proposed regulations and laws that are discussed and approved. Minority opinions may accompany the report. The media and Parliament often use these reports as a basis for debate. The Council has a permanent research staff and an annual budget of nearly 6 million euros. In addition to its reports on regulations, the CES studies topics of interest to its members.

– *Informacion publica* (notice and comment). A third way to organise consultation is by carrying out a notice and comment procedure during the development of a regulation. For some types of rules, like land use or municipal rulings, notice and comments are mandatory, for others it is a suggested alternative to be used by the sponsor of the regulation. However, this type of procedure is less frequently used than the other consultation procedures. In part, this is due to scepticism surrounding the method and the poor results of the consultation obtained. Nonetheless, the Ministry of the Environment recently published a White Paper and a proposal for a new water law to widen the public debate on the proposal.

Forward regulatory planning that would permit public consultation on the overall regulatory and legal agenda proposed by the government does not exist in Spain, as it does for instance in the United States. However, some ministers have tried to publish on a biannual basis their regulatory agendas. The Tribunal for Defence of Competition presented an interesting consultation/communication scheme on regulatory budgeting in 1993, unfortunately not implemented (see below).

Box 5. Legal framework for public consultation in Spain

Which regulations should be included in public consultation? Consultation is mandatory for subordinate regulations with general impacts on citizens. Only severe effects on the public interest justify omitting consultation. For proposed laws, consultation is at the discretion of the Council of Ministers. The legal doctrine considers that the discussions in the Parliament should be the main consultation mechanism for laws. In practice, however, most proposed laws are also subjected to public consultation.

Who should be consulted? The regulator should consult citizens if the subordinate regulation affects their "legitimate rights and interests". The consultation is to be done either "directly or through the representative organisations and associations legally established ... and whose objectives are directly connected with the goal of the proposal". The Council of State has defined "legitimate interests" as persons or bodies who "have professional or economic interest in the matter" and when the impact can be "considered serious, important or very direct" to a group of citizens.* In practice, wide discretion is provided to regulators when identifying citizens and/or their representative bodies. Some sectoral laws require consultation with ad hoc advisory groups. For instance, the Telecommunication Advisory Council reviews all proposed regulations prepared by the ministry and sectoral regulator, and the Economic and Social Council reviews all laws and regulations with economic and social impacts.

How much time does consultation take? The law indicates that the consultation period must allow a minimum of 15 working days, regardless of the mechanism chosen. However, it permits the regulator to reduce that time to a minimum of seven working days, if this is justified in the final written statement.

How is the consultation organised? Different forms of consultation are permitted by the law, as described in the text above. Neither the law nor a by-law defines permissible forms. No specification is provided concerning when during the regulatory process consultation should occur, nor the information that should be provided to the consulted party. The only discipline is that regulators must, at the end of the process, justify the choice of the consultative mechanism.

* Consejo de Estado (1993), *La Audiencia de los Ciudadanos*, Memoria del Consejo de Estado, Madrid, p. 107-126.

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Assessment. In recent years, Spain has expanded and made more rigorous the public consultation process. The 1997 law amending the 1958 procedure is a clear break with older practices, and is a positive step towards a more transparent, uniform, and structured consultation system. Cases where regulations have been annulled by the courts for lack of consultation indicate the seriousness of the mechanism.[46]

However, important weaknesses should be corrected. Discretion given to regulators in choosing the consultation strategy is too wide to ensure transparency and accessibility, to provide an independent quality control mechanism, and to protect against capture. The law requires adequate consultation, but leaves regulators with important incentives to strategically control the information provided to the public and the extent and form of participation. The fact that a spirit of open government may exist among Spanish civil servants cannot compensate the fact that for tactical reasons or by tradition, consultation may be too hasty, may not reach important groups, or may be captured by interest groups.

Resistance to the use of notice and comment procedures for laws and subordinate regulations should be re-assessed. Initial experiments in Spain have shown meagre results. But experience in other countries shows that, as a complement to more pro-active forms of consultation and with due time and effort to embed the notice and comment approach in the regulatory and public culture, this tool can provide an effective and credible safeguard against information monopolies in the public administration and other regulatory abuses.

Although the 1997 reform increased the minimum time for sending comments during a consultation from 10 to 15 working days, this period is short for a thorough and widely-based consultation. In particular, representative organisations may experience difficulties in consulting their members and responding within this timeframe. The consultation becomes even more difficult if the 7 working days consultation period for exceptional cases is used. In the Australian state of Victoria, after nearly 10 years of RIA based consultation, a review of the law led to an increase of the minimum consultation period from 21 to 28 days, while the circumstances in which exemptions from RIA and consultation requirements can be granted are clearly specified and strictly limited. A few years ago, the US federal government increased the time for comments to 60 days after finding that 30 days was insufficient in many cases.

A third concern relates to the extent of the review of the written consultation statement by the *Consejo de Estado* and the CGSYS. This key compliance and quality control mechanism is done too late, at the very end of the process. At this time, only very major flaws in the consultation can be detected and repaired. Important inputs and ideas that could have come from an adequate and early consultation may have been lost. Because regulators prepare the dossier, an incentive may exist to minimise the importance of negative comments. This phenomenon is even more important as no clear rules exist on making public comments or answers to them.

3.1.4. *Transparency in implementation of regulation: communication*

Transparency requires that the administration effectively communicates the existence and content of all regulations to the public, and that enforcement policies be clear and equitable. As a basic and fundamental rule, the Spanish Constitution mandates that all rules should be publicised (Article 9.3). The 1997 Law of the Government ratified this precept and regulated it indicating that all laws, royal decrees and ministerial orders be published in the Official Gazette (*Boletín Oficial del Estado*). Spain has rules permitting all persons access to administrative information, though they must demonstrate a legal interest to consult the dossier for a regulation.

A system of identification of laws and regulations according to the date of publication has been in place since 1959. However, practical and functional access to regulations in force is not as easy in Spain as in other countries, and this may have impacts on legal security. A business survey conducted in 1997 found for instance that most businesses were having important difficulties in identifying existing environmental regulation.[47]

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The most problematic issue concerns the lack of a consolidated code or registry. This creates difficulty in knowing which law, subordinate regulation, or articles can be enforced and which ones have been abrogated, totally or in part, by more recent laws and regulations. Three main reasons for the confusion are worth noting.

– First, matters are regulated by an array of laws on distinct matters. This is a more or less recent phenomenon identified by the Council of State as "legal mixture" which appeared in the 1980s,[48] and which was recently exacerbated by coalition governments. This trend is mostly manifested by annual enactment of the *Ley de Acompañamiento*, a special law similar to the US Omnibus Law, which is voted at the same time as the budget, and which includes dozens of modifications to other laws. Because the reforms are negotiated in the Parliament, they do not follow the procedures described in the previous subsections.

– Second, regulators (including the Parliament) have complied with difficulty with the obligation to have at the end of new laws or regulations an *exhaustive* list of articles and laws being abrogated by the new measure.[49] By law, a table (*tabla de vigencias*) summing up which articles have been derogated should accompany each new measure (either creating or reforming a regulation). Yet, according to the *Consejo de Estado*, more and more new laws and regulations tend to use a general formula indicating that "all previous rules which are contrary to the one being enacted are henceforth repealed".

Box 6. The role of the *Consejo de Estado* in the regulatory process

The Council of State is the successor to previous advisory Royal Councils established since the 16th century. During the 19th century, it took a comparable form to its French counterpart, mixing administrative and judicial aspects. However, the constitutions of the last two centuries have always recognised the Council as the supreme consultative organ of the state. By mandate or tradition it has thus played a key role in administrative and legal matters. One of its important responsibilities is to advise the government on its use of regulatory powers. This advice is voluntary concerning legal proposals (although frequently used) and mandatory for subordinate regulations. In the latter case, the recommendations are not binding; however, the government must indicate explicitly its disapproval in the preamble of the regulation. In general terms, the type of advice can be divided into six categories:

1. A *legality control*. The Council verifies if the proposed measure is in conformity with the Constitution and the general legal framework. In particular, it controls if the authority has the legal power to regulate and to sanction and if the rank of the measure is adequate (a law versus a subordinate regulation).
2. *Control of competencies*. Here the Council of States checks if the distribution of competencies between the Central government and autonomous communities has been respected.
3. *Control of conveniency*.[1] In this case, the Council oversees the compatibility of the measure with European and international law. In particular it ensures the conformity of the transposition of EU Directives into state and/or regional law.
4. *Control of the process to produce laws and regulations*. In this control, the Council focuses in the extent and quality of the dossier, verifying if all of the mandatory reports and opinions were provided.
5. *Control of the quality of the legal drafting*. In this scrutiny, the Council concentrates, on one hand, on the legal techniques used (terminology, coherence of the parts, etc.), and on the other, on the readability and user friendliness of the text.
6. *General advice on administrative matters*. Through their crucial position at the end of the regulatory process, and based on the extensive experience of governmental matters, the *Letrados* (members of the Council of State) have developed a series of parameters that permit them to provide a non-binding opportunity assessment of the measure. Occasionally this assessment permits avoiding duplication and overlap and improving co-ordination between administrations. In a few cases, the Council has recommended not issuing the measure.[2]

1. Fundación Entorno (1998), *Libro Blanco de la Gestion Medioambiental en la Industria Española*, Madrid, p. 162.
2. Consejo de Estado, communication.

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– Finally, legal security and overall transparency of the regulatory environment have decreased due to rapid shifts in the distribution of regulatory competencies across levels of government – European, national, and sub-national.

Facing these challenges, the government has been working on a series of initiatives to improve regulatory information. Most are based on a growing use of information technology. An important scheme assessed in Section 4 has been the setting up of a consolidated registry of administrative procedures on the Internet. The project to publish the *Boletin Oficial del Estado* on the Internet will further improve access to the regulatory framework, though this is not a replacement for a consolidated registry, which definitively could improve legal certainty.

Improving the readability of legal texts by non-experts is also an important area for regulatory communication. Policies to increase simplicity and clarity require guidance, training and instructions to write regulations in "plain language". Complex or unclear regulations tend to increase compliance costs, as when specialists are required to interpret them. This is particularly the case for SMEs. Spain has developed training programmes on drafting techniques. The National Institute of Public Administration has trained more than 260 administrators in drafting skills. A legal think-tank (GRETEL) formed by public administrators and university professors, has also been active in improving and disseminating better legal techniques. Recently, the Council of State, ultimate guardian of legal quality, published a series of recommendations stating that what is important is that the addressee of the regulation clearly understand the rights and duties. In particular, it has advocated that regulations be clear, complete and easy to use.[50] Further, MAP has published manuals for administrators on style and accessibility. These include the *Style Manual* and the *Manual of Administrative Documents* published in the early 1990s. Currently, MAP is working on an ambitious effort to harmonise the design of all government documents, including formats based on principles of legibility and user-friendliness.

3.1.5. *Compliance, enforcement, and appeal mechanisms*

Adoption and communication of a regulation is only part of the regulatory framework. To achieve policy objectives through regulations, citizens and businesses must comply with them and the government must enforce them. An appeal mechanism against regulatory abuse must also be in place.

A low level of regulatory compliance threatens the effectiveness of regulations, public policies, and ultimately the capacities and credibility of governments in taking action. It is notoriously difficult to tackle the compliance issue. Some countries, such as the Netherlands, have launched initiatives on this area.[51] In Spain, the issue has received little attention – in part because regions and municipalities are predominantly in charge of implementation and enforcement. Nonetheless, problems with compliance may be substantial (see Box 7), and some innovations have recently been launched. The tax revenue agency is implementing a scheme based on covenants to improve tax compliance by multinational and large firms. In these pacts, the firm and the agency agree on the value of the transactions between the firm and its subsidiaries (advance price agreements) in exchange for a less complex and burdensome regime and supervision.. A network involving the autonomous communities and the ministries in charge of European structural funds has also been set up to monitor the enforcement of European Directives and regulations.[52]

Improving enforcement strategies has recently become more prominent on the government agenda, in particular for tax and environmental regulations. This is reflected in an increase in the number of inspectors and a more intensive use of computerised databases for obtaining the information needed to control.[53] For instance, under the 1996 pension reform agreement (*Pacto de Toledo*), a Bureau on National Investigation of Tax Evasion (*Oficina Nacional de Investigación del Fraude*) was created. In the environment area, the Ministry of Environment has set up surveillance networks for air, toxic waste and sea water quality controls to help autonomous communities to compare their performance.[54]

Spain has not yet emphasised the need to design compliance-friendly regulations from the beginning by assessing the likely effects of regulatory rules and implementation strategies on target populations. This approach would require the regulator to understand how the regulated population will respond to rules and enforcement strategies, and how they can be encouraged to comply with regulatory objectives.[55]

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Box 7. The state of regulatory compliance in Spain

Although some sectoral analyses have been published, no general study on regulatory compliance has been prepared. However, important signs show that a compliance problem may exist in Spain. The problem may be more acute for certain regulatory areas and for some sizes of enterprises. The 1996 *Report on the State of the Environment* indicated that as much as 25% of solid urban waste in Spain was dumped illegally. For instance, the OECD *Environmental Performance Review* concluded that, in general, the degree of compliance by industry with environmental laws varies by company size.[1] In the case of complying with social security contributions, some studies have shown that the size of the informal economy (*economía sumergida*) may account for more than 7% of GDP.[2] This topic was so prominent some years ago that a "recommendation" to study the issue was part of the 1996 negotiation between employers and unions during the Pacto of Toledo reform of pension systems. Moreover, the complexity of the regulatory system may put pressure on the rate of compliance. Surveys from the General Council of Chambers of Commerce of Spain reveal that 90% of the new entrepreneurs ignore the formalities and other requirements when establishing their start up. Strategies to avoid compliance with onerous regulations can also be detected. The high proportion of very small enterprises and micro enterprises (with one to nine employees) may reflect an extensive use of subcontracting to circumvent tight job protection measures.[3] Non-compliance may grow in the future. Until today, Spain has greatly relied on public investments and subsidies to achieve higher regulatory standards. The possible reduction or re-orientation of European funds that have supported these public programmes may have an indirect impact on the level of compliance in some sectors, as enterprises may find great difficulties to finance their compliance costs through their own investments.[4]

1. OECD (1997), *Environmental Performance Review*, p. 129.
2. Consejo Economico y Social (1999), *La Economía Sumergida en Relación a La Quinta Recomendación del Pacto de Toledo*, draft report (April). For this study the definition of submerged economy centred on low and non-compliance with social security and pension contributions.
3. OECD (1997), *Environmental Performance Review*, Paris, p. 134.
4. According to officials at the Ministry of the Environment, compliance with some European Directives has been problematic in Spain. In part because the transition periods were to short, in part because some of the directives and methodologies were designed with other parameters (social, economical, and ecological) corresponding to more Nordic European countries. For instance, the Water Quality Directive has been hard to apply in Spain because the average level of water, which determines the concentration of pollutants, changes radically, when the measurements are done during the dry or the wet season.

Another key element in a quality regulatory framework is an effective and timely appeal mechanism that affected parties can use to correct or protest regulatory decisions or new regulations. In addition to their value in terms of efficient dispute mediation and legitimacy, good appeal mechanisms have in many countries been powerful tools in improving the regulatory framework through "reality checks" and *ex post* valuation.

Spain has a comprehensive and diversified appeals system that provides protection to citizens against possible abuses by the authorities. The main element is the existence of tribunals that deal with all complaints against actions (normative or executive) of the public administration. These tribunals (*tribunales contencioso-administrativos*) are not administrative but judicial bodies. The decisions of these tribunals can also be appealed to the Supreme Court (*Tribunal Supremo*). In parallel to this judicial venue, citizens can also complain against singular administrative decisions by using administrative appeals directed to the author of the decision or superior decisions (respectively, *garantias de recursos* and *recurso de reposición*). An important novelty introduced by the 1999 reform is that the administrative appeals can now include appeals against not only decisions but also underlying regulations.[56] Finally, a claimant can denounce a regulatory practice to specialised bodies, including the National Institute for Consumers and the Service for the Protection of Competition. Other appeal venues include the constitutionally independent ombudsman, the *Defensor del Pueblo*, and procedures involving European bodies.

Spain's appeal mechanisms are accepted as fair, but also criticised as complex, slow, and costly compared to other OECD countries.[57] According to the Administrative Tribunal, some claims have taken 5-6

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years to reach the Tribunal, and between 12-18 more months to be settled. Slowness is due to the fact that some offices are overloaded by cases, for instance those of Madrid and Barcelona. But mostly it is due to the complexity of the procedures, which force claimants to hire lawyers and other specialists to manage cases. Moreover, the appeals procedure has a disproportionate cost for smaller firms.

Facing these challenges, the government has launched measures that focus on establishing credible dispute resolution mechanisms. For instance, reforms to the Common Administrative Procedure Law in 1999 created a new arbitration instrument based on agreement and mediation. At the sub-national level, some autonomous communities like Catalonia and Madrid have created Arbitration Councils to handle small complaints. Another approach being explored is to improve existing complaint systems so that they can be used for administrative feedback, as is done in Japan. In 1997, the Ministry of Economy and Finance established a special broad-based council, *Consejo de Defensa del Contribuyente*, to speed complaints and reduce appeals against tax laws and the revenue service. The system has already improved the internal management of the Tax Revenue Agency: 59 out of 500 complaints triggered concrete organisational and administrative changes.

3.2. Choice of policy instruments: regulation and alternatives

A core administrative capacity for good regulation is the ability to choose the most efficient and effective policy tool, whether regulatory or non-regulatory. The range of policy tools and their uses is expanding as experimentation occurs, learning is diffused, and understanding of the markets increases. At the same time, administrators often face risks in using relatively untried tools, bureaucracies are highly conservative, and there are typically strong disincentives for public servants to be innovative. Reform authorities must take a clear leading role supportive of innovation and policy learning – if alternatives to traditional regulation are to make serious headway into the policy system.

In Spain, as in many countries such as the United States, Denmark, and the Netherlands, the use of alternatives to traditional regulation is more developed in environmental protection, compared to other policy areas. Spain is less innovative than those countries, but some initiatives are noteworthy and may be seeds for future use in other regulatory fields where command and control styles are dominant.

In the past decade, a series of *voluntary agreements* was concluded between firms and corresponding government authorities. At a national level, agreements with the automotive industry have been signed to promote the recycling of used cars. Community administrations are also using voluntary agreements. In Catalonia, the local ministry has signed agreements to promote cleaner production practices in the chemical industry. In the mid-1990s, the government of Catalonia also launched a programme to help more than 600 companies that could not comply with pollution standards to continue operating under a voluntary agreement to gradually improve their environmental performance.[58]

Certification programmes have become important tools to achieve higher standards, in particular when targeting compliance by small businesses. Recent clarification and adoption of rules by the Spanish Standardisation and Certification Association have fostered implementation by firms of third party ISO compatible certified environmental audits. The number of certification bodies for environmental management systems (series ISO 14000) nearly doubled during 1996-1997.[59] According to the Ministry of Environment, such a development will increase the penetration of instruments such as eco-labelling and over the medium-term will reduce pressures on enforcement activities.

Properly structured, *economic incentives* offer two great advantages over traditional "command and control" regulation. First, they allow business and others to achieve regulatory goals in the least costly manner. Second, market incentives reward the use of innovation and technical change to achieve these goals. Spain has lagged in the use of economic instruments. In 1996, the OECD inventoried six schemes at the national level based on charges for environmental services, including wastewater and coastal area management, and a dozen schemes in regions and municipalities to collect fees from polluting installations and for garbage collection. In part, such infrequent use of monetary instruments is explained by the complex distribution of fiscal authorities between levels of government, and the reluctance of municipalities to address tax issues.[60] It is also related to scepticism by regulators in the value of unfamiliar policy instruments. For instance, no marketable permit programmes have been adopted in Spain, though in the

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discussion of the preparation of a new law on water, some studies have proposed creating a market for tradable water concessions.

3.3. Understanding regulatory impacts: the use of Regulatory Impact Analysis (RIA)

The 1995 OECD *Recommendation on Improving the Quality of Government Regulation* emphasised the role of RIA in systematically ensuring that the most efficient and effective policy options were chosen. The 1997 OECD *Report to Ministers on Regulatory Reform* recommended that governments integrate regulatory impact analysis into the development, review, and reform of regulations. A list of RIA best practices is discussed in detail in *Regulatory Impact Analysis: Best Practices in OECD Countries*,[61] and provides a framework for the following description and assessment of RIA practice in Spain.

In Spain, all proposals for laws and subordinate regulations must be accompanied by a report on the necessity and opportunity of the measure, and an economic memorandum estimating costs, together with additional reports and assessment deemed necessary to guarantee the appropriateness and legality of the text.[62] No guidance or directive specifies the content of these documents. However, for laws and royal decrees, regulators may use an Evaluation Questionnaire for Norms (*Cuestionario de Evaluacion de Proyectos Normativos*) to comply. This structured checklist is designed to help organise and summarise the main elements of the dossier (see Box 8) when presenting the proposal to the Council of Ministers. In the case of ministerial orders, the assessment is done by the internal services of the responsible ministry.

Box 8. The regulatory dossier

The regulatory procedure consists of a gradual compilation of a series of reports and assessments, which will form the dossier considered by policy officials such as ministers. This will usually have the following elements:

- The legal text with its preamble in a harmonised official format.*
- *Report on the necessity and appropriateness* of the regulation – mandatory.
- *Economic Memorandum* on the future costs of regulation (*Memoria economica*) – mandatory.
- *Written assessment on the consultation process*, justifying the type of mechanism used or why no consultation was done – mandatory.
- *Opinion of the Consejo de Estado on the legality of the measure* – voluntary for laws, mandatory for subordinated regulations.
- MAP's *authorisation* – mandatory if the proposal has impacts on the distribution of competencies between the central government and autonomous regions, contains administrative procedures or has effects on the human resource policies of the administration.
- *Evaluation questionnaire for Norms*, which summarises the above reports – voluntary.

* Since 1991, Spain established standards to submit legal and subordinate regulations to the Council of Ministers: *Directrices Sobre la Forma y Estructura de los Anteproyectos de Ley*. The standards are not mandatory, yet are widely followed; in part because they have been included in the curricula of law students.

The Evaluation Questionnaire is widely used for proposals of laws and, to some extent, royal decrees. The General Director sponsoring the regulation answers it and prepares the economic memorandum. The Technical General Secretariat in the responsible ministry is in charge of certifying it. The Budgetary Office of the responsible ministry also needs to certify the economic memorandum. The Questionnaire has 20 questions divided in three sections: *i*) necessity of the project, *ii*) legal and institutional impacts, and *iii*) social and economic impacts. Typically, the ministry reports and the answers to the questions are descriptive and do not include quantitative assessments. The only exception is the economic memorandum, which should be included in Part 3, and concentrates in practice on the possible impacts of the proposal for the public budget.

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No overall assessment or evaluation has been made on the use and quality of the Questionnaire and associated reports (in particular due to the lack of centralised control). In the following assessment against OECD best practices, this system is considered as the Spanish regulatory impact analysis system.

Maximise political commitment to RIA. Use of RIA to support reform should be endorsed at the highest levels of government. Spain's system meets this criterion. The Government Law clearly mandates promoters to assess the legal, social, and economic impacts of laws and regulations, and the CGSYS and the Council of Ministers review such assessment.

Allocate responsibilities for RIA *programme elements carefully.* To ensure ownership by regulators, while at the same time establishing quality control and consistency, responsibilities for RIA should be shared between regulators and a central quality control unit. Spain's RIA programme scores poorly here. The regulators (the Technical General Secretary together with the General Directorate) prepare the reports and the answers to the Questionnaire. These documents are then distributed to the CGSYS and to the Council of Ministers. If the economic impacts are deemed significant, *the Comisión Delegada* also reviews the dossier before, and even sometimes after, being submitted to the CGSYS. However, no parameters define the quality of the reports and the Questionnaire is not mandatory. More problematic, no central body scrutinises the quality of the answers on a consistent basis, and no criteria or parameters exist to provide direction to drafters and respondents. The ministerial orders are not externally reviewed.

Train the regulators. Regulators must have the skills to prepare high quality RIA, including an understanding of the role of RIA in assuring regulatory quality, and an understanding of methodological requirements and data collection strategies. Training and guidance are also essential to ensure methodological consistency between the RIAs, and contribute to cultural change within the administration. In Spain, there are currently no formal training programmes or guidelines on how to prepare the reports and answer the Questionnaire.

Use a consistent but flexible analytical method. The Spanish RIA does not specify a method to analyse the impacts of regulation. Economic memoranda, according to officials, usually focus on impacts on the government budget. This is mostly driven by strong political commitment to keep with the ambitious medium term policy set to achieve the Maastricht criteria. Although important for policy decisions, clearly this type of analysis is most limited when evaluating the true impact to citizens, businesses and society as a whole. Worrisome gaps, as noted, are the absence of any cost-benefit principle, of any reference to economic compliance costs for citizens and businesses, and of a structured approach to assessing benefits. The lack of a uniform approach to regulatory assessment dramatically reduces the usefulness of the programme in supporting good decision-making.

Develop and implement data collection strategies. No data collection strategies are developed as such for the regulatory analyses. Since data issues are among the most practically difficult in conducting quantitative analysis, the development of strategies, and guidance for ministries on data collection would provide support for a successful RIA programme.

Target RIA efforts. RIA efforts should be targeted at regulations where the impact is greatest and where the prospects are best for altering outcomes. The law in Spain, however, makes no distinction between the importance of regulations. The reports and Questionnaire do not have a threshold level and in theory should be done for all new or reformed measures. A consequence is a flood of RIAs. This may not allow regulators to maximise the value of their analytical resources by concentrating on more important proposals. As more quantitative methods are used, the importance of targeting also grows, since the resource requirements involved are larger.

Integrate RIA *with the policy making process, beginning as early as possible.* Integrating RIA with the policy making process is meant to ensure that the disciplines of weighing costs and benefits, identifying and considering alternatives, and choosing the best policy option are a routine part of policy development. In some countries where RIA has not been integrated into policymaking, impact assessment has become merely an *ex post* justification of decisions or a meaningless formality. Integration is a long-term process, which often implies significant cultural changes within ministries. In Spain, the questionnaire and most of the accompanying reports are often finalised just before the presentation to the CGSYS and the Council of Ministers. What is more, it is frequent that the CGSYS members receive only part of the dossier and

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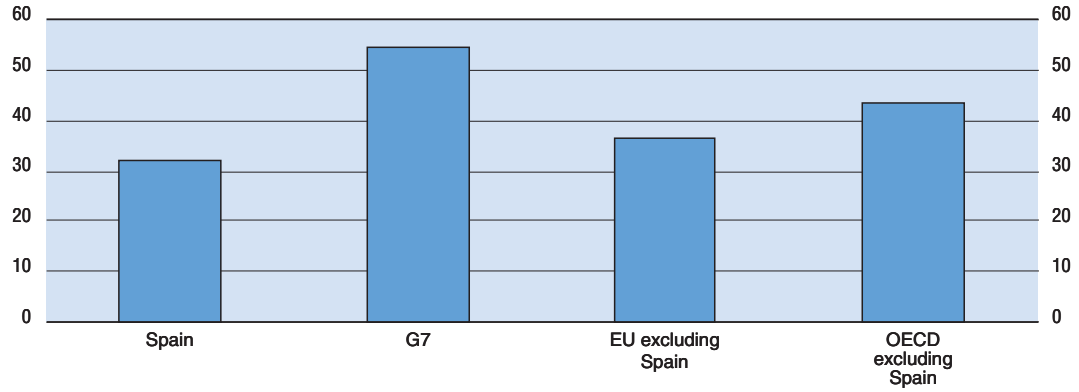
rarely the Questionnaire. This late preparation of the analysis greatly reduces its usefulness as a decision-making instrument, and suggests that it may be only a formality.

Involve the public extensively. Public involvement in RIA has several benefits. The public, and especially those affected by regulations, can provide data necessary to complete RIA. Consultation can also provide important checks on the feasibility of proposals, on the range of alternatives considered, and on the acceptance of the proposed regulation by affected parties. In Spain, the law does not require regulators to share the reports and Questionnaire with consulted parties. In practice, the analysis is rarely made public. A summary description of the proposal is the only element that accompanies the proposal when sent to consultation participants.

Box 9. The formal scope and breadth of the RIA system

This indicator looks at several aspects of the use of RIA, and ranks more highly those programmes where RIA is applied both to legislation and lower-level regulations, where independent controls on the quality of analysis are in place, and where competition and trade impacts are identified. Spain lags behind OECD countries and rest of the EU member states on this criterion. Key shortcomings are that the quality of the impact assessment reports and evaluation questionnaire are not reviewed by a body independent of the regulator, RIA is not applied to all cases, and RIA is not released for consultation. Systematically reviewing the quality of these documents, making them mandatory, and integrating them with consultation are a key policy priority.



Source: Public Management Directorate, OECD, 1999.

In sum, RIA in Spain is not functioning well as an aid to good regulation. The lack of uniform methods and quantitative tests that examine all of the important regulatory impacts reduces the usefulness of the legal requirements. As the recommendations below suggest, necessary reforms include the use of quantitative methodologies that estimate economic costs for citizens and businesses, a wider and earlier sharing of the reports and Questionnaire with the affected public, and better guidance and training for regulators, combined with creation of mechanism and institution for independent scrutiny and quality control.

A wider and more consistent use of regulatory analysis has also been examined in Spain. The Tribunal for the Defence of Competition proposed in 1993 a scheme similar to a regulatory budgeting exercise for laws and regulations. The proposal was to compile all estimated costs from economic restrictions on competition. An annual budget covering all sectors, and their respective laws and subordinated regulations would provide the monetary value of the costs imposed on society by regulations. The intent was

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to present this budget every year to Parliament for information. Since then, the proposal has not been elaborated further.[63] Indeed, no OECD country has succeeded in developing a workable regulatory budget (see the OECD *Review of Regulatory Reform in the United States*).

3.4. The changing institutional basis for regulation

As have other countries, Spain has created a number of new regulatory institutions to manage the new market-oriented regulatory frameworks. New agencies are increasingly in charge of the revision, extension, and application of the regulatory system. The Government Law of 1997 acknowledged this trend in regulatory management in the preamble of the Law of Government and provided a clearer institutional basis for the development of agencies. In particular, the law tried to reduce the heterogeneity of institutional and administrative design for such bodies.

Currently, 68 autonomous agencies (*organismos autónomos*) operate in Spain. Most are executive agencies with few regulatory powers. For instance, since the mid-1980s, autonomous agencies, private associations, and other third type organisations have handled tax receipts (*Agencia Estatal de Administratción Tributaria*), operated harbours (*Ente Público de Puertos del Estado*), and run other state-owned enterprises (*Sociedad Estatal de Participaciones Industriales*). However, in the past four years, a new kind of regulatory body has been established to regulate important economic sectors. The most important of these are:

- The National Commission for Electricity (CSEN) established in 1995, which will be replaced at the end of 1999 by a new commission on energy including the gas sector (see background report to Chapter 5).
- The Commission for the Telecommunication Market (CMT) established in 1997 (see background report to Chapter 6).
- The National Commission of the Securities Market, (CNMV), reformed in 1997 and provided with a higher degree of independence
- The Commission of the Tobacco Market (CTM) established in 1998 with widespread regulatory powers.

The performance of these agencies, with respect to providing high quality regulatory frameworks for market competition, depends on several factors, including governance dimensions. Since most of these agencies are very recent, an assessment of their performance is preliminary, but some issues are emerging.

Establishing clear regulatory roles and objectives, particularly between ministers and regulators, makes regulation more effective by removing conflict and uncertainty. To that end, regulators should have a clear statement of functions and objectives. In Spain, the regulatory agencies are established in laws that make a division between policy functions on the one hand, and executive and regulatory functions, on the other hand. Policy powers are kept in the ministries, and regulatory powers delegated to the agencies. However, in some cases, the line is not clear. Important regulatory functions like scrutinising entrants and deciding on entry concessions are shared between the regulators and the ministry.

Autonomy helps to ensure that regulators are free to satisfy their stated objectives transparently and neutrally. In accordance with European Directives, CMT, CNMV, and CSEN enjoy substantial autonomy in staffing and budget policies. Fixed-term appointments of senior commissioners are government nominations, communicated in advance to the Parliament. The tenure of the commissioners is longer than the maximum time frame for a legislature, theoretically increasing the political neutrality of the appointments over the medium term . These Commissions disclose their activities through biannual reports to the Parliament.

Autonomy must be accompanied by accountability for performance. The Spanish system of accountability is based on a submission to Parliament of an annual report. Appeals can be brought through the judicial system.

Transparency requires that regulators publish and explain their actions. By law, all Spanish agencies publish and explain their decisions. New rules take the form of ministerial orders, and follow the procedure described in Section 3.1, though they are exempted from scrutiny by a horizontal body like the *Con-*

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sejo de Estado, the *Comisión Delegada*, and the CGSYS. Additional transparency is provided through *ad hoc* consultative bodies. The government has also tried to ensure transparency by the process of granting market entry concessions for electricity and telecommunication services. That can be difficult to achieve, though, because the process of granting concessions is inherently discretionary. Increasingly, OECD countries are turning to open auction procedures to grant such permits, because they convey a clearer guarantee of transparency and protection against the risk of undue discretionary power, and reveal more clearly the price set by a free and open market.

4. DYNAMIC CHANGE: KEEPING REGULATIONS UP-TO-DATE

Most OECD countries have enormous stocks of regulation and administrative formalities that have accumulated over years or decades without adequate review and revision. The OECD *Report on Regulatory Reform* recommends governments review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively. In the past 20 years, Spain has extensively reformed its regulatory frameworks. However, such revision has not been systematic. Ministries have been responsible for updating and adapting their laws and regulations. Moreover, no centrally organised programme, with the exception of improving administrative procedures (see below), has taken place. Tools like sunsetting or mandatory periodic reviews are absent from the legal tradition. As a result, there is a risk in Spain that damaging regulatory rigidities will be durable, and that the costs will grow over time as regulations become increasingly ill-suited to changing conditions.

One example, however, of good practice in Spain is a review process aimed at reducing the response time for all existing administrative procedures. As noted in Section 2.1 these efforts culminated in 1999 in the establishment of an Inter-ministerial Commission on Simplification. Setting-up, operating and closing a business in Spain appears to be a more cumbersome process than in other countries (see Box 10). The main culprit is a complex system of authorisations, permits and licences existing at all levels of government. Indeed, government authorities have traditionally relied on *ex ante* controls, instead of relying

Box 10. Administrative compliance costs in Spain

Irrespective of an entrepreneur's decision to incorporate the firm, all new enterprises must carry out 13 to 14 general formalities to start a business, and some additional ones in particular sectors.[1] The legal registration of a business involves a minimum of five steps. On average, each step requires four pieces of documentation, and involves a minimum of six different agencies. The total time required to fulfil these legal requirements is estimated to be between 19 and 28 weeks, although for a non-incorporated firm, the period can now be reduced to one day. In contrast, it takes around half a day to establish a new enterprise in the United States.[2] On average, according to the business confederation (CEOE) an entrepreneur needs 500 000 PTAs (3 000 euros) and six months to start a business. Operating a business is also complex and burdensome. An OECD business survey in 1999 estimates that the administrative compliance costs related to fiscal, employment and environmental regulations for SMEs in 1998 was around 5 777 billion pesetas (around 6.9% of GDP). This amount represents 425 000 pesetas (2 554 euros) per employee.[3]

1. These steps are set out in detail on the website of the Ministry of Economics *http://www.ipyme.org/temas/empresas/crea.htm*.
2. OECD (1998), *Economic Surveys: Spain*, p. 130-133.
3. SMEs analysed were firms with 1 to 500 employees in the manufacturing and service sector (*i.e.* self-employees, large firms, and firms in agriculture, mining were excluded). The estimates are based on a labour unit cost of 1 878 pesetas/hour, and a GDP in business sector at factor cost in 1998 of 82 650 billions pesetas. The survey was conducted between April and June 1998, based on a common framework developed by the OECD in consultation with the OECD's Regulatory Management and Reform Group. It was implemented by the *Direccion General de Politica de la Pequeña y Mediana Empresa, del Ministerio de Economia y Hacienda* in co-operation with Gallup, Spain. PUMA/OECD (2000), *Multi-Country Business Survey on Benchmarking the International Regulatory and Administrative Business Environment: Report on the Results for Spain*, (forthcoming).

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on *ex post* surveillance, self-regulation or other performance-related regulations. One-third of the 2 080 existing procedures are authorisations and many share the same information requirements across numerous government agencies in three levels of government.[64] The overall burdens are disproportionately borne by the very large SME sector in Spain composed of around 2.5 million non-rural enterprises – 55% of which are self-employed businesses. This is even more important as in Spain SMEs represent a much higher proportion of the private sector than elsewhere in Europe.[65]

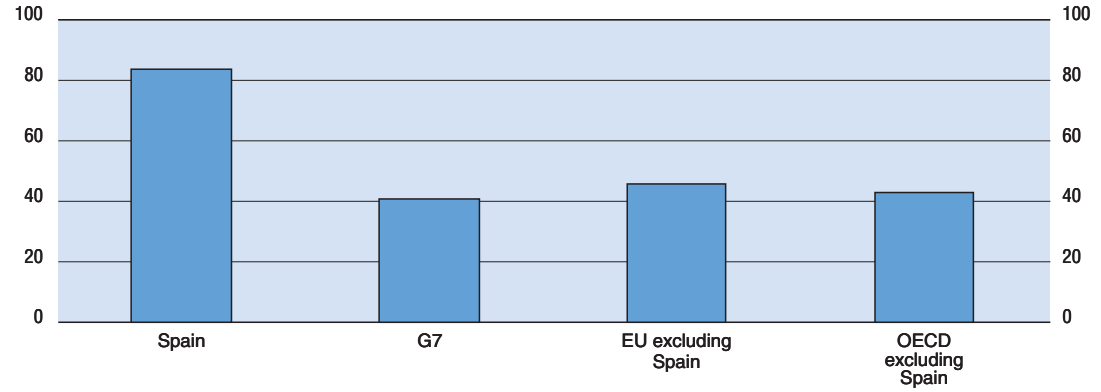
Contradictions and abuses in the application of these authorisations have also been identified. In land zoning permits, mayors hold important discretionary powers. In a few cases this has created incentives to ask for "contributions", either in money or in kind (for example through the "donation" of land or public installations to the town hall), in exchange for prompt delivery. Indeed, this system has worked as a substitute for unpopular local tax increases. This situation results in a lack of regulatory transparency and accountability, and establishes an environment favourable to corruption.

The Spanish administration has launched a series of initiatives to reduce or solve these problems. An important project, begun at the end of 1992, was a review of all procedures to incorporate the tacit authorisation rule contained in the Common Administrative Procedure Law.[66] The law also required that response periods be reduced to a maximum of three months, unless otherwise specified in a law or a subordinate regulation. Further, the law required the government to inventory all existing procedures, clarifying for each the situations when non-response means tacit authorisation (*presunta estimatoria*) or negation (*presunta desestimatoria*).

The State Secretary for Public Administration (one of the two secretaries of MAP) was charged with the review. Ministries and agencies, with the help of a questionnaire, reported their procedures to MAP. Three years later, the first inventory was published. In November 1997, it was updated and published on the Internet (*http://www.igsap.map.es*). The current registry lists 2 080 formalities, categorised according to

Box 11. Simplifying business licences and permits

This synthetic indicator of efforts to simplify and eliminate permits and licences ranks more highly those programmes where countries use the "silence is consent" rule to speed up decisions or to have set up one-stop shops for businesses, where there is a complete inventory of permits and licences; and where there is a specific programme, co-ordinated with lower levels of government, to review and reduce burdens of permits and licences. Spain ranks very high on these scores relative to other G7, EU and OECD countries. In particular this is due to general policy to establish the 'silence is consent rule' and the underway programme to review and reduce the number of licences and permits.



Source: Public Management Directorate, OECD, 1999.

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type of procedure, effect of non-response, official time for responding, objective of the procedure, legal basis, and administrative unit in charge.

This review was an important step in transparency and better management of administrative procedures. However, in terms of simplification and reduction of response times, the results appear disappointing. Less than 23% of the formalities incorporated the "tacit authorisation" rule, and most opted for the maximum permissible response time. The reasons for such results appear to be lack of political support at the highest levels and resistance from ministries.[67]

These considerations were instrumental in the 1999 modification of the law launching a second review. The process is entrusted to the Inter-ministerial Simplification Commission and deadlines have been set. In addition to the general "tacit authorisation" rule, the new programme has a mandate to rationalise and eliminate formalities. MAP has indicated its intention to continue to improve the capacities and accessibility of the Internet registry with enhanced search capabilities and with the publication of a user-friendly guide to finding formalities

A second effort to reduce administrative burdens is the establishment of one-stop-shops and start-up shops for entrepreneurs. The MAP project *Ventanillas Unicas* has two components. First, co-operation agreements are signed with local authorities to establish a series of performance-based service standards. Then the central government provides formats, access to databases and manuals. In parallel, the governments has supplemented the programme with a business start-up scheme, *Ventanillas Unicas Empresariales*, which adds to previous elements, an information service unit and some approval capacities to help start ups by persons and very small businesses. For this project, each start-up shops is staffed by special officers delegated by the Ministries of Economy and Finance, of Public Administration and of Employment and Social Affairs. Since June 1999, six of these shops have been set up in Valladolid, Palma de Mallorca, Santa Cruz Tenerife, Las Palmas de Gran Canaria, Getafe and Madrid. In the first three months more than 150 new firms have been created and about 700 requests of information have been attended through the shops. In April 1999, the programme was extended to chambers of industry and commerce, which can sign similar agreements to install *ventanillas unicas empresariales* in their areas.

The MAP is developing information technology systems to support the expanding web of one-stop shops. The PISTA project will permit the interconnection of registries and files of all the administrations. This system, based in Electronic Data Interchange (EDI) technology, should implement the legal right, established since 1992 but technically unfeasible until now, of permitting applicants to provide only once the requested information or documentation to any authority. The authorities would share their data banks. Pilot PISTA systems have been set up in the Valencia and Galicia regions and eight municipalities.

5. CONCLUSIONS AND RECOMMENDATIONS FOR ACTION

5.1. General assessment of current strengths and weaknesses

In 20 years, Spain has experienced an historic process of social, political, and economic change of a magnitude seen in few other OECD countries. This has brought Spain considerably closer to the mainstream of regulatory practices in the OECD, and in some areas it is moving ahead. Democratisation, devolution to regions, and convergence with the rest of Europe have transformed its governance system and its administrative and legal environment. The pace of change toward market-oriented policies and government institutions has accelerated in recent years through a series of bold economic reforms. These economic reforms will of necessity work their way through the regulatory system, driving regulatory reform into new areas and directions. Perhaps due to strong political leadership, these changes seem to be well accepted in Spain. Though there is considerable debate about the pace at which new reforms proceed, there are few calls to halt or reverse the process.

A second factor supporting further regulatory reform is the recognition by the government of the importance of the regulatory framework in the economic development of Spain. Because the European Monetary Union and the EU Stability Pact constrain demand-side policies, the government has indicated

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that it will support national competitiveness by concentrating on microeconomic reforms such as improving regulatory frameworks to boost competition and innovation.

Yet carrying out current policies, as well as launching new policies, requires more effective capacities for implementation. A disconnect exists between the relatively well-developed policies based on deregulation and competition, and the government's less-well-developed capacities to produce the high quality regulatory regimes that are needed. The direction of change, though, is positive. The 1997 reforms to the Government Law moved Spain in the right direction toward more transparent and less discretionary regulatory practices. Today, the Spanish administration has a clear mandate to use regulation more carefully and more in line with market-led growth. Regulatory transparency is much better today, and represents a real success that inspires confidence in other reform measures. The government has also recently strengthened administrative simplification policy, which should permit a reduction of the burdensome formalities that are strangling entrepreneurs throughout the economy. As other countries' experiences show, this could stimulate SME growth in the short to medium-term. New institutions to manage regulations and construct sectoral regulatory regimes are promising, though still evolving. Their performance is not yet demonstrated.

But these initiatives are not sufficient to change the regulatory practices of the administration as quickly or deeply as current policies require in order to be successful. Much change has been achieved in economic deregulation, but the quality of social regulations has not been systematically enhanced. Regulatory impact analysis is not yet a useful tool for good decision-making, and there is considerable resistance inside the administration. Reducing administrative burdens, too, poses unmet challenges. The meagre results of the previous simplification policy argue for bolder and more robust approaches. New and worrisome problems are emerging. Co-ordination of regulatory policies and reform between levels of government is improving, but inefficiencies from regulatory layering seem to be large and perhaps growing. Overall, legal security may be declining in Spain. Problems with regulatory compliance may be larger than suspected. Innovation and use of other policy instruments such as economic incentives are rare, and the focus on procedures rather than results will slow the introduction of new methods. These problems may significantly reduce the potential benefits of economic structural reforms.

Remedying six weaknesses would be particularly beneficial for Spain in the short and medium term:

- Spain's 1997 policy on regulatory improvement does not provide a clear policy framework for reform. A strong and articulated commitment is needed if a complex, government-wide, and multi-annual policy is to successfully achieve its ambition.
- Reform institutions find it difficult to carry out administration-wide reforms. Difficulties encountered in past reforms indicate that strong opposition to change will slow attempts to strengthen disciplines on regulatory quality. A more rationalised and centralised structure might be needed. The number and the duplication of competencies of inter-ministerial commissions, plans and diverse programmes erode the impact of the regulatory reform policy.
- The Spanish regulatory process leaves excessive discretion to regulators. Without explicit parameters, mandatory elements of quality control could become mere formalities, not useful to decision-making. The evaluation questionnaire in particular has not achieved its potential because it is not mandatory, it is implemented too late in the process, and it is not made public. Public consultation, too, would be more useful if there were clearer rules about who is consulted, when, and what material is shared. Ministerial orders, which often contain costly requirements, avoid the scrutiny and consultation controls altogether.
- Transparency has improved significantly across the government. Yet the Spanish system still falls short of best OECD practices. The consultation process is unsystematic. It is vulnerable to manipulation by ministries and capture by interest groups. The proliferation of regulations at multiple levels adds to the opacity of the legal and regulatory environment, makes it difficult for administrations to enforce the rules, and fosters a propensity for non-compliance by citizens and firms.
- Administrative simplification policy and competition policy should be more closely integrated with the policy to improve the quality of new regulations. It is more efficient to redress anti-com-

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petitive effects and paperwork burdens before regulations are adopted than trying to repair the damage once the regulations and administrative frameworks are in place.

– Government actions rely on an excessively legalistic approach as the standard for quality. A clear preference for legal details and technicalities is still pervasive in the preparation or application of regulations. This *modus operandi* is not yet balanced with an efficiency test. Lack of attention to cost-effectiveness and benefit-cost ratios is one reason for the undue reliance on control and command regulations instead of market-based or other approaches.

5.2. Policy options for consideration

This section identifies actions that, based on international consensus on good regulatory practices and on concrete experiences in OECD countries, are likely to be beneficial to improving regulation in Spain. They are based on the recommendations and policy framework in the 1997 OECD *Report to Ministers on Regulatory Reform*. In brief, Spain would benefit from several steps to improve the responsiveness, accountability, and transparency of the regulatory management and reform:

– ***Adopt at the political level a broad policy on regulatory reform that establishes clear objectives, accountability principles, and frameworks for implementation***

The 1997 reforms created an implicit policy that is closer to international best practice. Yet this policy will have limited success until it becomes explicit. An explicit policy adopted at the highest levels of government should be based on principles of good regulation such as those in the 1997 OECD *Report to Ministers on Regulatory Reform*. Such a policy could integrate the various reform efforts now underway, and establish a uniform set of quality standards. Significant gaps remain in defining the dimensions of regulatory quality, such as the principle that regulations shall be adopted only if costs are justified by benefits. Competition principles should be strengthened in the overall policy framework, perhaps through incorporation of the "competition test" advocated by the Tribunal for the Defence of Competition.[68] For the success of the policy, political accountability and targets should be clarified, with a clear relationship with competition policy, market openness, and public management reform.

– ***Establish an oversight unit with i) legal authority to make recommendations to the Council of Ministers, ii) adequate capacities to co-ordinate the programme through the administration, and iii) a secretariat with enough resources and analytical expertise to provide an independent opinion on regulatory matters.***

The achievement of ambitious structural reforms embodied in the accession to EMU demonstrate that Spain has the political will and technical machinery to change quickly. The successful mechanisms in place for monitoring progress and achieving results in terms of liberalisation of product and service markets and adoption of European Directives also provide valuable precedents. A similar determined approach is now needed if government objectives on regulatory reform are to be reached. As a central element, an institution to promote, steer and co-ordinate the reform programme is required. Its mandate, political accountability and operation should be more focused than current institutions. It should also bring economic and public management skills to complement work on legal quality performed by the *Consejo de Estado*.[69]

Such a central oversight unit should have clear responsibility for regulatory quality control across the administration, and should be integrated directly into the rulemaking process. To ensure that it has a broad policy view, it should be close to the Prime Minister or Council of Ministers, rather than in a sectoral or line ministry. For this central unit to deliver expert advice and to co-ordinate, two distinct elements should be strengthened. First, the unit would need a well-resourced secretariat with cross-governmental views. Its personnel should be drawn largely from non-regulatory ministries to enhance its "challenge" function; it should have sufficient financial resources to collect and assess information and buy the expertise of private think-tanks and scholars; and its role in the government's legislative and regulatory procedures should be formalised. Second, the unit would need to assist in designing thematic and sectoral programmes of reforms, co-ordinated across all relevant policy areas. With the regulatory ministries, the unit would develop performance targets, timelines, and evaluation requirements, and would advise the centre of government on the quality of regulatory and reform proposals from regulatory ministries. The

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central unit could also assist in reviewing new regulations under a "notice and comment" process (suggested below). One possible interim solution would be to create a secretariat on regulatory reform reporting directly to the Council of Ministers, or eventually to the *Comision Delegada*. In the longer-term, the government should consider creating a permanent advisory and analysis central unit on regulatory reform that is responsible to the Prime Minister.

– ***Revise the evaluation questionnaire on the basis of* OECD *best practices, make it mandatory for all proposed regulations, including ministerial orders, and make the responses publicly available as part of public consultation procedures. As part of this, implement across the administration a step-by-step programme for improving regulatory impact assessment, based on* OECD *best practice recommendations, for all new and revised regulations. The analysis should begin with feasible steps such as costing of direct impacts and qualitative assessment of benefits, and move progressively over a multi-year period to more rigorous and quantitative forms of analysis as skills are built in the administration. For rapid and successful implementation, a useful step would be creation of a training programme, managed by the regulatory oversight unit discussed above, to instil the necessary skills in the public administration.***

The current regulatory process, where drafts are negotiated and discussed, has advantages. The possibility of checking with all government agencies, through collegial membership of the CGSYS, can strengthen the quality of proposals, as can the legal check by the *Consejo de Estado*. The evaluation questionnaire is an important tool supporting more transparent analysis of the impacts of a proposal.

However, more effort is needed to operationalise good regulatory practices in the "culture" of the public administration. As noted, the current process lacks the explicit disciplines and uniform parameters needed to enable regulators to consistently judge if a regulation is necessary or if there are better alternatives. A key step to improve regulatory quality is to improve the analysis of social and economic impacts. Three-quarters of OECD countries now use RIA and the direction of change is universally toward refining, strengthening and extending the use of RIA disciplines. RIA can be a powerful tool, especially if integrated with notice and comment procedures, to boost regulatory quality by giving policy officials better information on the impacts of regulation on the economy. While benefit-cost analysis may be a long-term goal, interim steps feasible with current administrative skills, such as user panels and surveys, could be implemented quickly. OECD's best practice principles should be the basis for a RIA programme, overseen by an appropriate quality control body with analytical expertise at the centre of government. To make this RIA operational as soon as possible, a training programme and support capacities should be implemented.

– ***Improve transparency by further strengthening the public consultation process, by adopting uniform notice and comment procedures, and by launching a programme of codification to reduce legal uncertainty.***

Spanish regulators typically consult affected parties, and consultation is increasing. However, the consultation does not always produce higher quality outcomes. The most frequent form of consultation is the sectoral advisory group involving social partners and other organised interest groups. Yet such interests can unduly represent "insiders" who have incentives to limit competition. A lack of clear participation rules and of carefully scrutiny by the government (independent from the promoting ministry or agency) puts the approach further at risk of a rent-seeking approach to regulation. A useful improvement would be a further clarification of the consultation rules established in the Government Law. As in the case of the previous recommendation, this could be done through the development of clear guidelines and parameters. For example, the consulted parties should have direct access to the reformed evaluation questionnaire, and the promoters of the regulations should also be required to prepare written and public replies to the comments expressed by consulted parties.

Other steps to improve the efficiency and effectiveness of consultation processes may merit consideration. First, it might be useful to reduce the number of advisory groups. The Netherlands discovered that reducing the number of advisory bodies from almost 500 to 100 improved the quality and speed of consultation. Second, the government should experiment with new target-oriented methods like the Danish Business Panels and focus groups. These groups can help to identify the costs of a proposed regulation and assist in the development of more effective and efficient alternatives. Third, the legal requirement for notice and comment, already required for technical standards, should be extended to

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all proposals. Other countries' experiences show that this mechanism can complement other procedures as a safeguard against possible abuses. Adoption of a general requirement covering all substantive new laws and subordinate regulations (including ministerial order) would promote both the technical values of policy effectiveness and the democratic values of openness and accountability. The effectiveness of the notice and comment requirements would be further enhanced with the provision of better information, based on a robust evaluation questionnaire. Moreover, the adoption of notice and comment procedures would also permit a central unit, such as the recommended secretariat on regulatory management, to review new ministerial regulations against the principles of good regulation.

– ***Establish a centralised registry of all regulatory requirements with positive security.***

A single authoritative source for regulations would significantly enhance transparency for users in terms of the content and form of permissible regulatory actions, and force a rationalisation of ministry rules. "Positive security" means that regulations must be included in the registry to have legal effect, which ensures against any non-compliance by ministries. This central registry, based on citizens' needs and information technology platform, should be a complement and an added value instrument to the Official Gazette.

Spain is among the few OECD countries that have adopted an indicative registry for administrative procedures. Based on this experience, the government should pursue its effort into two directions. First, it should seek to give positive security to the registry. Additionally, the government could implement a certification process consistent with good quality standards to be renewed every five years, together with a logo delivered on completion, for all formats. Such a process could be inspired on the French CERFA (*Centre d'Enregistrement et de Révision des Formulaires Administratifs*) model. More ambitious, Spain could adapt the 1980s Swedish initiative, where after establishing a central registry of regulations and giving time to ministries to register individual regulations, the government, through delegated powers of the Parliament, nullified – through the well-known "guillotine" mechanism – all the hundreds of regulations that were not individually enlisted.

– ***Strengthen the administrative simplification policy by i) assuring that good regulation guiding principles and specific parameters are used in the revision of existing formalities, ii) by assigning to the Simplification Commission a dedicated secretariat with analytical expertise and resources, and iii) by concentrating on reducing authorisations, licences and permits.***

The establishment of the inter-ministerial Simplification Commission was an important step toward making the administration more slim and efficient. To achieve its potential in improving the quality of administrative procedures, it should at an early stage develop detailed methodological requirements for the presentation of each ministry's proposals. To improve the ministries' accountability in the process, the Commission should also put the onus on the ministries to justify objectively and publicly the need for each procedure. Second, experience shows that in such complex reviews asymmetric information favours the regulator *vis-à-vis* the reviewer. An important element for the success of a review is a capable secretariat reporting to the Commission. Third, to maintain political support, early and visible results are needed. The 9-10 months limit to eliminate unnecessary formalities is a useful target. To produce the most benefits in this period, the Commission should concentrate its resources on eliminating or improving permits and licenses, which are among the most damaging of government formalities with respect to business start-ups and among the most costly to administer. Last, the government should assist the Commission in clarifying and simplifying the institutional network for administrative simplification, particularly in ensuring communication and co-ordination among the various bodies at work. The strengthening of linkages between the Commission's work and the government's SME policy and initiatives stirred by the Ministry of Economic and Finance is an important step forward and should produce results in the short term. The work of the Commission should also be clearly linked to the regulatory reform and competition policies.

– ***Encourage regulatory reform by co-ordinating initiatives with the autonomous communities and municipalities, and by assisting them to develop management capacities for quality regulation.***

Progress in devolving regulatory powers to bring them closer to citizens and business has been impressive. The orderly way that this has been done could be considered a lesson for many countries.

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However, managing regulations at different levels creates potential concerns for the future coherence and efficiency of the national regulatory system. Safeguarding the gains made at the national level through regulatory reform will require intensive efforts to promote regulatory quality at sub-national levels. Adoption by autonomous communities and municipals of programmes of reform based on consistent principles should form the basis for more formal co-operation measures. Consideration should be given to establishing fora for such purposes as well as to resolve issues arising from regulatory conflicts. A complementary strategy should also be developed to help autonomous communities encourage municipalities to launch regulatory reform programmes. Continued leadership from the centre to encourage and learn from experimentation at the sub-national level will speed up efforts.

5.3. Managing regulatory reform

Spain's regulatory reform programme has concentrated on economic regulations. Market openness, deregulation, privatisation, and liberalisation reforms of product, capital, and labour markets have shown positive results. Administrative regulations have also been a focus of reform, though results are not yet apparent. Little consideration has been given to improving the quality of social regulations, although estimates from the United States indicate that, in that country, social regulations impose costs 3-4 times higher than do economic regulations and that administrative regulations have a disproportionate impact on SMEs.

This suggests that Spain should balance its regulatory reform programme to gain its full potential benefits. But the expansion of the programme means also a new approach. Social regulations will continue to be an important instrument to carry out government policies. Administrative regulations are necessary for modern governments needing extensive information to target policies. Deregulation and privatisation cannot be the guiding philosophy for reform in social and administrative areas. The approach should be based on a case by case analysis of trade-offs between different forms of government action and no action at all. The OECD recommendations are based on the belief that this will be possible only with a more permanent, transparent, and empirical decision-making process based on adoption of regulatory quality standards, regulatory impact analysis, public consultation, a wider assessment of alternatives to regulation, and constant review and updating of regulation.

An equally important determinant of the scope and pace of further reform is the attitude of the general public. Willingness to support reform may dwindle when important elements of what they considered founding blocks of their recently new Welfare State are scrutinised. Communication and consultation strategies are key. Evaluation of the impacts of reforms and communication with the public and all major stakeholders with respect to the short and long-term effects of action and non-action, and on the distribution of costs and benefits, will be increasingly important for further progress.

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NOTES

1. In October 1998, with only 2.7% not yet implemented of the 156 Single Market Directives, Spain was ranked the 6th country among the EU State Members, European Commission (1998), *Single Market Scoreboard*, No. 3, DG XV October, p. 4.
2. Consejo de Estado (1993), *De Cara a la Union Europea*, Memoria del Consejo de Estado, Madrid, p. 175.
3. Consejo de Estado (1992), *La Recepción del Derecho Communitario*, Memoria del Consejo de Estado, Madrid, p. 140 and Consejo de Estado (1993), *De Cara a la Union Europea*, Memoria del Consejo de Estado, Madrid, pp. 178-184.
4. An interesting exception is the budgetary comptroller, IGAE. With convergence to EMU strategy and implementation, its role and power have in the past few years increased.
5. This in part is linked to rigidities in the enrolment and management of the civil service. Alba, Carlos (1995), "L'administration publique espagnole: réforme ou modernisation", *Revue Française d'Administration Publique*, No. 75, July-September, p. 389. Sanchez, Antonio Ramiro (1997), "Más reformas en la Administración, Para qué?" *Gestión y Análisis de Políticas Públicas*, No. 9, May-August, p. 63.
6. Consejo de Estado (1992), *La Seguridad Jurídica*, Memoria del Consejo de Estado, Madrid, p. 103.
7. OECD (1998), *Economic Surveys: Spain*, p. 136.
8. Consejo de Estado (1992), *La Seguridad Jurídica*, Memoria del Consejo de Estado, Madrid, p. 101.
9. Consejo de Estado (1992), *La Seguridad Jurídica*, Memoria del Consejo de Estado, Madrid, p. 107.
10. José Luis Palma (1997), *La Seguridad Jurídica ante la Abundancia de Normas*, Centro de Estudios Politiccos y Constitutionales, Cuadernos y Debates, No. 68, Madrid.
11. Labour reforms have also been prominent in the Toledo pact and agreements. Financial reforms were mostly completed by mid1980s through the application of European Directives.
12. Reino de España (1992), *Programa de Convergencia*, Madrid, March.
13. Kingdom of Spain (1998), 1998-2002 *Stability Programme*, p. 3 and p. 43.
14. Sanchez (1997), p. 63; Alba (1995), p. 39.
15. MAP (1992), *Plan de Modernización de la Administración del Estado*, April, Madrid, p. 208.
16. Alba (1995), p. 397.
17. Sanchez (1997), p. 63.
18. The Legal Regime of the Public Administration and Common Administration Procedure Law (30/1992) *Ley de Régimen Jurídico de las Administraciones Públicas y del Procedimiento Administrativo Común*.
19. Ley de Organización y Funcionamiento de la Administración General del Estado or LOFAGE (6/1997).
20. Consejo de Estado (1992), *La Seguridad Jurídica*, Memoria del Consejo de Estado, Madrid, p. 112. Lastly, some additional legal reforms to the old administrative procedure law concentrated on improvement to the appeal procedures, the rules for using information technology instruments, the definition of new rights with regard to access to administrative archives and records, etc. See Plaza Marin, Carmen (1995), "Note on Spanish Public Law", *European Public Law*, Volume 1, No. 4, p. 57.
21. OECD (1997), *The* OECD *Report on Regulatory Reform: Synthesis*, Paris, p. 37.
22. OECD (1995), *Recommendation of the Council of the* OECD *on Improving the Quality of Government Regulation*, OCDE/GD(95)95, Paris.
23. The Legal Service of the State, *Servicio Jurídico del Estado*, provides also advice on improving the legal quality of draft laws and regulations from ministries that required its assistance (Ley de Asistencia Jurídica al Estado e Instituciones Públicas (52/1997)).
24. Other mandatory notifications to MAP concern civil service employment policies and the establishment of new administrative procedures.
25. In 1993, the Consejo de Estado recommended clarifying the consultation requirements. Consejo de Estado (1993), *La Audiencia de los Ciudadanos*, Memoria del Consejo de Estado, Madrid, p. 107-126.

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26. The Commission was established by Royal Decree of 23 April, 1999.
27. Government Law 50/1997, Article 24.3.
28. The General Directorate replaced the General Inspection Service of Public Administration (IGASP).
29. Tribunal de Defensa de la Competencia (1993), *Policies to Boost Free Competition in the Service Sector and Put an End to the Damage done by Monopolies*, p. 30-31.
30. Melilla and Ceuta, two city enclaves in Northern Africa, also enjoy a particular autonomous regime similar to the autonomous communities.
31. OECD/PUMA (1996), "Spain Country Report", *Managing Across Levels of Government*, p. 327-340. Malaret Garcia, Elisenda (1998), "Multidimensional Decentralizations in Spain; Variable Geometry Decentralization", *International Review of Administrative Sciences*, Vol. 64, p. 663-664.
32. A strong and old, but long suppressed, tradition of self-rule has existed in Spain dating from the unification of the Kingdom in the 15th century. A clear reminiscence is the continued existence of the "Derecho Foral" in some regions like Aragon, Baleares, Catalunia, Navarra, and Basque country, and to some extent Ayala, Baylio, Viecedo, and Galicia. These legal codes involve some aspects of civil law and local taxation. Sometimes limiting the geographic jurisdiction of these codes has been problematic, as is the case of Vizcaya. Consejo de Estado (1993), *El Derecho Foral*, Memoria del Consejo de Estado, Madrid, p. 157-174.
33. Central control is exercised over Autonomous Communities by the Constitutional Court for regulatory matters; by the Court of Audit with regard to financial and budgetary matters; and by the government in consultation with the Council of State. Most autonomous communities have, in turn, provided for the creation of their own Court of Audit exercising authority over their own territories. OECD/PUMA (1996), p. 329.
34. Fundación Entorno (1998), *Libro Blanco de la Gestion Medioambiental en la Industria Española*, Madrid, p. 173.
35. The cost-benefit test is in Article 63.1 of the Common Administrative Procedure Law (3/1989). The general framework and guidebook was in part based on the Germany's Landers experiences with *checklisten* and cost-benefit tests. For instance, the Catalan guidebook divides the costs into three components: those to prepare the regulation, to comply with the regulations, and to enforce it.
36. Spanish Government response to OECD Review Questionnaire on Regulatory Reform, March 1999, p. 4.
37. Consejo de Estado (1992), *La Seguridad Jurídica*, Memoria del Consejo de Estado, Madrid, p. 101. Javier Font, estimates that by late 1990s, "[the autonomous communities] legislative production … had reached more than 2 000 laws ... [which were however] hardly innovative". Font, Javier (1999), *Managing Value and Devolution; The Experience of Spanish Regional Governments*, presentation at the International Working Group on Public Sector Productivity, IIAS, Portoroz, March 4-5.
38. OECD (1998), *Economic Surveys: Spain*, Paris, p. 94.
39. OECD/PUMA (1999), *Public Sector Pay and Employment Database*, Paris.
40. It should be noted that in the case of the *Comisión de Política Fiscal y Financiera*, formed by the financial counsellors of all regional governments and chaired by the Ministers of Economy and Finance and Public Administrations to discuss and reach agreements on the financing of regional governments, meetings can be convoked by the national government but also by regional governments when a certain number of them ask for it.
41. OECD/PUMA (1996), p. 337.
42. Reforms of the Common Administrative Procedure Law (4/1999).
43. European Environmental Agency (1998).
44. The European Union, Directive 98/34/CE establishes the procedure for informing other Member States and the Commission about standards and technical regulations.
45. Deighton-Smith, Rex (1997), *Regulatory Impact Analysis: Best Practices in* OECD *Countries*, OECD, Paris, p. 221.
46. For instance, with the royal decree on professional co-operative groups (*Colectivos de Profesionales*) repealed in the early 1990s.
47. Fundación Entorno (1998), *Libro Blanco de la Gestion Medioambiental en la Industria Española*, Madrid.
48. Communication of the Consejo de Estado (1999).
49. This rule was first established in the General Tax Law of 1963.
50. Consejo de Estado (1993), *Cuestiones de Tecnica Normativa*, Memoria del Consejo de Estado, Madrid, p. 146.
51. OECD/PUMA (1999), *The State of Regulatory Compliance : Issues, Trends and Challenges.*
52. Ministry of Environment, communication.
53. Communication from the Spanish Government to the OECD, March 1999.
54. Ministerio de Medio Ambiente (1998), *El Sistema de Inspección Ambiental en España*, p. 18-20.
55. OECD/PUMA (1999), *The State of Regulatory Compliance : Issues, Trends and Challenges.*

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56. Reforms to the Common Administrative Procedure Law (6/1999).
57. OECD (1998), *Economic Surveys: Spain*, p. 146 and Kingdom of Spain (1998), *Progress Report on the Reform of Goods, Services and Capital Markets*, November, p. 19.
58. OECD (1998), *Economic Surveys: Spain*, Paris, p. 134.
59. Communication from the Ministry of Economy and Finance (1999).
60. Fundación Entorno (1998), *Libro Blanco de la Gestion Medioambiental en la Industria Española*, Madrid.
61. OECD (1997), *Regulatory Impact Analysis. Best Practices in OECD Countries*, Paris.
62. Articles 22.2 and 24.1.b of the Government Law (50/1997).
63. Tribunal de Defensa de la Competencia (1993), *Policies to Boost Free Competition in the Service Sector and Put and end to the Damage done by Monopolies*, p. 30-31.
64. MAP (1998), *Estudio sobre los Procedimientos Administrativos de la Administración General del Estado. Relación de Procedimientos*, p. 15-21.
65. OECD (1998), *Economic Surveys: Spain*, Paris, p. 144-146.
66. It should be noted that speeding and improving the administrative procedures has been a century old goal of the government. The Council of State cites different initiatives since 1889, when a law stated that all formalities should be finished in a period of one year. The 1958 Administrative Procedure Law reduced that period to six months and for the first time established a silence is a negation rule. This was an improvement in legal sense, because after such a period an applicant needed only to prove the passing by of the six months to start an appeal in the judiciary, instead of waiting for a confirmation from the authorities stating that the request had actually been negated.
67. Sanchez (1997), p. 57.
68. Tribunal de Defensa de la Competencia (1993), *Policies to Boost Free Competition in the Service Sector and Put an End to the Damage Done by Monopolies*, p. 26.
69. The Consejo de Estado, acknowledged this situation when a few years ago, it recommended to the government delegating to a dedicated body the study of the regulatory inflation. Consejo de Estado (1992), *La Seguridad Jurídica*, Memoria del Consejo de Estado, Madrid, p. 113.

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BACKGROUND REPORT ON THE ROLE OF COMPETITION POLICY IN REGULATORY REFORM*

* This report was principally prepared by **Michael Wise** in the Directorate for Financial and Fiscal Affairs of the OECD. It has benefited from extensive comments provided by colleagues throughout the OECD Secretariat, by the Government of Spain, and by Member countries as part of the peer review process. This report was peer reviewed in May 1999 in the OECD's Competition Law and Policy Committee.

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Is competition policy sufficiently integrated into the general policy framework for regulation? Competition policy is central to regulatory reform, because its principles and analysis provide a benchmark for assessing the quality of economic and social regulations, as well as motivate the application of the laws that protect competition. Moreover, as regulatory reform stimulates structural change, vigorous enforcement of competition policy is needed to prevent private market abuses from reversing the benefits of reform. A complement to competition enforcement is competition advocacy, the promotion of competitive, market principles in policy and regulatory processes. This report addresses two basic questions. First, is Spain's conception of competition policy, which will depend on its own history and culture, adequate to support pro-competitive reform? Second, do its institutions have the right tools to effectively promote competition policy? That is, are the competition laws and enforcement structures sufficient to prevent or correct collusion, monopoly, and unfair practices, now and after reform? And can its competition law and policy institutions encourage reform? The answers to these questions are assessed in terms of their implications for the strategies and sequencing of regulatory reform.

Competition policy in Spain revived in the 1980s as Spain moved to align its policies with the EU. Comprehensive competition policy action plans from the early 1990s targeted non-traded services where competition problems were most likely. The government has followed through to implement much of these plans, both by applying the competition law directly and by reforming and removing anti-competitive regulations. Many sectors have been privatised and liberalised, and indeed, in some respects Spain's efforts are more ambitious than its neighbours or EU requirements. In some sectors, though, the process has left market power in place, while in others the process is just beginning.

The competition policy bodies, the Tribunal and the *Servicio*, have been increasingly active, focusing their attention on sectors undergoing liberalisation. Notable illustrations are several recent orders, backed up by substantial fines, to ensure the development of competition in telecoms. But they may need more resources to do their jobs effectively, as their caseload has grown rapidly while their personnel levels have remained constant. Policy analysis and advocacy by the competition authorities, which can be the most effective kind of action against problems that are shielded by government sanction, appear to have declined, in part because of resource priorities.

There are few explicit sectoral or functional exemptions from competition policy, but the law includes a potentially broad exemption for officially authorised conduct. The Tribunal interprets that exemption narrowly, and programmes to reduce the remaining anti-competitive regulations and exemptions proceed. Some steps appear ambivalent, though. The recent legislation to liberalise the tobacco market retained a monopoly in distribution, for example. Remaining exemptions and constraints on competition should be removed, and the anti-competitive effects of special laws about retailing should be limited. Current moves to strengthen the competition institutions will add resources, refine and strengthen powers, and thus reinforce the priority and importance of competition policy. To ensure that competition policy remains a central theme of reform, it would be desirable to strengthen the functions of policy analysis and advocacy, as well as enforcement. To make competition policy more broadly effective, changes in the relationships among the institutions should be considered, to give the independent, decision-making Tribunal more control over the agenda, and to ensure that competition policy plays a central role in government decisions about restructuring prior to remaining privatisations.

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1. COMPETITION POLICY FOUNDATIONS

Much has changed in Spain's government and economy over the last 20 years, as the country has taken its place within the European Community. Competition policy, which had long been dormant, has become a higher priority. The basic laws and institutions of competition policy, which have been in place since Spain's first competition law of 1962, became much more important and visible in the 1990s as Spain moved to reform its traditional interventionist economic policy. Meanwhile, Spain is creating and empowering other institutions, such as the new sectoral regulators and the regional governments, the *comunidades autónomas*, whose actions may influence or affect competition policy, or, in the case of the *comunidades*, might sometimes affect the degree of market competition. The national government has proclaimed that competition policy is important and needs to be made stronger. What does that mean, and how will proposed reforms, including strengthening the competition law itself, accomplish that goal, in the Spanish context?

1.1. Spain's competition law and institutions, created in the 1960s, were not employed until the 1990s.

Whether Spain's competition policy has grown from domestic roots, or whether it has been a response to outside pressures, has been a matter of debate. The first official statement about the desirability of a competition policy, a 1953 agreement with the US, suggests that external influences were critical (Cases, 1998, pp. 180-81). And a generation later, competition policy was an element in the process of integration into the European Community. But there were also historic links between competition policy and internally-motivated reform movements, evidenced by debates in the 1950s about the relationship between industry concentration and prices, and calls for laws to prevent market domination and cartels. The government even decreed, but never collected, an "antitrust tax" on profits from cartels. The

Box 1. **Competition policy's roles in regulatory reform**

In addition to the threshold, general issue, whether regulatory policy is **consistent** with the conception and purpose of competition policy, there are four particular ways in which competition policy and regulatory problems interact:

- Regulation can **contradict** competition policy. Regulations may have encouraged, or even required, conduct or conditions that would otherwise be in violation of the competition law. For example, regulations may have permitted price co-ordination, prevented advertising or other avenues of competition, or required territorial market division. Other examples include laws banning sales below costs, which purport to promote competition but are often interpreted in anti-competitive ways, and the very broad category of regulations that restrict competition more than is necessary to achieve the regulatory goals. When such regulations are changed or removed, firms affected must change their habits and expectations.
- Regulation can **replace** competition policy. Especially where monopoly has appeared inevitable, regulation may try to control market power directly, by setting prices and controlling entry and access. Changes in technology and other institutions may lead to reconsideration of the basic premise in support of regulation, that competition policy and institutions would be inadequate to the task of preventing monopoly and the exercise of market power.
- Regulation can **reproduce** competition policy. Rules and regulators may have tried to prevent co-ordination or abuse in an industry, just as competition policy does. For example, regulations may set standards of fair competition or tendering rules to ensure competitive bidding. Different regulators may apply different standards, though, and changes in regulatory institutions may reveal that seemingly duplicate policies may have led to different practical outcomes.
- Regulation can **use** competition policy methods. Instruments to achieve regulatory objectives can be designed to take advantage of market incentives and competitive dynamics. Co-ordination may be necessary, to ensure that these instruments work as intended in the context of competition law requirements.

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1959 Stabilisation Plan, which followed a request to the IMF and the OEEC (the OECD's predecessor) for assistance, called for the government to promote measures to prevent monopolistic practices (Borrell, 1998; Government of Spain, 1999).

The first competition law was adopted in 1963 and became effective in 1964. The law and enforcement institutions were influenced by OECD advice and EC models. The law, like the one now in effect, included a prohibition against anti-competitive restraints and abuse of dominance, modelled on Artices 85 and 86 of the Treaty of Rome, applied through a process of notification and authorisation for restraints. It provided for exemption from the prohibition for restraints due to other laws. And it called for registration for mergers (Cases 1998, p. 181-82).

The enforcement structure established at that time is still in place, too. The *Tribunal de Defensa de la Competencia* (Tribunal) was created as the main decision-making body, empowered to adjudicate, authorise exemptions, impose fines, and publish reports and studies. The *Servicio de Defensa de la Competencia* (Servicio), which at that time was a General Directorate in the Ministry of Trade, provided investigative support and follow-up[1] (Cases, 1998, p. 185).

But the law "remained largely unimplemented and unenforced for more than 20 years." (Borrell 1998, p. 448) After the first years, the number of filings dropped off. The Tribunal decided only an average of 14 matters per year. Budgets and personnel declined, and little attention was paid to the quality of appointments to the Tribunal. The Tribunal did not impose economic sanctions under the law until 1988. Meanwhile, intervention, rather than competition, seemed to be delivering economic growth, so interest in strong competition policy was low. Indeed, the political impetus for promoting competition seems to have been expended in adopting the law (Borrell, 1998; Cases 1998, pp. 186-87).

The second phase of reform that followed the Moncloa agreements of 1977 made a gesture towards competition policy, when the new constitution in 1978 established competition policy as a state market-regulating function. The constitutional change called for modifying the competition policy institutions, in particular removing the Tribunal's quasi-judicial character. But changing the role did not, at first, lead to increased enforcement or activity. The Tribunal went without a chairman for six years, from 1976 to 1982 (Borrell, 1998).

In the 1980s, competition policy revived. The prospect of EC integration in the 1980's encouraged the third phase of reform, of opening up domestic markets and deregulating business activity. This brought with it a new competition act, and finally, in the 1990s, a period of active enforcement. The decision to modernise competition policy was made in 1985, when the government appointed a new head of the Tribunal, reorganised the Servicio and added to its resources, and made competition policy a budget line item. A committee drawn from the Servicio and the Tribunal recommended against special laws to conform Spain's law to the EC treaty, because the Treaty would be directly applicable with respect to competition policy anyway. But it did recommend revising the 1963 Act so it could deal more effectively with domestic competition problems that would not be reached by EC jurisdiction (Borrell, 1998; Cases, 1998, pp. 188-89).

The new Competition Act of 1989 retained the old institutions (except for the Council). Additions to the 1963 Act include provisions about public aids and authorising the Tribunal to engage in advocacy. Although the technical changes were modest, they were enough to reinvigorate competition policy. The Tribunal became much more active. Moreover, the Tribunal focused on policy concern about "dual inflation" in services in the early 1990s to take a prominent position in the debate over regulatory reform.

1.2. Competition is now considered an important policy standard.

Official pronouncements underline the importance of competition in national economic policy. The competition law states:

> *Competition, as the governing principle of the entire market economy, represents an inseparable element of the model of economic organisation of our society and constitutes, in the sphere of individual liberties, the first and most important manifestation of the exercise of freedom of enterprise.*

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(Competition Act, Preamble).[2] By associating competition policy with individual liberties, in the context of freedom of enterprise, this statement implies that competition's salient features would be absence of constraint on business decision-making or on entry into a market. The government has also emphasised that, because competition policy aims at improving the functioning of markets, so prices reflect production costs, it can be a tool against inflation.

The Tribunal's own view of competition policy's goals, announced in a critical 1989 review of Spain's experience, is expansive. The Tribunal recognised that competition policy not only controls the market and protects against restraints on business freedom to compete, but it also promotes dispersion of economic power, helps achieve monetary stability, brings down prices, protects consumers, promotes innovation, and improves services (Borrell, 1998, p. 461).

Public authorities have a mandate to defend competition derived from Artice 38 of the Constitution, which recognises the right of freedom of enterprise. The Constitutional Court interpreted this provision as authorising the government to adopt and apply laws to eliminate practices that can affect or seriously damage competition. That is, "competition law enforcement is a necessary protection, not a restriction, of the freedom of enterprise and of the market economy, which could be threatened by the absence of control of its natural tendencies" (Cases 1998, p. 188). The Constitutional Court evidently did not consider *laisser faire* to be an acceptable approach to vindicating the right of free enterprise.

But the constitutional and statutory mandates also call for balancing competition against other policy interests. For example, the defence of competition is to be in accordance with the needs of the economy, including planning (Constitution, Art. 38; Competition Act, Preamble). The objective of the Act is to guarantee the existence of sufficient competition and to protect it against any attack contrary to the public interest, while at the same time being compatible with those other laws that regulate the market in accordance with other legal or economic requirements of a public or private nature (Competition Act, Preamble, ¶2). This statement describes a problem, as much as an objective. Restating the problem, the Servicio says that the primary objectives pursued in the application of the general competition law have to do with economic efficiency and the public interest (Government of Spain, 1999, Item 1).

1.3. Spain's statist traditions, and efforts to reverse them, explain aspects of its reform process.

Spanish popular opinion appears to support competition policy, however its goals are conceived. One reason for support may be historical. Spain was one of the most closed and interventionist economies in Europe before 1960. Embracing competition and markets implies correcting the policy mistakes of that period. Moreover, keeping costs low through increased competition and deregulation could now represent Spain's comparative advantage within Europe.

Spain has been engaged in reform for a generation. Since 1977, both the government and the private sector have been moving to adapt Spain's economic and legal frameworks to the European ones. Reforming the institutions of economic control has been difficult and time-consuming, because of the long history of either state ownership or tight, centralised regulation. But the goal, and then the fact, of membership in the European Community has been an impetus for reform. Changes in Spain's regulatory approach, including its competition policy, coincide with efforts to conform to EU standards. The pace of change has accelerated over the last ten years. Indeed, within the European community Spain takes positions on economic policy issues pushing for further reform and liberalisation. The government has been committed to a wide programme of reform and privatisation for several years. Since the last election, the government has tried to intensify it, even to change the social consensus about the role of regulation. This means developing a new concept of the state's role, as well as ensuring that deregulation, privatisation, and competition policy are applied correctly and in the right sequence.

Privatisation, a centrepiece of this process, illustrates both progress toward the new concept and persistence of old patterns of retaining control. Since 1996, under the State Enterprise Modernisation Programme, interests in most of Spain's biggest state-owned companies have been sold, raising over 4.5 trillion Pesetas. More sales are planned, so that by the year 2000 the only activities left within the public enterprise sector will be mining and certain defence companies (other public entities would remain, in postal services, railroads, and broadcasting) (Government of Spain, 1998). The government no longer

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has significant holdings in these firms, although in some cases the government has retained a "golden share". But the process has either left, or produced, dominant firms in several sectors, such as electric power, telecoms, and tobacco.

The attitude of business and the public toward the state's role in regulation was long based on a strategy of rent-seeking. Breaking that habit is a major challenge and a subject of debate now in Spain. Critics claim that, even though the government has announced its commitment to markets and competition, the regulatory framework has aimed narrowly and permitted dominant firms to persist in some infrastructure sectors, leading to increased costs for Spanish firms. The government responds by pointing out how prices have been declining as those sectors are being liberalised. Despite the government's repeated statements about the importance of ensuring that the benefits of competition are passed on to consumers, (for example, Government of Spain, 1998) some observers contend that consumer impacts have not been prominent enough in the public policy debate. Other critics point to development of networks and webs of influence through designation of government-connected insiders to boards and managements of privatised companies. But since those appointments are now up to the private owners, rather than the government, they might well represent private choices, not government policy.

Another topic of current debate in Spain is increasing concentration of control over business. Consolidations of banks, which are the principal holders of equity in Spanish enterprises, could lead to large, and overlapping, investment holdings in competing industrial firms. On the other hand, some experts point out that combinations must be understood in the right context, and that firms may need more resources to compete in a larger European market or to expand in Latin America.

To develop a new concept of the state's role in regulation will require grappling with the changing roles of political institutions. Pro-competitive reform led by the central government must deal with a complicating aspect of political reform, namely the constitutional devolution of powers to regional governments who may not agree with the national government about decisions or priorities. The Constitutional Court has rejected national legislation reforming the land law and retail shop hours, because these matters are the responsibility of regional governments. Too much variation in regional legislation, as regional governments differ in their appreciation of market institutions, could lead to fragmentation of the internal market. There is concern that such initiatives could threaten or weaken the next wave of liberalisation, involving airports, ports, retailing, and urban land, and also, through indirect effects, gas and coal. The first wave of liberalisation, including electric power and telecoms, may have been facilitated because those projects generally did not involve these constitutional problems.

One concern is that local and regional governments might be taking actions that run counter to the national efforts to conform to EU liberalising directives. Municipalities and regional governments are said to be re-introducing monopoly operations or promoting combinations in sectors such as cable television and electric power. Other functions provided by local monopolies, which have been in place for some time, include bus services and funeral homes. Some of these operations could be considered part of the local government administration, while others are formally separate enterprises. To some extent, fears that local or regional actions could fragment the internal market are aimed at the economic effects of initiatives about social regulation, rather than at matters that are more directly the object of competition policy.

In Spain as in many other EU countries, a principal object of national competition policy is services and other sectors that are not affected by international trade. And in Spain as elsewhere, evidence commonly cited to show that there is a problem is comparatively high inflation rates for these sectors. From the early 1990s, the problem of higher inflation in non-tradable services has been well recognised (Tribunal, 1992). From 1991 to 1998, services prices rose by 47%, compared with a 25% increase in consumer prices of non-energy industrial goods (inflation is measured by the consumer price indexes published by the National Statistics Institute). In 1998, inflation in services, at 3.6%, was still two times higher than the general inflation rate. Such a gap does not reflect wage pressures in services, which are generally more labour intensive than other sectors, since compensation per employee in the service sector rose just 2% (less than in the industry and construction sectors). Contending that chief contributors to the services inflation were postal services, telecoms, rent, medical services, and drugs, labour groups have called for

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more activity by the competition authority. But over the last three years the top contributor to services inflation was hotel accommodations and tourism, a sector that appears substantially competitive. One reason for the disparate effects may be that Spain is still catching up to Europe's average income level, and as that process proceeds, services prices would be bid up faster. Moreover, in the past government intervention kept some of these prices low, notably for telecoms and postal services. Much of the "dual inflation" data may thus be explained by demand or income effects in the particular sectors.

To demonstrate the high priority it has assigned to competition policy, the government has announced that it is committed to increasing the available tools and resources. The government's 1996 reform package made some changes in the law, to give the competition authorities power to reject complaints about matters that are too small to threaten the public interest, and to clarify how the law would apply to restrictive agreements arising from actions of government or of public entities. The government has proposed or implemented additional changes, including greater resources for the competition institutions, more transparent assessment of state aids, compulsory notification for mergers, improved co-ordination with EU competition enforcement processes, and providing for consent settlement ("*termination conventional*") of sanctions proceedings (Government of Spain, 1998). Increasing resources will evidently mean adding two more members to the Tribunal and increasing the budget and staff of the two organisations (Romero, 1999).

2. SUBSTANTIVE ISSUES: CONTENT OF THE COMPETITION LAW

If regulatory reform is to yield its full benefits, the competition law must be effective in protecting the public interest in markets where regulatory reform enhances the scope for competition. Spain's substantive competition law has been based on EU norms since 1963. The legal criteria and available sanctions are generally comprehensive enough to cover competition problems that may have been required or encouraged by regulation, or that will appear as regulatory structures change. Uncertainty about the role and priority of competition policy in decisions about mergers had been a weakness, but recent actions to strengthen legal tools and apply them more aggressively suggest that has changed.

2.1. The prohibition concerning agreements prevents anti-competition co-ordination.

All agreements, decisions and concerted practices which have as their object or effect to restrict, impede or distort competition in all or a part of the national market are prohibited (Art. 1). As in the EU legislation, there are two kinds of exemptions from this prohibition: case-by-case authorisations, granted by the Tribunal, and exemptions by categories, granted by the government (Art. 4, Art. 5). The exemptions process is elaborated in an implementing decree. The EU block exemptions have been incorporated into Spanish national law where the relevant agreements affect only the national market.

One set of criteria for granting exemption is similar to those under the EU Treaty (Art. 3.1). In addition, there is another set of criteria, not derived from the EU treaty. Restraints that would otherwise be prohibited can be authorised, to the extent that is justified by the general economic situation and the public interest, if their objective is to promote exports (and they are consistent with Spain's external obligations), or to adapt supply to demand under conditions of declining demand or uneconomic excess capacity, or to improve social or economic conditions in depressed regions, or if they are otherwise too insignificant to affect competition (Art. 3.2).

Applying the law to industry-wide agreements sometimes encounters objections based on regulation, such as claims that horizontal price fixing was necessary to comply with product quality regulations. Such claims have been rejected. For example, the Tribunal found that a dairy industry association document setting out premiums or discounts based on quality amounted to a price recommendation. That some 49 dairy firms applied these "recommended" prices showed that the action was the result of an agreement and not simply a consequence of the Common Market Organisation and the European Regulation for milk. The Tribunal fined the association 15 million Pesetas, and fined the 49 individual dairy firms a total of more than 1 billion Pesetas (Government of Spain, 1999).

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Box 2. The competition policy toolkit

General competition laws usually address the problems of monopoly power in three formal settings: relationships and agreements among otherwise independent firms, actions by a single firm, and structural combinations of independent firms. The first category, **agreements**, is often subdivided for analytic purposes into two groups: "horizontal" agreements among firms that do the same things, and "vertical" agreements among firms at different stages of production or distribution. The second category is termed "**monopolisation**" in some laws, and "**abuse of dominant position**" in others; the legal systems that use different labels have developed somewhat different approaches to the problem of single-firm economic power. The third category, often called "**mergers**" or "**concentrations**", usually includes other kinds of structural combination, such as share or asset acquisitions, joint ventures, cross-shareholdings and interlocking directorates.

Agreements may permit the group of firms acting together to achieve some of the attributes of monopoly, of raising prices, limiting output, and preventing entry or innovation. The most troublesome **horizontal** agreements are those that prevent rivalry about the fundamental dynamics of market competition, price and output. Most contemporary competition laws treat naked agreements to fix prices, limit output, rig bids, or divide markets very harshly. To enforce such agreements, competitors may also agree on tactics to prevent new competition or to discipline firms that do not go along; thus, the laws also try to prevent and punish boycotts. Horizontal co-operation on other issues, such as product standards, research, and quality, may also affect competition, but whether the effect is positive or negative can depend on market conditions. Thus, most laws deal with these other kinds of agreement by assessing a larger range of possible benefits and harms, or by trying to design more detailed rules to identify and exempt beneficial conduct.

Vertical agreements try to control aspects of distribution. The reasons for concern are the same – that the agreements might lead to increased prices, lower quantity (or poorer quality), or prevention of entry and innovation. Because the competitive effects of vertical agreements can be more complex than those of horizontal agreements, the legal treatment of different kinds of vertical agreements varies even more than for horizontal agreements. One basic type of agreement is resale price maintenance: vertical agreements can control minimum, or maximum, prices. In some settings, the result can be to curb market abuses by distributors. In others, though, it can be to duplicate or enforce a horizontal cartel. Agreements granting exclusive dealing rights or territories can encourage greater effort to sell the supplier's product, or they can protect distributors from competition or prevent entry by other suppliers. Depending on the circumstances, agreements about product combinations, such as requiring distributors to carry full lines or tying different products together, can either facilitate or discourage introduction of new products. Franchising often involves a complex of vertical agreements with potential competitive significance: a franchise agreement may contain provisions about competition within geographic territories, about exclusive dealing for supplies, and about rights to intellectual property such as trademarks.

Abuse of dominance or **monopolisation** are categories that are concerned principally with the conduct and circumstances of individual firms. A true monopoly, which faces no competition or threat of competition, will charge higher prices and produce less or lower quality output; it may also be less likely to introduce more efficient methods or innovative products. Laws against monopolisation are typically aimed at exclusionary tactics by which firms might try to obtain or protect monopoly positions. Laws against abuse of dominance address the same issues, and may also try to address the actual exercise of market power. For example under some abuse of dominance systems, charging unreasonably high prices can be a violation of the law.

Merger control tries to prevent the creation, through acquisitions or other structural combinations, of undertakings that will have the incentive and ability to exercise market power. In some cases, the test of legality is derived from the laws about dominance or restraints; in others, there is a separate test phrased in terms of likely effect on competition generally. The analytic process applied typically calls for characterising the products that compete, the firms that might offer competition, and the relative shares and strategic importance of those firms with respect to the product markets. An important factor is the likelihood of new entry and the existence of effective barriers to new entry. Most systems apply some form of market share test, either to guide further investigation or as a presumption about legality. Mergers in unusually concentrated markets, or that create firms with unusually high market shares, are thought more likely to affect competition. And most systems specify procedures for pre-notification to enforcement authorities in advance of larger, more important transactions, and special processes for expedited investigation, so problems can be identified and resolved before the restructuring is actually undertaken.

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As in other systems based on the EU principles, most of the detail about exemptions from the prohibition of restrictive agreements deals with vertical relationships, such as exclusive distribution, exclusive purchasing, selective distribution, and franchising. But most of the individual exemptions that have been granted (25 in 1996 and 27 in 1997) involve registers of late-paying clients, and only a few cover vertical restraints such as exclusive and selective distribution agreements (four in 1996 and three in 1997) (Government of Spain, 1999; OECD/CLP, 1997*a*; OECD/CLP, 1998*a*).

The competition law has been applied to prevent vertical distribution arrangements from being used to extend a monopoly authorised by law. The issue, which has arisen elsewhere in Europe, was vertical price fixing and exclusive distribution of non-prescription items, such as cosmetics, through pharmacies. The same system of exclusive distribution of cosmetics through pharmacies has been used elsewhere for many years and has drawn the attention of both France's *Conseil de la Concurrence* and the Commission of the EU (Government of Spain, 1999).

Box 3. The EU competition law toolkit

The Spanish law follows closely the basic elements of competition law that have developed under the Treaty of Rome:

- **Agreements**: Artice 85 prohibits agreements that have the effect or intent of preventing, restricting, or distorting competition. The term "agreement" is understood broadly, so that the prohibition extends to concerted actions and other arrangements that fall short of formal contracts enforceable at civil law. Some prohibited agreements are identified explicitly: direct or indirect fixing of prices or trading conditions, limitation or control of production, markets, investment, or technical development; sharing of markets or suppliers, discrimination that places trading parties at a competitive disadvantage, and tying or imposing non-germane conditions under contracts. And decisions have further clarified the scope of Artice 85's coverage. Joint purchasing has been permitted (in some market conditions) because of resulting efficiencies, but joint selling usually has been forbidden because it amounts to a cartel. All forms of agreements to divide markets and control prices, including profit pooling and mark-up agreements and private "fair trade practice" rules, are rejected. Exchange of price information is permitted only after time has passed, and only if the exchange does not permit identification of particular enterprises. Exclusionary devices like aggregate rebate cartels are disallowed, even if they make some allowance for dealings with third parties.
- **Exemptions**: An agreement that would otherwise be prohibited may nonetheless be permitted, if it improves production or distribution or promotes technical or economic progress and allows consumers a fair share of the benefit, imposes only such restrictions as are indispensable to attaining the beneficial objectives, and does not permit the elimination of competition for a substantial part of the products in question. Exemptions may be granted in response to particular case-by-case applications. In addition, there are generally applicable "block" exemptions, which specify conditions or criteria for permitted agreements, including clauses that either may or may not appear in agreements (the "white lists" and "black lists"). Any agreement that meets those conditions is exempt, without need for particular application. Some of the most important exemptions apply to types of vertical relationships, including exclusive distribution, exclusive purchasing, and franchising.
- **Abuse of dominance**: Artice 86 prohibits the abuse of a dominant position, and lists some acts that would be considered abuse of dominance: imposing unfair purchase or selling prices or trading conditions (either directly or indirectly), limiting production, markets, or technological development in ways that harm consumers, discrimination that places trading parties at a competitive disadvantage, and imposing non-germane contract conditions. In the presence of dominance, many types of conduct that disadvantage other parties in the market might be considered abuse. Dominance is often presumed at market shares over 50%, and may be found at lower levels depending on other factors. The prohibition can extend to abuse by several firms acting together, even if no single firm had such a high market share itself.

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2.2. The law against abuse of dominance has been applied to government-backed firms and to deregulated network industries.

The substantive law of abuse of dominance is again based on the EU norms (Art. 6). As is common elsewhere, the prohibition of abuse applies even if the dominant position has been established pursuant to legal authority (Art. 6.3).

A common market-dominance setting in Spain has been funeral services, which were typically municipally sponsored monopolies before legislation in 1996 liberalised this sector. The fact of local government authorisation complicated enforcement action. In an early case under the revived 1989 competition law, an association of insurance companies filed a complaint in 1991 against the monopoly provider in Madrid, EMSFM, for increasing the price of services, eliminating less expensive services, imposing a 300% surtax on burial of non-residents, and extending its monopoly over transporting remains to other cities. It took until 1995 for the Servicio to decide not to pursue the case, because EMSFM, as a monopoly established under law, was protected by the Competition Act's exemption for conduct authorised by law or regulation. The Tribunal reversed the Servicio decision. The exercise of market power was undeniable. The new, higher prices had been approved by the Madrid municipal government, though, so the central question was whether EMSFM, which was partially owned by the municipal government, was obliged to accept the "public prices" that government had approved. The Tribunal decided that this "official" action and the partial public ownership made no difference to EMSFM's liability, and imposed a fine of 138 million Pesetas (1.5% of EMSFM's 1996 turnover) (Government of Spain, 1999). Since the liberalisation, the Servicio has opened a number of cases in this sector.

The telecoms sector has produced several important decisions about abuse of dominance (OECD/CLP, 1997*a*; OECD/CLP, 1998*a*). An illustration is an early case about competing public telephones and denial of access by Telefónica de España, S.A. (Telefónica), the historic legal monopoly, to companies providing enhanced services. One of these, 3C Communications España, planned to introduce credit card public telephones. In applying for authorisation from the regulator, 3C described these units as modems. But when Telefónica learned that they were actually used as public telephones, it rejected or delayed the new lines, particularly in airports. Whether or not these units provided an "enhanced", and thus liberalised, service, or a final service which would still be subject to Telefónica's monopoly, the Tribunal ruled that refusing service to 3C was abusive. The reason, though, was grounded in regulation: Telefónica could not unilaterally cut off, reject or delay telephone lines without approval from the regulatory authority, which it did not have. Exacerbating the threat to competition was the fact that Telefónica was delaying a pioneering competitive entry to give it more time to introduce its own credit card phones, for which it was demanding five-year exclusivity clauses that would have further inhibited competitive responses. The Tribunal's remedies included orders protecting 3C's access and a fine of 124 million Pesetas. On several other occasions, the Tribunal has had to take enforcement action, including interim orders and sanctions for violating them, against Telefónica's efforts to resist or delay deregulation.

2.3. In merger review, the Tribunal's competition policy role is advisory.

The competition law (Art. 14) and an implementing regulation set out rules and procedures governing mergers, including the content of notifications. The law applies to mergers affecting the Spanish market if they result in a firm with a 25% or greater market share (either of the national market, or a substantial part of it), or the parties' combined annual turnover in Spain exceeds 40 billion Pesetas. (That threshold was increased by decree from 20 billion Pesetas in April 1999.) Authority to take action about mergers rests in the government, not the Tribunal. The government's powers over mergers that meet the statutory standards are very wide. Sanctions or remedies include an order of divestiture or controls on prices or other conduct.

Notification of mergers and acquisitions is now required within a month after the parties' agreement is reached, or in any case before the transaction is consummated. Failure to notify is now subject to fine. (Previously, notification was voluntary, but notifying gave the merging parties legal certainty over the timing of the government's action.) The April 1999 Decree, which has since been made into law, made noti-

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fication mandatory. Notifications are made to the Servicio, which determines whether the transaction raises issues that call for study and report by the Tribunal.

It is up to the Servicio, and thus the ministry, whether to refer a notified merger to the Tribunal. There is no institutional check on the ministry's determination of whether there is an effect on competition that would call for referral to the Tribunal. If the ministry does not refer it, then the Tribunal will have no role. If the Tribunal does receive the file, it must issue an opinion. The Tribunal may request information from other parts of the government and from private parties. It may hold a hearing. And it must advise the parties to the merger of the information or allegations received from others. The Tribunal's opinion can include recommended conditions to impose or means to re-establish effective competition. In all, though, the Tribunal's role is advisory; the decision is made by the Council of Ministers.

In evaluating a merger, the Tribunal in its advisory report and the government in its decision may take into account the usual competition issues, of market definition and structure, substitution possibilities, economic and market power, development of supply and demand, and external competition. In addition, both may also consider general interest principles. Factors to be considered include, among others, the improvement of systems of production or commercialisation, the development of technical or economic progress, the international competitiveness of the national industry, and the interest of consumers and users (Art. 16). The Servicio has developed a methodology for market definition and assessing market concentration and other criteria. The Servicio and the Tribunal are most concerned about competition policy impacts, leaving questions about effects on economic development to the government (Government of Spain 1999).

In the past, only a handful of merger matters were considered by the Tribunal. For example, in 1996, there were 23 notifications to the Servicio. (In addition, the Servicio undertook 27 merger inquiries that year, of which three resulted in formal notifications). Of those, only two were referred to the Tribunal, which produced four reports (OECD, 1997*a*; OECD/CLP, 1997*a*; OECD/CLP, 1998*a*). In 1999, the Servicio had the highest number of notifications ever – 51 – and 15 of those, or nearly 30%, were referred to the Tribunal. Before notification became mandatory, the Servicio often considered mergers that came to its attention through the financial press, private parties or otherwise. The Merger Unit in the Servicio also examines transactions notified to the European Commission, and if they are likely to affect the Spanish market, the Servicio may request referral.

Because mergers have been treated leniently – until 1999, the government had never blocked a merger – a few companies (two in four years) have been tempted to present agreements to co-operate as though they were mergers. The law was amended in 1996 to address this loophole. The revision gave the Servicio a month to determine whether the notified transaction is a concentration or whether the filing should be treated as an application for authorisation of a restrictive agreement (Art. 15; OECD/CLP, 1997*a*).

An example of the application of merger law to firms in recently deregulated industries was the Retevision-Redes TB-Servicom transaction. Retevision, which had entered as a new telecoms operator after the partial liberalisation of 1996, acquired Redes TB and Servicom, two Internet services and access suppliers, in 1998. The incumbent monopolist, Telefónica, also had subsidiaries in the Internet services market. The merger was authorised, so that Retevision could compete more efficiently with the dominant firm in downstream telecoms markets (Government of Spain, 1999). On the other hand, Endesa's acquisition of controlling shares of other electric power firms, Fecsa and Sevillana, late in 1996, was not notified to the Servicio, and the Tribunal was not consulted about the combination. While the acquiring company, Endesa, already owned large stakes in the two acquisitions, Sevillana and Fecsa, an opportunity was missed at the time of privatisation in 1996 to reduce concentration in the sector.

Mergers and acquisitions in the financial sector have been the subject of debate recently. One dimension of potential concern would be competition within the financial sector itself. If mergers reduced competition, that could increase interest rates; on the other hand, interest rates in Spain are now relatively low, and mergers might combine resources and promote diversification and effective participation in larger markets. Another potentially more important issue, though, is concern about concentration of investment and thus of corporate control. The major investors in Spain now are banks, although institutional investors are increasingly important. Thus, the use of bank equity holdings in the exercise of management influence, leading to interlocked control over industrial sectors, could be a matter of com-

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petition concern. The recently proposed merger of Banco Santander and Banco Central Hispano was referred to the Tribunal, and future bank mergers will be referred. Responding to this transaction's effects in telecoms, the Council of Ministers required that the merged bank sell its equity holdings in one of the two telecoms firms in which they have significant participation.

Privatisation decisions are made by the Council of Ministers, based on ministry proposals and the approval of the *Comisión Delegada del Gobierno para Asuntos Económicos*. The *Consejo Consultivo de las Privatizaciones* was set up to ensure transparency in the process. The Servicio and the Tribunal do not have a formal role in that process, although some merger cases have come out of it.

Sectoral regulators have some role in mergers in telecoms, electric power, and insurance. The regulatory agencies in telecoms and electric power markets must issue a report to the government on mergers in their respective markets if the mergers are subjected to Tribunal review and report under the Competition Act. The General Directorate for Insurance must notify the Servicio of mergers that meet the Competition Act thresholds, at which point the Competition Act process applies and the insurance directorate's consideration is suspended pending the outcome.

2.4. Provisions about state aids may be strengthened.

Government aids are addressed in the Competition Act[3] (Art. 19). The Minister of Economics and Finance can require that the Tribunal provide an opinion about the competitive effects of a particular programme of state aid. The minister may then propose termination or modification of the programme, to maintain or re-establish competition. That decision need not take into account the assessment of competitive effects or even the balance of costs and benefits. The Tribunal's powers to act are thus minimal. The provision was described in the original parliamentary debate as "very timid" and even "ineffective" (Cases 1998, p. 195).

State aids from local or regional governments are an increasing concern. The European Commission has taken action against industry aids provided by Spain's regional governments. The ministry has proposed strengthening this part of Spain's law, so that the Tribunal will be empowered to initiate cases about state aids. Although the Tribunal would not have power to regulate them, its analysis and resulting transparency may help ensure that decisions about them take account of their competitive effects.

2.5. The laws about unfair competition complement, and sometimes conflict with, the Competition Act.

Rules about unfair competition are set out in a separate law, and the two bodies of law are kept distinct. The Competition Act and the Unfair Competition Act[4] are said to aim at different objectives. The Competition Act is enforced by the Tribunal, and the Unfair Competition Act, by the ordinary courts. There is some conceptual overlap, though. The Competition Act refers to distortion of free competition by unfair acts, by making the Tribunal "competent to adjudicate, in the terms established by the present law regarding prohibited conduct, those acts of unfair competition which affect the public interest by falsifying, in an appreciable manner, free competition in all or part of the national market" (Art. 7). The Competition Act could thus be applied to a practice that is unfair pursuant to the Unfair Competition Act, if it met those conditions (Government of Spain, 1999).

The Unfair Competition Act includes "exploitation of economic dependence" as an unfair practice, if suppliers or clients have no alternatives to dealing with the provider. This could be relevant to competition-based claims of "buyer power." Another overlap is presented by the 1996 retailing law, which was promoted by traditional retailers and tries to control competition from non-traditional sellers such as hyper-markets by regulating payment terms, sales at a loss, and business hours. But the conception of "sale at a loss" is different under the Retail Trade law than it is even under the Unfair Competition Act. The competition authorities believe that the general competition law is a more satisfactory way to deal with the (rare) problems of dominance in the retail distribution sector (OECD/CLP, 1998*b*).

An interesting application at the interface of these two laws involved resale price maintenance. Resale price maintenance is permitted for textbooks. They can be discounted, but only up to 12%. The Tribunal refused to entertain a complaint that someone who was discounting too low was engaged in

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unfair competition. The Tribunal found that, although this practice may have violated another law, it was not anti-competitive, so it was not the Tribunal's responsibility to correct or remedy it.

2.6. Consumer protection bodies co-operate with the competition authorities and initiate many complaints.

The Spanish Constitution instructs public authorities to protect the consumers' economic interest (Constitution, Art. 51). Competition and consumer protection policies are linked twice in the Competition Act. Exemptions from the prohibition against anti-competitive agreements depend on a showing that consumers or users will benefit from them (Art. 3). And a report of the Council of Consumer Associations is necessary in considering applications to authorise otherwise prohibited restraints (Art. 38.4). Many competition matters are initiated by complaints forwarded by the National Institute of Consumption, the secretariat for the Council of Consumer Associations. The Institute maintains a continuing working relationship with the competition agencies.

3. INSTITUTIONAL ISSUES: ENFORCEMENT STRUCTURES AND PRACTICES

Reform of economic regulation can be less beneficial or even harmful if the competition authority does not act vigorously to prevent abuses in developing markets. Spain's two competition policy institutions have the necessary tools, but they could use more resources.

3.1. Competition policy institutions include both a ministry department and an independent decision-maker.

The two institutions of Spanish competition policy are the *Tribunal de Defensa de la Competencia* (Tribunal) and the *Servicio de Defensa de la Competencia* (Servicio). The Servicio is responsible for investigation and preparation of reports to the Tribunal; the Tribunal is responsible for resolving matters, taking into account the report of the Servicio and the outcome of its own investigation, if any (Government of Spain, 1999).

The Tribunal was created originally by the 1963 competition law as an agency within the Ministry of Commerce, but with a quasi-judicial status. (Its precise jurisprudential nature has been a matter of debate. It is an administrative body that is not technically part of the judiciary, but it functions much like a court). It has sole power to reach decisions under the competition law. (The 1963 law provided that those decisions were not reviewable by another court.) It was conceived as independent, and independence is assured by protected tenure. Originally, appointments were for indefinite terms, which meant in effect that they were permanent (Cases, 1998, p. 182).

Now, Tribunal Members are recommended by the Ministry of Economic and Finance and appointed, by the government, for fixed terms of six years, renewable for three years. Thus it is possible, even likely, that members will not have been appointed by the government in power at any time. Members cannot be suspended or dismissed, though they may be removed for cause, such as conflict of interest (Art. 23). A member can be ousted for non-performance, but only by a vote of three-fourths of the Tribunal members (given the size of the Tribunal, this means a nearly unanimous vote of the other members). Members have the status of senior civil servants (Art. 27; Cases, 1998, p. 190). A basic qualification requirement is at least 15 years of professional practice (including academic work) in economics or law. There are now eight members, serving terms staggered at 3 year periods (with four appointments in each appointment year), plus the president. On the present (March 1999) Tribunal, two members including the chair are economics professors, four others are economists, and two are former judges or prosecutors.

The Servicio, which was until 1996 a separate General Directorate in the Ministry of Economy and Finance, is now part of the General Directorate for Economic Policy and Protection of Competition. The Servicio takes the enforcement initiative and forwards cases to the Tribunal for decision if it finds evidence. The Servicio's two principal departments are for Restrictive Practices and for Mergers and Studies (OECD/CLP, 1997*a*). (Before the 1996 reorganisation, when it was still a separate General Directorate, there were three: Investigation, Monitoring and Registration, dealing with restraints and prohibited practices; Control of Competition Structures, for mergers; and Research and International Competition, han-

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dling studies of sectors, collaboration with European Commission, and co-operation with international institutions) (Cases, 1998, p. 192). The studies unit follows current issues and backs up enforcement operations; subjects of recent studies and research include banks and credit cards.

3.2. Enforcement processes, spread between two institutions, are now subject to deadlines to prevent delays.

The Servicio initiates action either on its own or in response to a complaint, which can be submitted by any person. When the Servicio opens a file, the interested parties are notified, and notification may also be published in the Official Journal and a national or regional newspaper. If the Servicio decides that the evidence demonstrates a violation of the law, it will present a statement of objections to the presumed violators, giving them an opportunity to reply and present a defence. If the Servicio declines to take action, the complainant can appeal that decision to the Tribunal. If the Servicio decides to proceed, it will send the file to the Tribunal, with a report and a preliminary legal assessment. The Tribunal may convene a hearing, and parties may have an opportunity to bring additional matter to the Tribunal's attention. Tribunal decisions, which are considered administrative, not judicial, can be appealed to the Chamber of Administrative Litigation of the National Supreme Court (Government of Spain 1999; OECD, 1997*a*).

The Tribunal may issue orders to cease and desist and to eliminate the effects of violations, and it may impose fines. Fines can be up to 150 million Pesetas, plus up to 10% of the firms' annual turnover in cases of serious and repeated violations, and the firms' directors and senior management can also be fined up to 5 million Pesetas each. Fines may be re-imposed periodically if a violation continues (Government of Spain 1999; Cases, 1998, p. 193). The Tribunal can impose interim relief, for up to six months, pending its final resolution. An example is the Tribunal's 1997 interim order that Telefónica and related companies stop a joint marketing campaign, including using a single access number, that was arguably preventing competition in Internet services. When it appeared that the parties had not complied with the order, the Tribunal imposed a fine of 148 million Pesetas (OECD/CLP, 1997*a*).

Responding to concerns about how much time competition matters were taking, deadlines have now been established (Art. 56). As of 1 January 1998, the basic deadline for Servicio investigation is 18 months, and for a Tribunal decision, 12 months. Each step in the process is also subject to (short) time deadlines, too. The Tribunal's final decision must be issued within 20 days after proceedings have been closed (Government of Spain, 1999). The proposed new provision for "consent" resolutions may also respond to a desire to make proceedings more expeditious. This resolution would be more formal than a comfort letter. It evidently would involve agreement among the Director of the Servicio, the complainant, and the respondent, and it would provide for a notice and comment process to ensure that the resolution does not harm third parties.

Servicio officials may inspect and obtain documents, including originals, and may have access to premises, pursuant to court order. Individual, firms, and government agencies are obliged to co-operate with Servicio investigations. The Servicio has powers to impose fines in order to enforce compliance with its investigations ranging from 50 000 to 1 000 000 Pesetas (Arts. 32-34).

Private lawsuits are possible in theory, but have been little used. The Act's prohibition and nullification *ab initio* of anti-competitive practices gives the courts jurisdiction to award damages under the Civil Code. But any judicial action would take a long time to obtain relief (Government of Spain, 1999). The court system is backlogged, with old procedures and few resources. Despite many reports about the problem, there has not been much movement toward solving it. In a competition matter a few years ago, after a big fine was issued, the victim went bankrupt, and the creditors went to court and eventually recovered; however, it took eight years. Nonetheless, some private suits are expected following on recent telecoms cases. (Actions that infringe Artices 85.1 and 86 of the EC Treaty may also be the basis for damages actions in national courts.) Criminal proceedings are also possible, in principle, under general provisions of the administrative law; if brought, they would suspend resolution of administrative proceedings based on the same facts (Cases, 1998, pp. 192-93).

Spain's competition policy institutions are authorised, by decree, to apply EU law in Spain. The relevant responsibilities are distributed among the different bodies. The General Directorate of Economic Policy and Protection of Competition deals with co-operation on competition matters with the EU Commission. The Servicio has the power to open files related to Artices 85.1 and 86 of the EC Treaty and to

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deal with issues related to the EU merger regulation. The Tribunal applies Artices 85.1 and 86 of EC Treaty in Spain, and can also render decisions on merger issues related to the Council regulation. Finally, the government exercises the power to decide whether or not to clear mergers which have been submitted by the Commission under Artice 9 of the Council regulation (Government of Spain, 1999).

Mergers with substantial effects on trade in other member states of the EU usually comply with the thresholds established in the EU regulation and then are handled by the European Commission. After the last amendment of EU Merger Regulation, other thresholds have been established for concentrations without a community dimension but with a significant impact in at least three member states, to avoid conflicting remedies imposed by several national authorities. Where there is national jurisdiction in Spain, its regulations require examining its effects in the Spanish market, even if the relevant geographic market is broader than Spain alone.

Market openness, as it affects barriers to entry or potential competition, plays a substantive role when assessing competitive effects. Co-operation among the national authorities is essential in this process, and Spain intends to improve co-operation and exchange of views, to the extent that confidentiality is not violated. Spain has not, however, entered any co-operative agreements with other countries. There are no special procedures concerning foreign firms or transactions for obtaining information or for notification, in enforcement generally or in the merger notification programme. Spanish procedure does not vary according to the nationality of the parties. There are no differences related to the nationality of parties. Competition authorities in Spain have no role in the regulation of international trade through measures such as anti-dumping laws, because those are EU-level responsibilities (Government of Spain, 1999).

3.3. Competition policy resources have remained constant while the workload has doubled.

Resources assigned to competition policy have been basically unchanged for several years. Although the Tribunal now has about 15% more human resources than it did six years ago, its budget has not increased commensurately. Its total staff of 34 (including the nine members of the Tribunal themselves) has fewer than a half dozen professional support staff. Individual members have no direct staff support. The Servicio, meanwhile, evidently shrank by more than 10% between 1993 and 1998. Taking the two bodies together, the total commitment of person-years to competition issues was about the same in 1998 as it was in 1993.

Yet the workload has increased markedly, especially in the last year or so. From 1990 to 1995, the Servicio received an average of about 90 complaints per year; in 1996, though, it received 120, and in 1997

Table 1. **Trends in competition policy resources**

Servicio	Person-years	Budget (million Ptas)
1998	64	340.1
1997	64	333.0
1996	75	330.5
1995	75	303.1
1994	71	285.5
1993	73	290.7
Tribunal		
1998	34	227.1
1997	34	224.3
1996	32	214.7
1995	28	202.6
1994	30	212.2
1993	29	210.1

Source: Government of Spain 1999. For the Servicio's budget expenditure, the figures are estimates, as the Servicio is included in the budget of the General Directorate for Economic Policy and Protection of Competition.

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Table 2. **Trends in competition policy actions**

	Horizontal agreements	Vertical agreements	Abuse of dominance	Mergers	Unfair competition
1999: Matters opened	76		58	51	36
Sanctions or orders sought	22		9	–	3
Orders or sanctions imposed	13		9	–	1
Total sanctions imposed (Ptas)		3 366 585 000		–	–
1998: Matters opened	58		39	31	51
Sanctions or orders sought	18		10	–	2
Orders or sanctions imposed	5		2	–	1
Total sanctions imposed (Ptas)		356 520 000		–	–
1997: Matters opened	48		57	19	45
Sanctions or orders sought	17		10	–	2
Orders or sanctions imposed	5		3	–	–
Total sanctions imposed (Ptas)	1 492 087 080		247 710 000	–	–
1996: Matters opened	56		62	23	29
Sanctions or orders sought	14		7	–	–
Orders or sanctions imposed	9		3	–	–
Total sanctions imposed (Ptas)	188 000 000	134 975 000	–	–	–
1995: Matters opened	23		33	20	30
Sanctions or orders sought	6		4	–	–
Orders or sanctions imposed	6		1	–	1
Total sanctions imposed (Ptas)	100 300 000	–	124 000 000	–	–
1994: Matters opened	19		21	13	20
Sanctions or orders sought	7		4	–	1
Orders or sanctions imposed	5		3	–	–
Total sanctions imposed (Ptas)	36 690 000	–	–	–	–
1993: Matters opened	34		46	15	21
Sanctions or orders sought	7		10	–	–
Orders or sanctions imposed	8		3	–	–
Total sanctions imposed (Ptas)	99 140 000	–	195 400 000	–	–

Source: Government of Spain 1999.

over 200, mostly concerning the service sector (OECD/CLP, 1997*a*). And the sanctions imposed in 1997 soared, amounting to five times more than the record set just the year before.

At the Servicio, because of the reforms to merger control, the staff of the Studies Unit (a total of 10 people) focuses efforts now on national and EU merger cases. Compulsory notification will reduce the effort it now spends on finding non-notified transactions, but it will also increase the number of items to be reviewed. Studying post-merger situations and monitoring compliance with conditions is an important task, but resource constraints make it difficult to do.

The Servicio's top priority now is competition problems in network markets and newly liberalised sectors. A number of recent cases have targeted restraints in industries that have recently been liberalised, such as professional services and petroleum products, or that have some degree of exemption from the competition law, such as tobacco and pharmaceuticals.

Table 3. **Recent actions in selected sectors**

Cases since 1995	Professional services	Petroleum products	Tobacco products	Pharmaceuticals
Files opened	37	33	7	13
Pending, Servicio	9	11	2	8
Pending, Tribunal	9	1	–	2
Orders, Tribunal	7	7	1	2

Source: Government of Spain 1999.

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4. LIMITS OF COMPETITION POLICY: EXEMPTIONS AND SPECIAL REGULATORY REGIMES

Whether competition policy can be a credible, useful framework for broad-based regulatory reform is partly determined by the breadth of its effective coverage. The extent and justifications for general exemptions or special treatment for types of enterprises or actions measures the relative importance and impact of the general competition laws. At the national level, Spain is reducing the number of nationally-owned firms and cutting back on special competition rules or exemptions for sectors. The remaining general provision that can authorise exemption is potentially broad, but the competition bodies have worked to keep its application narrow. At the sub-national level, regulations are sometimes invoked to avoid competition policy, and here too the Tribunal has construed those exemptions strictly.

4.1. Other regulatory programmes take precedence over competition policy, in the event of conflict

The principal means of exempting conduct or firms from the reach of competition law is through the general provision concerning regulatory compulsion or authorisation, that is, the rules or conditions under which the exercise of authority by another government body displaces or overrules competition law. The effects of this exemption are detailed below, in discussions of the anti-competitive features of regulations in particular sectors. Most of those sectors are not covered by laws or provisions that confer explicit exemption from the competition law. Instead, their laws and regulations permit or require non-competitive conditions and behaviour in a way that meets the competition law's general exemption criteria.

Conduct that is authorised by other law or regulation is excluded from the coverage of the Competition Act (Art. 2). That is, the Act's prohibitions do not apply to agreements, decisions, recommendations and practices that result from the application of a law or of the regulations that are issued in application of a law. Where anti-competitive conduct enjoys this protection from liability, the Tribunal may submit proposals to the government, through the Ministry of Economy and Finance, to modify or correct the laws or regulations that lead to this result.

This exemption was tightened up some in 1996, to make it clearer that the law nonetheless applies to the actions of public bodies themselves, when they are not properly protected by legal authorisation. A new paragraph was added to Art. 2 of the Competition Act, intended to clarify that competition law is also applicable to restrictive agreements which are the result of actions carried out by the public administration or public enterprises, if their actions were not authorised by law. In other respects, competition policy applies completely to public owned or managed enterprises (Government of Spain, 1999).

The exemption for conduct authorised by regulation, though seemingly broad in its literal terms, is construed strictly. Laws in existence before 1989 that continue in effect and authorise or require conduct which is otherwise in violation of the Competition Act still confer an exemption. All the Tribunal can do about them is propose modifications. As for later acts, though, there must be a clear showing that the legislature intended to create an exclusion. The government may not allow anti-competitive conduct by means of decisions or regulations that are not based on a law under which the legislature clearly intended to create an exemption. And the link between the practice and the norm is strictly interpreted. The law need not set out an explicit statement of exclusion, but it must be clear that the legislature intended to permit conduct that could not be modified to conform to the competition law.

The Tribunal has taken the position that only national government laws can support this immunity for private conduct. And it has held that even national laws have to be explicit. Examples of explicit laws are those that authorise margin or price fixing for books and pharmaceuticals. Parties making more imaginative claims have lost. Cosmetics makers unsuccessfully argued that the Drugs Law authorised them to limit distribution of their own products to drug stores, for example.

The problem of monopoly authorised by local regulation is exemplified in a case about funeral services. The Tribunal decided it had no power over an abuse of dominance by the monopoly provider in the city of Vigo, which was a mixed enterprise partly owned by the city and regulated by it. The Tribunal held that the enterprise could be liable for violating the Competition Act, despite its publicly-owned status, if it operated beyond its regulated authority. But the law could not be

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applied to the particular conduct at issue, because that had been duly authorised. The Tribunal highlighted the problem, that the regulator was dominated by the regulated company. Using this case as an example, it recommended that the government review the law that authorised local governments to establish mortuary monopolies (OECD, 1997*a*). That advice was followed a few years later, when funeral services were liberalised in 1996. The episode illustrate the theme of "success through failure", that is, motivating the elimination of an exemption by trying, and failing, to apply the law to the problem.

The extent of monopoly sponsored by local or regional government, or of business protected by local or regional government regulation, is not clear. Spanish law includes principles to control how much regional governments can obstruct national economic markets (Constitution, Arts. 139.2, 157). But there are also strong interests in permitting regional autonomy. Decisional gridlock and concern about fairness may make it difficult to eliminate local constraints by means of something like the Australian solution, of compensating local governments to go along.

To accommodate the positions of smaller businesses, both particular and general authorisations for agreements with *de minimis* impact are possible. The Tribunal may authorise certain agreements to promote exports or rationalise production, if consistent with the public interest and justified by the economic situation (Arts. 3.2(d), 4). Although it does not appear in the statutory text, evidently this provision is conceived principally for small and medium sized businesses. In addition, the government may authorise agreements, decisions, recommendations, and concerted practices that have as their purpose or effect to rationalise or improve the competitiveness of companies, especially small and medium-sized companies (Art. 5.1(c)). The only part of this authority that has been developed so far is the clauses about distribution agreements and intellectual property rights. That is, no block exemptions have been issued under the very broad "catch-all" paragraph.

In June 1996, a provision was added to the Competition Act giving the competition authorities the flexibility to apply a *de minimis* rule (Art. 1.3). The authorities can reject complaints that, due to

Box 4. Examples of local and regional government actions

Local or regional government action is often invoked as a defence, and the defence is often rejected. For instance, in 1996 an association of forestry firms in Aragón complained that a publicly owned enterprise abused a dominant position (and violated of the law on public procurement). The enterprise argued that its activities were protected, under a regulation approved by the regional government. But what was at issue was not a general regulation, but a particular action amounting to an agreement with the government giving it all the forestry work in the region. The Tribunal found that this agreement did not amount to regulated conduct protected by the statutory exemption.

The Consumers Association of Catalonia complained that bakers agreed to produce only a single type of bread to be sold Sundays and holidays. By law, bakeries could not open on those days, and the pastry shops that were allowed to open had agreed to sell only the so-called "enriched bread". The administration in Catalonia welcomed the bakers' agreement, believing it a satisfactory compromise among the interested parties. The Tribunal, however, found that the agreement violated the law. In rejecting the defence, that the administration supported the agreement, the Tribunal relied on constitutional principle. Because the Spanish constitution supports free market competition, administrative interventions in the market can only be justified by other public interests such as safety, health, or consumer protection. Here the administration had supported a restriction on market competition that was contrary to the interests of the consumers.

And in the cider cartel case, the companies argued that their agreement on a single price to pay for apples was supported by the Asturías Administration in order to promote the sector. The Tribunal resolution pointed out that the law confers protection only for conduct under administrative interventions authorised by a specific law. No national or regional regulation could authorise intervention over the price of apples.

In both the bakers case and the cider case, the Tribunal considered the administration involvement as an extenuation, leading to a lower fine than might otherwise have been imposed (Government of Spain, 1999).

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their small scale, do not affect the public interest. The rules do not fix any specific thresholds for what may actually amount to an agreement of "minor importance", nor is there any indication as to what the Servicio would consider *de minimis*. And the provision does not depend on the small size of the firms, but rather on the small size of the likely competitive effect. The provision gives the enforcement bodies some valuable flexibility in managing their workload, to concentrate on more important cases. It does not amount to an exemption from the prohibition as a matter of law, but as a practical matter it probably means that restrictive agreements among smaller enterprises may not be sanctioned as often, in part because the alternative of a private lawsuit will be impractical.

4.2. Sector-specific exclusions, rules and exemptions

The sectors explicitly excluded by law or regulation, in whole or in part, from the general competition law are the postal service, pharmaceuticals, and tobacco products (Government of Spain, 1999). Spain has been engaged in an active programme of liberalisation, but there are some sectors where remaining regulation authorises anti-competitive practices and conditions, and thus conduct that is exempted pursuant to the Act's general provision concerning regulatory authorisation. And in sectors that are being reformed to introduce more competition, sectoral regulators may have powers that affect competition (OECD/CLP, 1998*c*).

4.2.1. *Tobacco products*

Retail distribution of tobacco products is a monopoly, a status that was confirmed by a 1998 law.[5] The justification for this monopoly is given simply as the public interest. A new regulatory agency was created, which both regulates and, ostensibly, promotes competition, by separating regulatory functions from operating interests (Government of Spain, 1999). The retail monopoly is run by a concession system. Profit margins at retail are set by law. (This is tied to a monopoly in retailing postage stamps, too, which is being phased out). Regular retail licenses are issued by the Ministry of Economy and Finance, and licenses for resales at bars and restaurants are issued by the new regulatory agency.

The new legislation represents a small step toward liberalisation, in that the monopoly had previously included manufacture, import, and wholesale distribution too (Government of Spain, 1998). The government retains a small share of the firm that had the monopoly over these functions, Tabacalera, although there is no longer a government representative on its board or the boards of its subsidiaries. Although the new law formally removed the monopoly status, the requirements for a license are very demanding, and no competitor has entered as of early 1999. To get a license, a firm must demonstrate financial and entrepreneurial capacity, have property for storage in customs areas, have a contract with a shipper or other access to transport, not be vertically integrated downstream, commit to supplying a full line of products on request to any retailer in all regions of the country, and submit to other requirements about matters such as payment terms. The Tribunal objected, unsuccessfully, to the exclusionary effect of these license requirements.

4.2.2. *Pharmacies*

Regulation in this sector is applied by the Ministry of Public Health, (Government of Spain 1999) which sets the selling prices for pharmaceuticals. Profit margins at retail and wholesale levels are fixed, but wholesale mark-ups have recently been reduced. Pharmacies must be owned by persons with professional degrees in pharmacy. Authorisations for opening a pharmacy must be granted by the governments of the *comunidades autónomas*, subject to geographical and demographic parameters limiting the number of pharmacies based on population and setting minimum distances between shops. A decree in 1996 liberalised pharmacy opening hours and eliminated some constraints on opening new shops (OECD/CLP, 1997*a*). Business hours are thus free, but they must be communicated to the regional governments.[6] The 1997 law took control over opening new pharmacies away from the collegium of pharmacists and gave it to regional administrations. But in some regions, the result is more restrictive rules than before over such issues as transfers of pharmacy operations. The government points to other reforms in this sector such as reducing the mark-ups of pharmacies and wholesale distributors, rationalising the list

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of drugs financed by the Social Security System, introducing generic medicines, and establishing reference prices (Government of Spain, 1998). Note that some of these moves could have ambiguous competitive effects; for example, a reference price system setting a maximum price may also create a focal point and thus reduce, rather than encourage, competition (Puig, 1999).

4.2.3. *Postal service*

In Spanish postal sector, competition has long been open for courier and parcel services, urban mailing, and inter-urban and international mailing over 2 kg. The remaining postal services monopoly is moving toward liberalisation under recent legislation (Government of Spain, 1998). The changes respond to EU requirements (Government of Spain, 1999). Competition is allowed, in theory, for inter-urban and international mailing, but private operators providing these services for ordinary letters up to 350 grams must charge prices five times greater than the basic price charged by the public, universal service operator. The universal service operator is attached to Ministry of Telecommunications, which is responsible for regulation under the new law. Universal postal service is defined as urban and international ordinary mailing (letters less than 2 kg. and parcels less than 10 kg.), postal monetary orders and consignments of advertising and books. The universal service system is to be financed out of the budget and revenues from new entrants, whose contribution is limited to about 20% of the public system's needs. That limitation responds to a recommendation of the Tribunal. The stamp retailing monopoly is being phased out over four years; now, it is an adjunct of the tobacco retailing monopoly.

4.2.4. *Publications*

In book selling, resale price maintenance is authorised and discounts are regulated (OECD/CLP, 1997*b*). Retail prices in cash transactions can be discounted up to 5% off the price set by the publisher. The discount can be as high as 10% on National Book Day and at book fairs, festivals and trade events; for sales to libraries, archives, museums, educational and scientific and research institutions, the discount can be up to 15%. In 1997, the limit was raised to 12% for textbooks (OECD/CLP, 1998*a*). The Tribunal has recommended phased elimination of this exemption, to permit wholesale and retail level prices to be set by the market (Tribunal, 1997). The Tribunal has predicted that the effect of permitting greater discounts, particularly for textbooks, would be an annual consumer saving of 50 billion Pesetas (in a total market of about Ptas 400 billion). This estimate was based on demand elasticity of about five, and predicted discounts over 20% on texts and best-sellers.

4.2.5. *Professional services*

The Tribunal's first report about competition issues, in response to the government's requests under the Convergence Plan in 1992, was about professional services (Tribunal, 1992). The professional groups identified in this report as entitled to organise into *Colegios Profesionales* included the doctors, dentists, pharmacists, lawyers, engineers, architects, surveyors, and host of other types of business, administrative and scientific agents and specialists, such as economists.[7]

The general exemption for regulated conduct meant that constraints in these fields were beyond the reach of the Competition Act, because they were imposed pursuant to regulation, not merely by agreement within professional associations. The basic law, which includes the requirement to belong to a professional association in order to practice, is the Professional Associations Act of 1974. For some professions, such as lawyers, that constraint is included in the profession's own regulatory act, too. Other restrictions appear in laws about particular professions. Revisions to the Professional Associations Act in 1978 eliminated some of its pre-constitutional political aspects, but left the economic provisions unchanged.

The Tribunal's 1992 report described the commonly encountered constraints on competition. Some associations imposed geographic constraints, even in addition to belonging to the regionally based association. The extent of constraints on free operation is illustrated by those that applied to dentists: they had to join one of a small number of regional professional associations, practice within that region and

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within 50 kilometres of their province, open only one clinic, receive permission in writing to open a clinic in the same building as another dentist, wait a year before occupying an office vacated by another dentist who continued to practice in the area, and charge the association's prescribed minimum fees. They might not advertise, compare themselves with other professionals, contract directly with insurance companies, or enter arrangements that deny customers a choice of dentists. Lawyers could not practice in a group larger than 20, and could not establish more than one office per region. Several professions, including engineers, architects, and some medical associations, required clients to make payments through the professional association, in order to ensure that fee levels were being maintained.

The Tribunal recommended in 1992 that controls on prices should be eliminated. In addition, it recommended eliminating special rules about advertising, since professional advertising would still be subject to the generally applicable rules against deception in the Unfair Competition Act. And it recommended that territorial restrictions and restraints on business structures of professional practices should be abolished, as archaic and even harmful to Spanish professionals competing in the European Community (Tribunal, 1992, pp. 49-50). The Tribunal did not object to the basic legal requirement of association membership, though, because it did not appear to be used to exclude competition, as essentially everyone who met the qualifications was admitted to association membership (Tribunal, 1992, pp. 21-23).

The major reform to date was a 1996 decree (afterwards enacted as a Law 7/97) making clear that the competition law applies to professionals. It provided for free setting of fees, by preventing associations from prescribing minimum fees, and it permitted professionals to practice anywhere in Spain based on joining a single professional association (OECD/CLP, 1997*a*). A 1999 decree has extended the Competition Act's coverage to notaries, registrars, and commercial brokers. The associations' powers to compel payment through the association have also been eliminated.

But these steps have not yet succeeded in opening up the markets. Agreements on mandatory minimum fees are no longer permitted, but associations still announce recommended fees and rules against fee advertising. An association's effort to make members comply with agreements about recommended prices and advertising could violate the competition law. Many enforcement actions have been brought against "recommended" fees that were enforced in ways that showed their true, anti-competitive objective and intention. And the Servicio has forwarded cases against codes of conduct that restricted advertising. Enforcement can discourage this kind of behaviour by the associations, but little can be done to promote competition further if members simply go along with their associations' recommendations.

In resisting competition, the professions enlist the aid of regulators, concerning such threats as entry by foreign practitioners. Regional professional collegia are supposed to make agreements of mutual recognition with each other, but this does not always happen. In addition, and more importantly, professions such as architects and engineers are engaged in disputes about defining the limits of the professions and thus of regulatory competence. In the legal profession, *procuradores* and *advocats* have battled over their distinct roles. As proposed mergers between accounting and legal firms are under consideration, the bar associations are considering changing, or tightening, their ethical rules to control them.

Notaries in particular are a common subject of complaint. (Notaries were excluded from the Tribunal's 1992 report about professional services, on the grounds that notaries, like registrars and brokers, are civil servants, so that reform of those functions would stand on a different basis from the report's proposals for others). Rates for notary services were fixed as a percentage of transfer prices (as are the rates of property registers and stock transfer agents). The problem of controlling entry to limit competition appears to have been greatest for notaries. The notaries' special, monopoly powers and rights date from the 16th century, and changing their status raises sensitive political issues. The government lowered fees for real estate transactions in 1996 to encourage flexibility in refinancing. Measures the government has said might be considered include streamlining of the tasks now handled by different kinds of notaries, modifying fee schedules, and adapting notarial functions to changing market demand. In April, 1999, the government reduced the fees that notaries and certain other transactional professionals can charge, and permitted discounting from some of them as well.

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There are a few reports that the limited liberalisation has reduced professional services costs; however, there are no quantitative studies. The Servicio has not received complaints about price levels in professions, but it has not done a study of the issue.

4.2.6. *Air transport*

So far, the clearest liberalisation in transport has been in airlines. The process began in 1994, and two private-sector companies now compete with the state-run group Iberia. There has been a significant reduction in prices, accompanied by a wider range of fares, more frequent flights and improved service quality. Plans to privatise Iberia further continue to develop. Handling operations at airports have been liberalised. In 1996, the public company Aena ceded its monopoly at the major airports. Airlines there now have a choice of two providers, one of them private and not controlled by Iberia (OECD, 1997*b*). Prices for these support services have fallen to almost half of their former levels (Government of Spain, 1998). As of April, 1999, Spanish airlines can hire European pilots.

Much of the relevant competition policy oversight here comes from the EU, including block exemptions about code-sharing and fare consultations. Consumers obviously benefited from airline deregulation, as prices dropped up to 50%. But there have been accusations that airlines are colluding to share markets or keep prices up. Indeed, a recent Spanish competition case in this sector was about price fixing. The airlines claimed, unsuccessfully, that the practice was covered by the EU block exemption.

4.2.7. *Rail transport*

The state company RENFE effectively operates as a monopoly. But because of low prices, yet low demand, RENFE now barely covers half of its running costs, it has been forced to delay investments in infrastructure upgrade, and its losses demand budgetary transfers, which have run as high as 0.5% of annual GDP (Government of Spain, 1998). Plans are underway to separate track construction and management from rail transport services. The first step was the 1997 creation of a new public entity, *Gestor de Infraestructuras Ferroviarias* (GIF), and adoption of some measures to open the market to new operators (OECD/CLP, 1998*a*). But although infrastructure has been separated out, and commuter and long-run operations have been managerially separated, there are as yet no new operators.

4.2.8. *Road transport*

The framework law for these sectors acknowledges the importance of competition and market forces, as the basic framework for their development (Tribunal, 1992*b*). Still, some restrictions or non-competitive conditions persist in the actual application of regulation. The largest inter-city bus company, Enatcar, is still 100% publicly owned, although the government plans to privatise it. There are many private firms in the sector. Domestic routes have not yet been liberalised, but there is a deadline for doing so in a few years. Rules have been introduced to eliminate quotas and administrative authorisations, (Government of Spain 1998) which reportedly have been used to encourage or permit market division. Although the duration of concessions has been reduced some, Tribunal recommendations to open up entry, even on an experimental basis, have not been adopted.

The road freight sector remains fragmented. Licensing standards have been relaxed, (OECD 1997*b*) with quantitative restrictions replaced with qualitative ones (OECD/CLP, 1998*a*). A programme of progressive fare liberalisation has been adopted. The EU has effectively opened up this sector by requiring nations to permit cabotage, which was set to be fully liberalised by July 1998 (OECD, 1997*b*).

4.2.9. *Ocean transport and ports*

Ocean shipping conferences meeting the requirements set out in the Ports Law were exempted from the Competition Act's prohibition of restrictive agreements. A requirement under the Ports Act is that there be effective competition to the conference (OECD, 1997*a*).

In port services, there has been some limited liberalisation. *Puertos del Estado* is 100% state-owned. Freight loading and unloading is jointly run by shippers and the port authority, with other services out-

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sourced based on concessions. The government has promised to increase port autonomy in management and tariff matters (Government of Spain, 1998). Ports now have authority to set their own prices (OECD/CLP, 1998*a*).

4.2.10. *Telecommunications*

Details about reform in this sector are set out in Ch. 6. Full liberalisation in this sector came in December 1998, eleven months after the EU target date but in advance of the extended deadline that Spain had negotiated. A second operator in basic telephony, Retevisión, began to compete with Telefónica in January 1998. A third basic telephony licence was also granted, in May 1998, to the Lince consortium (led by France Telecom). In mobile telephony, Telefónica's monopoly ended in 1995 with the entry of Airtel; here, too, a third licence has been granted, to Retevisión Movile (Government of Spain, 1998).

The telecoms regulator, *Comisión del Mercado de las Telecomunicaciones* (CMT), has some merger and competition policy responsibility over firms in the sector, but without prejudice to the powers of the competition bodies or the Council of Ministers. Like the Tribunal, the CMT may submit a non-binding report of its views about a particular concentration or accord (OECD/CLP, 1998*c*). The April 1998 telecoms law sets out some of the relationship between the CMT's functions and the powers of the Servicio and the Tribunal under the Competition Act (OECD/CLP, 1998*c*). The telecoms law obligates CMT to inform the Servicio about anti-competitive practices and proposed mergers and take-overs that could infringe competition policy. Indeed, both the telecoms and competition bodies are obliged to share what they know with each other. The 1999 revision of the Competition Act made clear that the Tribunal and the Servicio retain all of their enforcement powers concerning anti-competitive practices in the telecommunications sector.

Many observers are encouraged by competitive developments in the telecoms sector. Firms are challenging Telefónica, in the marketplace and through complaints about its anti-competitive practices. The Servicio and the Tribunal have been very active, demonstrating the application of general competition law in this sector. The need for repeated action may also demonstrate the extent to which greater competition is being resisted, too. In early 1999, the Tribunal assessed substantial fines against Telefónica – 580 million and 750 million Pesetas – for abuse of dominance in basic and mobile telephony.

4.2.11. *Electric power*

Details about reform in this sector are set out in the background report to Chapter 5. Generation and distribution are presently vertically integrated oligopolies, in which two companies, the recently privatised Endesa group and Iberdrola, control around 80% of the national market, while the high-voltage transmission grid is run by Red Eléctrica, now in private hands. Spanish electricity prices are relatively high. Electricity imports amount to only about 3% of potential capacity and are constrained by logistical, geographical and environmental factors (Government of Spain, 1998).

Reform legislation, passed in November 1997, creates a wholesale spot market, reduces nominal regulated prices by 8% through 2003, and promises full price liberalisation in 2007. It provides for legal separation of generation and distribution, privatisation of grid ownership, and staged introduction of retail competition for large, medium and small consumers. Regulatory oversight is provided principally by the Ministry of Industry and Energy and a new independent regulator (Government of Spain, 1998). The Ministry has cut access tariffs for liberalised customers by 25% to encourage participation in the market. The thresholds and tariffs were reduced further by a decree in April 1999.

At first, the electric power regulator, CSEN, had responsibility to monitor anti-competitive practices in the electric power sector, but the law did not specify what it was to do about what it found. This led to uncertainty about how CSEN's jurisdiction overlapped with that of the Servicio and the Tribunal under the Competition Act. Now, the law instructs the CSEN to communicate to the Servicio about restrictive practices that the CSEN had spotted in the electric power industry, and submit a non-binding report about them (OECD/CLP, 1998*c*). The two bodies now co-ordinate closely.

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Several competition cases have already arisen in this sector. The EU is reviewing a joint venture between a Spanish and a Portuguese firm to build a transmission line. The Servicio is supporting the venture, because it creates a new supplier. The competition and energy regulators are co-operating in evaluating a joint venture between Gas Natural and Endesa, which was referred to the Tribunal for second-phase investigation into its potential market foreclosing effects. Complaints about access are being filed with the Servicio and reviewed by the Tribunal, which has decided at least three cases in this sector so far.[8]

Despite the reforms, though, business, consumer, and academic observers believe more could be done to promote competition. Consolidation that accompanied reform has left a highly concentrated industry with limited possibilities for entry.

4.2.12. *Natural gas*

The natural gas industry is essentially a monopoly. The private company Gas Natural has a 90% share of gas distribution and also owns the recently privatised ENAGAS, Spain's sole natural gas importer and quasi-exclusive operator of the high-pressure transport network (Government of Spain, 1998).

A long-term reform plan was adopted in late 1998, and some aspects were updated in April 1999. (Some previous, smaller reforms addressed retail distribution and third-party access to the pipeline net). Prices are to be liberalised over a 10 year period (reduced, in April 1999, from the originally planned 15 year period), beginning with largest customers (10 MM m^3 annual consumption, reduced from the original 25 million). A single tariff will apply for third-party network access. The concession system would be changed to a system of licenses with no time limits or regional limitations, and competition would be authorised in re-gasification, storage, and transmission. But cross-subsidisation is controlled only by accounting separation among transport, storage, and wholesale and retail distribution functions (Government of Spain, 1998; OECD/CLP, 1997; OECD/CLP, 1998).

4.2.13. *Financial services*

Business banking appears generally competitive, and interest rates for mortgages in Spain are the lowest in Europe. Some consumer rates, such as credit card and overdraft fees, are relatively high, though. And small businesses have complained that two firms controlling 80% of the payment systems market refuse to discount from their (common) merchant charges. Some of the Tribunal's recommendations to strengthen competition oversight have been adopted, notably submitting major bank mergers for competition policy review. But some others, such as to increase consumer protections and to put commercial banks and the *cajas de ahorro* (savings banks controlled by the *comunidades autónomas*) on a more equal competitive footing, have been rejected.

4.2.14. *Distribution*

The 1996 Retail Act, which sets out the regulatory framework for the sector, is more interventionist than the law it replaced. Though the aim of the law is to move towards complete freedom of opening hours in the year 2001, it is not clear that this goal will be met. The *comunidades autónomas* may curtail hours over the transition period. Even after 2001, the government will still have to reach agreements about opening hours with each of these regional governments. Other issues include restrictions on retailers' freedom to decide the timing of sales and the requirement of a second licence for opening large retail outlets (Government of Spain, 1998).

Opening new large-scale stores is controlled by the *comunidades autónomas*. There is a mild form of competition policy oversight, in that the local governments must obtain a non-binding report from the Tribunal before approving or denying an application. In 1997, the Tribunal issued 48 reports on proposed hyper-markets, and studied another 15 cases for which reports were deemed unnecessary (OECD/CLP, 1998*a*). In 1996, there were 30 such reports, and 12 cases where a report was deemed unnecessary (OECD/CLP, 1997*a*). The Tribunal virtually always recommends approval. The only exception, in Valencia, was for horizontal reasons; all the hyper-markets in the likely regional market were owned by the operator who wanted to open the proposed new one, in the only remaining good location. One control against abuse

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is that consumers are represented on the local commissions that make the decisions about permitting new stores. But the net effect of the process is to postpone entry. The latest controversy is over high-volume, single-theme "category-killer" outlets, where proposals for profile rules would prevent specialisation and high volume operations.

Opening hours had been unregulated from 1985 to 1996. They are now subject to a combination of national law and local decision. The current national standards are relatively liberal: stores may be open from 0800 to 2130, Monday to Saturday. Total hours are unrestricted up to 72 hours per week; at that point, regional authorities can impose an upper limit. And outlets may open at least eight Sundays and holidays per year, up to 12 hours per day. Convenience stores and some other categories are unrestricted (OECD, 1997*b*). But few of the *comunidades autónomas* have permitted opening hours longer than the national law requires. Consumers' views about this are split; a survey showed about 40% preferred more Sunday opening, but 30% did not object to the current situation. As elsewhere, the issue is one of conflict between the interests of large and small shops, and of regional government intervention ostensibly on behalf of the smaller ones. Representatives of the smaller retailers contend that consumers are not complaining and that the real problems are labour laws and social security costs which constrain the flexibility to take advantage of the hours that are available.

4.2.15. *Land use and transfer*

Distortions in the market for urban land are a serious concern, but reform is complicated by the constitutional devolution of responsibility to regional governments. A 1996 reform was overturned by the constitutional court, on the grounds that the particular issues at stake were matters for regional (and local) decision (OECD/CLP, 1997*a*). Land deals and land use control are a major source of funds for municipal budgets, and this aspect complicates decisions, increases costs and delays, (Government of Spain, 1998) and invites corruption. The latest reform effort, from 1998, included some of the Tribunal's recommendations, but not others. In principle, this reform reverses the old presumption and provides that all land is to be developable unless specifically ruled otherwise; nevertheless, it still permits local authorities to deny development rights. High and increasing prices for urban land remain a concern (OECD, 1999).

4.2.16. *Petroleum products*

Petroleum was once a state monopoly, but it is becoming increasingly competitive. The formal monopoly was eliminated when Spain entered the EU. Prices have been liberalised, although some of the changes came only recently. Diesel fuel prices were removed from the maximum price list in June 1996 (OECD/CLP, 1997*a*). It was not until the 1998 Hydrocarbon Law that prices for all home heating, gasoline and diesel fuels were freed.

Oil refining is an oligopoly dominated by Repsol, which was recently privatised, CEPSA, and BP. Transport and storage are handled practically exclusively by *Compañía Logística de Hidrocarburos* (CLH), which is controlled, in turn, by the three refiners. At retail, 90% of petrol stations are run under concession agreements with the three main players. These are long-term (10 year), fixed margin contracts. Although the old rule setting a minimum distance for new stations has been abolished, that will have little effect on competition until these concession agreements expire and are replaced (OECD, 1998, p. 110). The 1998 Hydrocarbon Law now provides for re-negotiation of these contracts, which could lead to arrangements that let the stations set the price (Government of Spain, 1998). That law also provides for transparent, equal third party access to oil storage and transport facilities. (Divesting CLH from the three wholesaler-refiners would be simpler and would obviate the need for special legislative access guarantees) (OECD, 1998, p. 128).

4.2.17. *Funeral services*

Funeral services have been provided by municipally-sponsored monopolies. The government has tried to permit competition by removing the municipalities' power to authorise these monopolies (OECD/CLP, 1997*a*, p. 17). Some have been privatised, and competition has increased since the 1996 lib-

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eralisation, but some monopolies remain. For example, there is only one provider in Barcelona. In theory, companies are free to compete subject only to compliance with technical and health requirements, and constraints on funeral transport services were dismantled (Government of Spain, 1998). But until there is actual entry, problems may remain and continued competition policy oversight will be called for.

5. COMPETITION ADVOCACY FOR REGULATORY REFORM

The competition bodies, especially the Tribunal, have statutory roles in administrative and legislative processes. The Tribunal has the authority to report and comment on draft laws and regulations concerning the Competition Act (Art. 26). It can issue reports on draft regulations that fall within its jurisdiction, send reports to other public bodies and agencies, and study and submit to the government proposals for the modification of laws. The Tribunal may be consulted by parliamentary committees about drafts or proposals for laws and about any other issues relating to competition. The Tribunal may also issue reports concerning competition policy upon the request of the government or any ministry department, the *comunidades autónomas*, local public administrations and business organisations, labour unions or consumers and users. The Tribunal can initiate and conduct studies and reports about competition. And the Tribunal may formulate proposals to the government, through the Ministry of Economy and Finance, to reform or eliminate restrictions on competition that result from other laws or regulations. The Tribunal's powers to issue opinions and reports, including recommendations about reducing or modifying exclusions from the law's coverage, date from the original 1963 Competition Act. (That law even required court approval, after a Tribunal opinion, for any newly adopted restrictions on competition) (Cases, 1998, p. 184). Since 1992, the Tribunal has made more than 150 recommendations for revising or repealing anti-competitive laws and regulations. About two-thirds of its recommendations were accepted, in whole or in part.

The Servicio performs some similar functions (Art. 31). The Servicio researches economic sectors, analysing the extent of competition and the possible presence of restrictive practices, and issues reports about competition policy problems. In the last three years, its studies and reports have concentrated on sectors which have been liberalised (Government of Spain, 1999). In 1997, the Servicio did 60 studies and reports about competitive conditions in markets; in 1996, there had been 44, of which nearly half were

Box 5. Comprehensive advocacy

The Tribunal prepared a major, comprehensive report on structural reforms in response to a government request in 1992 (Tribunal, 1992*b*). This report is a blueprint for reform and a model of integrating competition agency expertise in the policy process. Recognising that, at that time, there were more restrictions on competition in Spain than in most other developed European economies, the Tribunal initially chose sectors for study and recommendation based on three criteria: significance of impact on the economy's competitiveness, severity of restriction on competition, or success in liberalisation in other countries. The original focus was thus on electric power, local monopolies, public utility installation and maintenance, telecoms, and urban real estate. But the list quickly grew, to include water and gas distribution, publications, postal services, taxis, mass media, sea ports, pharmacies, and contracting. The report recommended changes in legislation. And it also outlined ways to overcome the inevitable opposition to change from the groups that benefit from these special-interest privileges. The report made several general recommendations about regulatory methods and the reform process: that regulators be fully independent from the regulated businesses; that reform be implemented by specific government actions pursuant to general parliamentary instruction; that social policies and objectives not be jeopardised by competition; and that cross-subsidies be eliminated by removing monopolies from public holdings. After the report appeared, the Government Commission for Economic Affairs asked the Tribunal to present an annual report on competition with both a general survey and in-depth analysis of competition in particular sectors. These annual reports were issued through 1995 (OECD, 1997*a*).

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about sectors being liberalised (OECD/CLP, 1998*a*; OECD/CLP, 1997*a*). The roles and competences of the Tribunal and the Servicio in these respects are complementary. The Tribunal has the principal decision-making and advisory powers, and thus the Servicio's work might be expected to follow Tribunal's lead and model. As a part of the government, though, the Servicio provides advice and analysis in deliberations and in developing the government's programme and priorities for competition policy. The Tribunal can be more effective as a voice in public debate analysing and criticising current policies, because of its independent position.

The Tribunal has continued to issue some reports and studies, but the pace and focus have changed. Tribunal reports in 1997 dealt with tobacco regulation, financing of public television, television satellite services, pharmaceutical distribution, sports broadcasting, electricity liberalisation, telecoms legislation, aid to cinema production, access to gas facilities, postal service liberalisation and universal service, and enforcement of EU rules (OECD/CLP, 1998*a*). In 1996, Tribunal reports dealt with distribution of motor vehicles, regulation of municipal markets, professional fees for construction, football broadcast rights, as well as draft regulations about corporate taxes and a draft local government industrial promotion plan (OECD/CLP, 1997*a*). Recent work includes reports on gas, textbooks, tobacco, postal services, and land use. The number of these studies has declined in the last few years. In 1996 and 1997, the Tribunal issued about 10 reports per year assessing competition issues in current or proposed laws and regulations; in the two years before, it had issued about 60 per year. Some of the early reports addressed very broad subjects or issues, while recent ones are more narrowly targeted to specific situations and rules.

The reduced rate of these reports, and the narrower focus, are explained by staff changes, and by a management decision that workload constraints meant other matters were higher priority. Another reason may be that the early reports addressed the most important issues, and appeared when public acceptance of competitive, market approaches was still unclear. Now, persuading the public is less important, and many of the major subjects have been addressed. Still, though, it would be unfortunate if the problem of resource constraints is met by reducing the Tribunal's advocacy role. Already, that role is less public than before, as some of the Tribunal's reports to the government about legislative proposals have not been published. Thus, this work is not available in public debate.

6. CONCLUSIONS AND POLICY OPTIONS

The Spanish economy has moved quite far over the last 20 years, and especially over the last ten, toward greater reliance on competition. The project of joining the EU and following EU reform programmes has been a powerful stimulus and guide for Spain's own reforms. And exposure to the competition within the European Community has no doubt helped spur Spanish industry to greater efficiency. Launching of modern competition policy in 1989 was complemented by active advocacy of reforming non-competitive regulations. The Tribunal's programme was virtually a blueprint for reform, both in content and in model of analysis and advocacy for the policy process. Much of the programme has been followed in efforts to introduce competition in telecoms, airlines and other transport sectors, electric power, and the professions.

But in some respects, moves toward reform still leave much to be done. It may be of concern that the Tribunal's policy advocacy role has appeared to decline in importance, even though some problems it identified remain only partly resolved. Its views are less prominent in public debate now, as recent Tribunal reports about proposals concerning tobacco, transport, drug stores, and other subjects have not been published. Sectoral regulatory bodies have only advisory powers with respect to some important issues, and the Tribunal's role is advisory, too, concerning major policies and mergers. In these circumstances, and in view of such actions as retaining a post-reform monopoly in tobacco and a highly concentrated electric power sector, it remains necessary to stress the priority of competition policy in reform.

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6.1. Policy options for consideration

– ***Remove remaining exemptions and unnecessary constraints on competition.***

In most of the sectors discussed above, some reform steps have already been taken and plans are in place to remove constraints in the future. For others, though, more deliberate action is needed. The special rule permitting price fixing for books should be changed, because consumers could benefit substantially from lower prices there. Competition among pharmacies remains limited. And professional services are unlikely to move toward significantly greater competition as long as they recommend prices and discourage advertising.

– ***Limit the anti-competitive effects of special laws about retailing.***

Before 1996, Spain's retail environment was subject to relatively few competitive constraints. Now, regional governments have powers to control new locations and operating hours. Control over entry risks affording unfair advantages to firms that were in place before the controls were adopted, and may permit them to exercise some market power. And the 1995 legislation also set special rules about unfair competition in this sector. It is unclear why general principles of competition law, and of unfair competition, would be inadequate in this sector. This legislation will be reviewed in 2001.

– ***Increase resources for competition policy.***

The Tribunal has virtually no professional staff to support the members. It is unlikely that the Tribunal could effectively conduct any independent or supplementary investigation, without the assistance of the Servicio or of parties to a controversy. One proposal to increase resources would involve adding members to the Tribunal. But with nine members, the Tribunal is already a fairly large decision-making body. To be sure, the Tribunal has a practice of rotating responsibilities, to use its members' time more efficiently. Still, more staff, rather than more members, would probably have a greater impact on its output and efficiency. The Servicio actually shrank in the last few years, even though it is handling twice as many complaints and may now review a larger number of proposed mergers, under tighter time constraints. The Servicio too is likely to be strained, especially as sectoral reforms expose previously sheltered firms to competitive forces.

– ***Consider consolidating decision processes.***

Originally, the Tribunal and the Servicio were separated because one was a quasi-judicial body and the other was administrative. But now that both are clearly administrative, and a further appeal to the judiciary is possible, that formal reason for separation no longer obtains. Separating the powers of initiation and decision may diffuse responsibility for developing policy and potentially lead to conflict about policy priorities. The Tribunal in 1989 suggested that the Servicio become a component of the Tribunal, so that the Tribunal would in effect have the power to open and conduct proceedings (Cases, 1998, p. 198). The Tribunal already has some control over its agenda, when it responds to complaints about the Servicio's actions and its failures to act. But as a practical matter, it appears that the Tribunal does not manage the development of competition policy. One way to strengthen its role could be to give other parties, such as sectoral regulators and even private complainants, greater powers to bring matters to the Tribunal directly. That could require a substantial increase in the Tribunal's resources.

– ***Make competition policy in merger review and privatisation more transparent by strengthening the role of the Tribunal.***

In these important functions, the Tribunal's role is advisory. And although competition policy is a principal concern, in some important decisions review by the competition policy bodies was not sought. One effective way to make competition policy the top priority in these decisions would be to give the Tribunal decision power over mergers and the power to disqualify potential privatisation bidders. That is the approach applied in Mexico, for example. If that assignment of power is thought inappropriate within the structure of Spain's government, then at least the Tribunal's analysis and recommendations in such matters should be publicly available before a final decision is reached.

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– Maintain the Tribunal's independent advocacy function.

Over the years, the Tribunal's public studies and reports have played a central role in the reform process. That process is not over. To be sure, the major subjects have been identified and many of the reform recommendations have been implemented. For others, the tasks are now to work out details and to resist back-sliding. But even if the level of reform is the details, continued study, analysis, and public debate will be important. The Tribunal, from its position of independence from the government, can be a particularly powerful and credible voice in that debate. The latest revisions to the Competition Law give the Tribunal a valuable new advocacy role, in making the anti-competitive impacts of government aid transparent. In addition, the competition policy analysis responsibilities of the Servicio have evidently been expanded.[9] The additional resources devoted to this function could be valuable, but it is important that the Tribunal's independent voice continues to be heard.

6.2. Managing regulatory reform

Other structural reforms are needed to supplement strengthening of competition policy. Spain's bankruptcy and temporary receivership laws are urgently in need of change, so that competition among market institutions can do its job of allocating resources. There is widespread recognition that Spain must undertake reform of bankruptcy procedures along the lines of those enacted in other countries (Government of Spain, 1998). And reform of the rules governing civil law procedures is necessary to the effectiveness of law-based enforcement and privately-initiated actions. Now, civil law proceedings are often too complex and drawn out, so parties seeking the aid or protection of the courts are often disappointed. A bill about civil procedures is under consideration. The most important innovations would be speeding up court cases by cutting out procedural stages, streamlining administrative requirements, and improving the notification system for hearings, as well as measures to improve processes for collecting debts (Government of Spain, 1998).

Clear, publicly acknowledged objectives for regulation and reform, taking consumer interests into account, and independent monitoring are important elements for ensuring that reform process is open and inclusive, and not just a dialogue between the government and the industry involved. Spain has had a long history of excessive economic regulation, an experience that has inevitably shaped public opinions and expectations. But Spain also appears determined to put that experience behind it. Reforms can be promoted as elements of a comprehensive programme, both to reduce input prices and thus maintain Spain's comparative advantage and to promote the interests of consumers generally.

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NOTES

1. The 1963 law also established a Council, with members from ministries and the trade unions, which had broad powers, to provide opinions, study sectoral problems, propose matters for action, and even be consulted before the Servicio forwarded matters to the Tribunal.
2. All citations are to the Competition Act 16/1989, by article or paragraph.
3. This provision is somewhat analogous to Art. 92 of the Treaty of Rome, which prohibits competition-distorting aids where the Treaty's jurisdictional requirements are met.
4. Unfair Competition Act 3/1991, 10 January 1991.
5. Law 13/1998, 4 April 1998, on the Tobacco Market.
6. Spain's laws concerning pharmaceuticals take account of Council Directive 85/432/CEE, concerning geographical distribution of pharmacies and monopolies for selling pharmaceutical products in member states.
7. The list also includes "stomatologists".
8. Eléctrica Eriste, r336/98, 27 Jan 99; Electra Caldense, 427/98, 19 Feb 99; Hidroeléctrica del Ampurdan, r180/96, 14 May /97, texts at *http://www.meh.es*/TDC.
9. See *El País*, 8 May 1999 (www.elpais.com), "Economía aumenta las sanciones para las empresas que violen la libre competencia."

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BACKGROUND REPORT ON ENHANCING MARKET OPENNESS THROUGH REGULATORY REFORM*

* This report was principally prepared by **Denis Audet**, Administrator of the Trade Directorate with the participation of **Sophie Bismut**, **Didier Campion** and **Mark Warner**. It has benefited from extensive comments provided by colleagues throughout the OECD Secretariat, by the Government of Spain, and by Member countries as part of the peer review process. This report was peer reviewed in June 1999 in the Working Party of the OECD's Trade Committee.

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Background Report on Enhancing Market Openness through Regulatory Reform

The accession of Spain to the European Communities (now the European Union) in 1986, the transposition of EU Single Market Directives and its recent qualification for the European Monetary Union have fundamentally changed the Spanish trade and investment environment. As a result, Spain has effectively moved away from a managed approach to foreign competition and towards full free movement of goods, services, capital, and people with EU member states and much more open trade relationships with non-EU countries. The Single Market Directives, aimed at eliminating internal obstacles to trade, have acted as policy anchors and brought benefits to the world community through several of their attributes, including transparency and non-discrimination requirements. Spain is generally recognised by member states for its diligent implementation of EU Directives, which have required considerable changes in the overall Spanish legal system.

Efforts were recently made to improve the elaboration process of domestic laws and regulations through the use of more transparent procedures and added recourse to justify and evaluate new laws and regulations. A legalistic approach still predominates in the elaboration process of domestic regulations and technical regulations with in practice limited use of economic instruments as benchmarks to evaluate the estimated economic costs and benefits of regulations. The process of public consultation is also characterised by the exercise of a certain degree of discretionary power by sponsoring ministries. Although draft regulations are not systematically assessed against the "efficient regulation principles", evidence is available to suggest that the principles of non-discrimination, use of international standards, and recognition of equivalence are given ample expression in practice.

Spain uses the Internet for disseminating central government formalities and regulations to the public. The use of the Internet for soliciting comments on draft regulations and for facilitating government procurement procedures can be improved as a means to improve transparency. Spain is among the leading EU member states in the implementation of an electronic-based customs system. At the EU level, higher priority should be assigned to the task of speeding-up the implementation of an EU-wide electronic-based system for customs procedures to respond more efficiently to the requirements of the Single Market, including transit operations.

Considerable efforts have been made to reduce the role of government in economic activities through a comprehensive privatisation programme. Efforts have been made to establish an institutional competition infrastructure through the Competition Defence Service, the Competition Tribunal and specialised commissions to regulate the telecommunications and the energy sectors. Evidence shows that the Spanish government has demonstrated a strong commitment to liberalising the telecommunications and electricity sectors and in promoting enhanced competition in these sectors. Nevertheless, continuous efforts are required to minimise the risk of the potential abuse of dominant position by certain firms in these sectors and the adverse effects that this situation may cause on the ability of both domestic and foreign firms to compete in Spain. In the automobile sector, Spain has attracted significant foreign investment, which has boosted its exports significantly. However, Spain has achieved this success against the background of relatively high tariff protection (the EU common external tariff) and a contradictory competitive stance by the EU Commission, although recent EU Commission positions have definitely been pro-competitive.

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1. MARKET OPENNESS AND REGULATION: THE POLICY ENVIRONMENT IN SPAIN

The accession of Spain to the European Communities (now the European Union) in 1986 and its subsequent participation in other EU-based integration initiatives have fundamentally changed the Spanish trade and investment environment. During the process, Spain has effectively moved away from a managed approach to foreign competition and towards full participation in the EU Single Market and more open trade relationships with non-EU countries. As a consequence of its accession, the United Nations graduated Spain from a developing country status to a developed country status. There is a symbolic value in this graduation but, underneath it, Spain made irreversible commitments within the EU and the World Trade Organisation (WTO) implying systemic policy changes, which have transformed the Spanish economy and brought benefits to the world community.

The EU accession has had a profound influence on Spanish policy formulation, because of the scope and pace of the policy reform that it has involved. By integrating into the EU Customs Union, Spain has foregone the right to follow an independent trade policy but in return gained improved market access to other EU member markets and a voice in the elaboration process of the EU common external trade policy. In particular, it meant the phasing-out of the prevailing Spanish customs tariffs over a seven-year period for most products originating from the EU and the European Free Trade Association (EFTA) countries, with a 10 year period for some agricultural products. For imports originating from other countries, differentials in duty rates between prevailing Spanish duties and EU common external duties were phased out during a seven-year transitional period.[1]

In addition to customs tariffs, Spain had over 4 500 quantitative restrictions (QRs) in application in 1986, which affected a whole range of imports from both EU and non-EU countries. In the context of the implementation of the European Single Market in 1993, these were dismantled along with QRs maintained by other EU member states. On this occasion, some 6 000 QRs applied by EU member states were unilaterally dismantled and few national QRs were converted into Community-wide quotas.[2]

Accession also meant that Spain had to assume all prevailing EU rights and obligations, the "*acquis communautaire*", some of it immediately upon accession and the rest over a transitional period.[3] In essence, Spain was required to provide free movement in the areas of goods, services, capital, and people – the four freedoms – to other EU member countries in return for similar commitments. These requirements have necessitated considerable changes in the overall Spanish legal system, including constitutional, administrative, fiscal, labour, and commercial laws. As an illustration of the scope of legislative changes involved, Spain along with other member states integrated some 1 400 EU Directives between 1985 and 1997.[4] The Single Market Directives themselves aimed at eliminating internal obstacles to trade have acted as strong policy anchors against the temptation to backtrack.

Prior to its accession, Spanish authorities estimated that the average rate of duty applied on industrial products from non-EU member countries was 11.3% in 1985. In 2001, once all EU tariff reduction commitments undertaken during the Uruguay Round are fully implemented, the average unweighted tariff rate on industrial products is scheduled to be 3.7% (3.0% taking account of tariff elimination commitments of the recent WTO Information Technology Agreement).[5] As expected, this regional integration process modified significantly the geographical composition of Spanish trade, with a jump in the share of total imports coming from EU countries, increasing from 39.1% in 1985 to 62.7% in 1990 and over 67% in 1998 (see Table 9). Reflecting trade liberalisation measures, the goods and services propensity ratios for Spain, measured in both current and constant pesetas, increased significantly particularly after 1990 (see Table 1). The goods propensity ratios (import plus export in current pesetas) had initially declined between 1986 and 1990 but increased steadily afterward from 29.1% in 1990 to 43.7% in 1998.

The Spanish foreign investment regulatory framework was radically modified in 1985 in preparation for the accession. It involved the removal of several restrictions on capital flows and the adoption of EU compatible technical regulations. Some restrictions were maintained, including the need for prior authorisation for investment in five special sectors (gambling, radio, television, air transport, and defence-related), the obligation to formally register through Spanish notaries and various obstacles to the transfer abroad of profits and dividends and the repatriation of capital.[6] In 1992, exchange controls were repealed

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Table 1. **Trade propensity ratios for Spain**

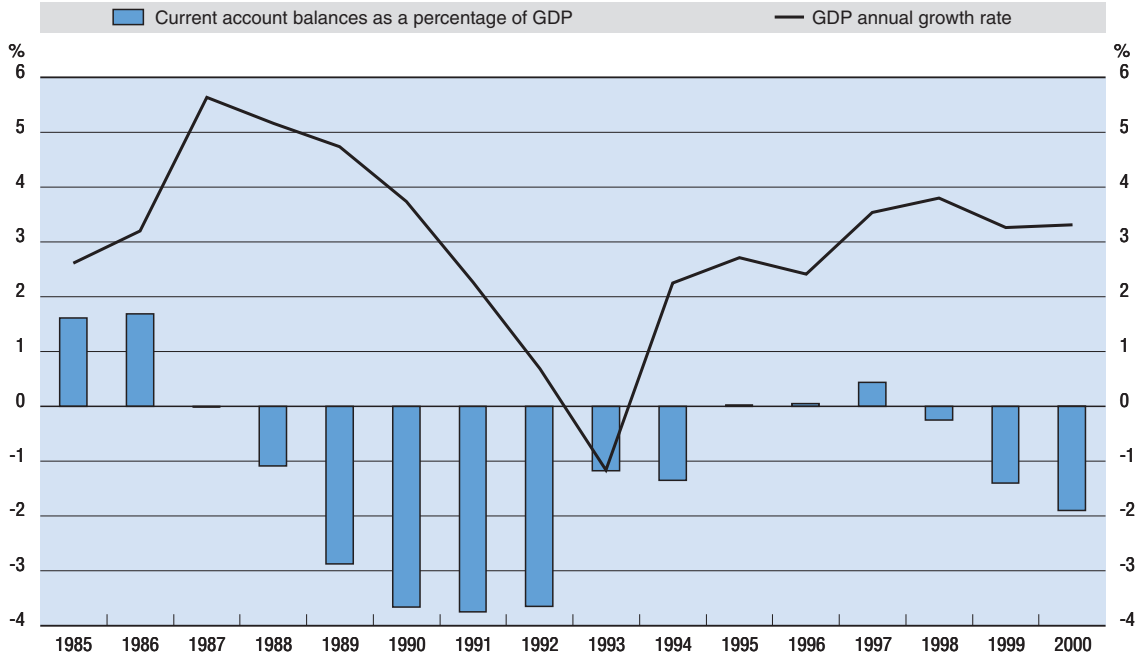
Trade propensity ratios	1986	1990	1995	1998
Goods and services (constant)[1]	37.58	45.05	60.96	N/A
Goods and services (current)[1]	37.37	37.34	46.77	58.4
Goods propensity ratio[2]	32.5	29.1	36.9	43.7
Import propensity	14.5	11.3	16.4	19.7
Export propensity	18.0	17.8	20.5	24.0

1. The Goods and services propensity ratios in constant and current pesetas represent the combined goods and services imports and exports as a percentage of gross domestic product (GDP).
Source: Prepared by the *Ministerio de Economia y Hacienda*.
2. The Goods propensity ratios are the sum of the import and export propensity ratios and they do not include trade in services. The import and export propensity ratios represent imports or exports as a percentage of GDP.
Source: OECD, *Main Economic Indicators*.

to transpose the EU Directive on the deregulation of capital flows. In April 1999, a new investment regime has been approved by Royal Decree that transposes various EU provisions relating the application of the Maastrich Treaty. It also eliminates remaining obstacles with respect to the clearance system, the registration through Spanish notaries and the prior authorisation for non-EU residents for investment in the special sectors, except in the defence-related sector.

Trade and investment liberalisation commitments have contributed to stimulate economic growth and to inject a dose of competition in the previously closed or semi-closed economy. Real GDP growth rate jumped from about 2.6% in 1985 to more than 5% in 1987 and 1988 and 4.7% in 1989. The opening of the economy was also accompanied by a series of sizeable annual deficits in the current account. The current account balance has been relatively stable since 1995 with three consecutive years of small surpluses. The outlook for 1999 and 2000 is for moderate but growing current account deficits.

Figure 1. **Spain real GDP growth rates and current account balances**



Source: OECD (1999), OECD *Economic Outlook,* June 1999 (data is estimated for 1999 and is projected for 2000).

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Due to its trade and investment liberalisation, Spain attracted sizeable levels of foreign direct investment (FDI) in both physical assets (see Direct FDI in Table 2) and portfolio investment (due to changes in the statistical time series of FDI, data is not available before 1992). For a combination of market factors, the level of direct investment marked a pause between 1995 and 1997 but resumed in 1998. Portfolio investments have fluctuated widely during the 90s and the volatile nature of these investments makes it very difficult to provide the explanatory factors behind these fluctuations. In 1997, large outflows (Spanish investment abroad) of capital emerged, underpinned by sustained domestic savings and dynamic financial institutions pursuing market opportunities on a world basis and, in particular, in Latin America. Spanish investors have made significant investment in Latin American countries taking advantages of privatisation initiatives in this region. Outflows multiplied by a factor of more than seven between 1996 and 1998.

Table 2. **Inflows and outflows of foreign direct investment in Spain**
Euro billion

	1992	1993	1994	1995	1996	1997	1998
Inflows	15.8	48.3	–9.1	20.4	7.5	16.7	25.6
Direct FDI	8.2	6.2	7.6	4.7	5.1	5.6	10.2
Portfolio	7.6	42.1	–16.7	15.7	2.4	11.1	15.4
Outflows	3.0	7.3	4.7	3.1	7.0	25.3	55.1
Direct FDI	1.3	2.0	3.1	2.7	4.2	11.0	16.5
Portfolio	1.7	5.3	1.6	0.4	2.8	14.3	38.6

Source: Banco de España, *Boletín Económico*, December 1999.

In recognition of the economic inefficiencies caused by under-performing public enterprises providing critical inputs to the rest of the economy, a reform of the public enterprise sector was launched to accelerate the process of restructuring and privatising. Initial efforts began in 1985 with the privatisation of some state enterprises and the restructuring of loss-making industries which resulted in significant labour shedding in the coal mining industry, the shipyards, rail and air transport companies. Between 1985 and 1996, some 65 state enterprises were totally or partially privatised from several sectors, including textiles, footwear, fertilisers, automobiles, and food. In 1996 the Spanish government launched a wider exercise known as the Modernisation Programme with the objective of improving the efficiency of state enterprises during the restructuring and privatisation process and selling all but a few selected enterprises over a five-year period. This market-based approach has yielded significant opportunities for foreign investors. Table 3 gives an indication of the scope and receipts from the privatisation process. Taking into account more recent privatisation developments, Endesa, Repsol, Telefonica, and Gas Natural are now completely privatised.

This privatisation exercise went beyond EU-based prerogatives to open up EU national telecommunications and electricity markets to competition, as well as by the convergence criteria for qualifying entry into the European Monetary Union. While the sales of shares in the telephone, oil, gas, steel, aluminium, electricity, and other public enterprises raised over two trillion pesetas in 1996 and 1997, which was equivalent to 3% of 1997 GDP, the privatisation proceeds are not incorporated into budget revenues under the Maastricht rules.[7] Over four trillion pesetas were raised when 1998 privatisation receipts are included. For the time being, remaining public enterprises are in the sectors of coal mining and public television, and the Spanish government has no immediate plan to privatise them because they implement public policies. Postal services have been partially privatised and railways are now open to private initiatives. However, the postal services are the subject of EU Directives seeking to open-up EU national postal services to competition..

More recently, spurred by EU convergence requirements to qualify for the European Monetary Union, Spain made considerable improvement in its fiscal position. One policy consequence for Spain and other EU qualified members is that they no longer have the option of devaluating domestic currencies as a policy instrument to improve the international competitiveness of their domestic firms. In this

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Table 3. **Main privatisations in Spain, 1985-1998**

Sector	Society	Date	Percentage of capital sold	Receipts (billion ptas)
Electronics	Secoinsa	1985	69.0	–
	Telesincro	1986	100.0	–
Tourism	Viajes Marsans	1985	100.0	–
	Entursa	1986	100.0	–
Textiles	Textil Tarazona	1985	70.0	–
	Intelhorce	1989	100.0	–
Automobile	Seat	1986	75.0	19
	Seat	1990	25.0	20
	Enasa-Pegaso	1991	100.0	–
Electricity	Endesa	1988	20.0	74
	Endesa	1994	8.7	138
	Endesa	1997	25.0	660
	Endesa	1998	41.1	1 490
Oil	Repsol	1989-93	57.4	345
	Repsol	1995	19.0	130
	Repsol	1996	11.0	140
	Repsol	1997	10.0	169
Bank	Argentaria	1993	49.9	168
	Argentaria	1996	25.0	155
	Argentaria	1998	25.1	325
Telephone	Telefonica	1987	–	82
	Telefonica	1995	12.0	165
	Telefonica	1997	20.9	630
	Telefonica International	1997	23.8	131
	Retevision	1997	70.0	181
Gas	Gas Natural	1996	3.8	36
	Auxini	1997	100.0	–
Steel	CSI (Aceralia)	1997	100.0	222
	Elcano	1997	100.0	6
Aluminium	Inespal	1998	100.0	62
Duty free shops	Aldeasa	1997	100.0	56
Tobacco	Tabacalera	1998	52.4	310

Source: *La Caixa*, *Informe Mensual*, January 1999 and OECD Secretariat.

new context, the importance of establishing a sound regulatory framework that minimises domestic obstacles to growth is more crucial than ever. Against this background, Spain would maximise the return of its comprehensive liberalisation initiatives and market-based approach by pursuing additional efforts in applying a set of efficient regulation principles as discussed in this review.

2. THE POLICY FRAMEWORK FOR MARKET OPENNESS: THE SIX "EFFICIENT REGULATION PRINCIPLES"

An important step in ensuring that regulations do not unnecessarily reduce market openness is to build the "efficient regulation" principles into the domestic regulatory process for social and economic regulations, as well as for administrative practices. "Market openness" here refers to the ability of foreign suppliers to compete in a national market without encountering discriminatory, excessively burdensome, or restrictive conditions. These principles, which have been described in the 1997 OECD *Report on Regulatory Reform* and developed further in the Trade Committee, are:

– Transparency and openness of decision making.

– Non-discrimination.

– Avoidance of unnecessary trade restrictiveness.

– Use of internationally harmonised measures.

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– Recognition of equivalence of other countries' regulatory measures.

– Application of competition principles.

They have been identified by trade policy makers as key to market-oriented and trade and investment-friendly regulations. They reflect the basic principles underpinning the multilateral trading system, concerning which countries have undertaken certain obligations in the WTO and other contexts. The intention in the OECD Country Reviews of regulatory reform is not to judge the extent to which any country may have undertaken and lived up to international commitments relating directly or indirectly to these principles, but rather to assess whether and how domestic instruments, procedures and practices give effect to the principles and successfully contribute to market openness. Similarly, the OECD Country Reviews are not concerned with an assessment of trade policies and practices in Member countries.

In sum, this report considers whether and how Spanish regulatory procedures and content affect the quality of market access and presence in Spain. An important reverse scenario – whether and how inward trade and investment affect the fulfilment of legitimate policy objectives reflected in social regulation – is beyond the scope of the present discussion. This latter issue has been extensively debated within and beyond the OECD from a range of policy perspectives. To date, however, OECD deliberations have found no evidence to suggest that trade and investment *per se* impact negatively on the pursuit and attainment of domestic policy goals through regulation or other means.[8]

2.1. Transparency, openness of decision making and appeal procedures

To ensure international market openness, foreign firms and individuals seeking access to a market (or expanding activities in a given market) must have adequate information on new or revised regulations so that they can base their decisions on an accurate assessment of potential costs, risks, and market opportunities. Regulations need to be transparent to foreign traders and investors. Regulatory transparency at both domestic and international levels can be achieved through a variety of means, including systematic publication of proposed rules prior to entry into force, use of electronic means to share information (such as the Internet), well-timed opportunities for public comment, and rigorous mechanisms for ensuring that such comments are given due consideration prior to the adoption of a final regulation.[9] Market participants wishing to voice concerns about the application of existing regulations should have appropriate access to appeal procedures. This sub-section discusses the above transparency and transparency-related considerations in Spain and how they are met.

2.1.1. *Transparency in the elaboration of* Spanish regulations

An important aspect of transparency arises from the administrative procedures put into place for the elaboration and adoption of domestic regulations. It is therefore essential to review some of the key steps involved in order to assess the transparency-friendliness of these procedures. The background report on Government Capacity to Produce High Quality Regulation provides a detailed discussion of the Spanish process for elaborating new regulations and offers detailed recommendations for improving the transparency of the process and the institutional setting.

Spain's administrative procedures were reformed in 1997 with the Government Law (50/1997). The elaboration of new regulations involves the preparation of a "Normative Dossier" by the sponsoring Ministries (hereby referred to as regulators). The "General Commission" (*Comisión General de Secretarios de Estado y Subsecretarios*) (CGSYS) approves the regulatory projects and transmit them to the Council of Ministers for final approval. When economic interests are involved the approval of the Commission for Economic Affairs (*Comisión Delegada del Gobierno para Asuntos Económicos*) is required before concerned regulatory projects can be transmitted to the Council of Ministers. The proposed regulations come into force generally 20 days after their publication in the Spanish Official Journal (*Boletín Oficial del Estado*). The elaboration of Ministerial Orders, which include the most important rules elaborated by ministries, also requires the preparation of a Normative Dossier but are rarely reviewed beyond the sponsoring ministry.

During the preparation of the Normative Dossier, regulators must organise public consultations and prepare a series of reports that are added to the Dossier as the process follows its course. The Dossier is

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composed of: a report on the necessity of proposed regulations; an "Economic Memorandum"; the opinion of the Council of State (*Consejo de Estado*) on the legality of the proposal; an assessment of the realised consultation process; and as necessary the opinion of the Ministry of Public Administration (MPA).[10] Draft laws and regulations to be discussed by the Council of Ministers have to be accompanied by an "Evaluation Questionnaire". The Questionnaire is a summary of the Normative Dossier, which is only available to the Council of Ministers.

Evidence suggests that in practice the preparation of the Normative Dossier and the Economic Memorandum is well done for draft laws having significant economic impact. However, for the elaboration of draft regulations, the qualitative assessment of the Economic Memorandum is often limited to an accounting impact on the public budget of draft regulations. The preparation of the Normative Dossier, including the Economic Memorandum, may be compared to a Regulatory Impact Analysis (RIA) in the sense of the OECD best practices.[11] However, during the preparation of the Normative Dossier, regulators are not explicitly asked to assess the quantitative impact of the draft regulations on society nor to do a formal cost and benefit analysis. Also, regulators are not asked to verify the respect of the efficient regulation principles in particular the non-discrimination or the least trade restrictiveness principles.

Public consultations on regulatory matters are a constitutional requirement in Spain, called *trámite de audiencia*. The 1958 Administrative Procedure Law provided specific consultation procedures. These were reformed in November 1997 by the Government Law (50/1997) and in 1992 by the Law (30/1992) on the Legal Regime of Public Administration and Common Administrative Procedures. Regulators are required to provide a reasonable period for public consultation, which in general must not be less than 15 working days, although it can be reduced to seven working days under certain conditions.[12] They are required to prepare a written statement, to be included in the Normative Dossier, summarising the consultations and justifying the consultation mechanism used. The regulators must answer all comments and the responses can be done in a generic way answering simultaneously all consulted interested parties only if they refer essentially to the same matters. Three different mechanisms of consultation are identified: consultation of interested parties; consultation with organised groups; and the notice and comment mechanism. At the end of the elaboration procedure for proposed regulations, the Council of State assesses the extent and results of the consultation (except for Ministerial Orders and some laws).

The Law (50/1997) specifies that the regulators should consult citizens if the proposed regulation affects their "legitimate rights and interests" either "directly or through the representative organisations and associations legally established … and whose objectives are directly connected with the goal of the proposal". While the law identifies various consultation mechanisms, it does not define the moment of consultation; the elements of the Normative Dossier to be provided to the consulted parties; the criteria to evaluate the quality of the consultation nor the decisions taken by the regulators on the selected consultation mechanism. In practice, regulators have discretionary power in deciding who are the interested parties that will be included in the consultation process and what information they have at their disposal to evaluate the proposed regulations.

On 23 April 1999, the "Inter-Ministerial Commission for Administrative Simplification" was created by Royal Decree (670/99) and it is composed of several Secretaries of States, Deputy-Secretary of all Ministries and it is under the chairmanship of the Minister of Public Administration. This Inter-Ministerial Commission has the specific mandate to "eliminate all unnecessary formalities before April 2000". The establishment of this Commission will certainly raise the priority assigned to administrative simplification, permit the reduction of existing authorisations, permits and licences, and improve the application of the remaining ones. However, this Commission's mandate does not include assessing the stock of existing regulations against economic criteria, such as a cost and benefit analysis or the efficient regulation principles.

Overall, significant efforts were recently made to improve the elaboration process of domestic laws through the use of more transparent procedures and added recourse to justify and evaluate new laws and regulations. The process of public consultation of domestic regulations could be improved. For example, the transparency of the process can be improved if draft regulations were published in the Official Journal and made available through the Internet. Similarly, consulted parties should have access to the Norma-

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tive Dossier. These steps would contribute to minimise the exercise of discretionary power by regulators in selecting who are considered as affected interested parties and what information consulted parties have at their disposal to assess the draft regulations. Also, it remains that the elaboration process does not explicitly require the assessment of draft laws and regulations, neither against the efficient regulation principles nor against a formal cost and benefit analysis. Therefore the elaboration process of regulations can be improved by implementing across the administration a step-by-step programme for improving regulatory impact assessment, based on OECD best practice recommendations for all new and revised regulations. From the perspective of market openness, the criteria of non-discrimination and least trade restrictiveness should be specifically added in the regulatory impact assessment process. The background report on Government Capacity to Produce High Quality Regulation provides detailed recommendations for strengthening the transparency and the institutional setting as well as minimising the discretionary powers of regulators.

2.1.2. *Transparency in the elaboration of government-sponsored technical regulations*

The Spanish elaboration of government-sponsored technical regulations (technical regulations) follows the same procedure as for Spanish draft regulations, discussed above. However, there are additional opportunities for interested foreign parties to take part in the elaboration process arising from the notification procedures resulting from Spain's obligations as a member of the EU and the WTO. These procedures aim at preventing the emergence of technical barriers to trade. They give interested parties the opportunity to comment on the regulatory decision-making process at a relatively early stage, before technical regulations are published and enter into force, and to raise any objections against technical regulations which could create obstacles to trade. They also provide for the creation of information points, which help disseminate the information on regulations.

In all EU member states, when draft technical regulations are not pure transpositions of EU harmonising Directives, they must be notified to the European Commission.[13] The obligation gives the European Commission and other EU member states the opportunity to comment on new or modified national rules for a period of three months, which may be extended for an additional three or 12 months depending on the circumstances. They can, for example, raise questions of interpretation, ask for further details, or challenge the conformity of prospective rules with Community law while they are still at the drafting stage. Failure to notify or to respond to comments can result in the Commission launching an infringement procedure (see Box 1 for details).

Although first directed at member states the procedure benefits the private sector in the EU by opening a window on national regulatory activities. Each week the European Commission publishes the titles of draft national technical regulations in the Official Journal of the European Communities. Any private individual or firm interested in a notified draft technical regulation can obtain the text from the administration. In this way, firms may anticipate the adoption of future regulations or participate more or less directly in the regulatory making process. They may submit comments to the Commission or their government (both can send official comments to the notifying member state). The European Commission's website will soon include information on notifications. This initiative should significantly promote the awareness of all interested parties, whether European or not, as regard national regulatory activities within the EU.

The notification procedure has enhanced the transparency of the regulatory decision making process all over the European Union, thus reducing the risks of regulatory capture. Since its inception in 1985, the procedure has helped build the principle of transparency into the regulatory practices of European countries as far as the technical rules are concerned. Enforcement is ensured through the infringement procedures, which the Commission can initiate when countries fail to notify their prospective rules. Between 1995 and 1997, the Commission launched six infringement procedures against Spain out of a total of 96 for all EU countries. The incentive of countries to notify, and thus the efficiency of the system, has been strongly reinforced by the 1996 "Securitel" decision by the European Court of Justice.[14] The decision established the principle that failure to comply with the notification obligation results in the technical regulations concerned being inapplicable, so that they are unenforceable against individuals.

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In the EU, the notification procedure has recently been complemented by a new procedure requiring member states to notify the Commission of national measures derogating from the principle of free movement of goods within the EU.[15] This procedure was established in view of persisting obstacles to the free movement of goods within the Single Market. Member states must notify any measure, other than a judicial decision, which prevents the free movement of products lawfully manufactured or marketed in another member state for reasons relating in particular to safety, health, or protection of the environment. For example, member states must notify any measure which imposes a general ban, or requires a product to be modified or withdrawn from the market. Whereas the notification procedure for draft technical regulations mentioned above acts on the period preceding the adoption of technical regulations, this procedure deals with measures taken after the adoption of technical regulations. So far, the new procedure has produced limited results. The general level of notifications remains very low (33 in 1997, 68 between 1.1.98 and 15.10.98) which, according to the European Commission, may indicate that the mechanism is under-used.[16]

To the extent that notified prospective regulations are not based on relevant international standards, the European Commission transmits the information to the WTO Secretariat and other WTO members in accordance with the WTO Agreement on Technical Barriers to Trade (TBT). Similarly, notification required under other WTO provisions, such as the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS), or regular notifications in the framework of WTO Agreements on Agriculture, Rules of Origin, Import Licensing, etc., is made to the WTO by the European Commission on behalf of member states. WTO members may comment on the drafts and the notifying country has to react. If not, the case may be raised in the WTO system via the TBT Committee and if this does not lead to an acceptable solution, then it is dealt with through the dispute settlement procedure. Fol-

Box 1. **EU notification requirements**

Provision of information in the field of technical regulation in the European Union

To avoid erecting new barriers to the free movement of goods, which could arise from the adoption of technical regulations at the national level, EU member states are required by Directive 98/34 (which has codified Directive 83/189) to notify all draft technical regulations on products, to the extent that these are not a transposition of European harmonised Directives. This notification obligation covers all regulations at the national or regional level, which introduce technical specifications, the observance of which is compulsory in the case of marketing or use; but also fiscal and financial measures to encourage compliance with such specifications, and voluntary agreements to which a public authority is a party. Directive 98/48 recently extended the scope of the notification obligation to rules on information-society services. Notified texts are further communicated by the Commission to the other member states and are in principle not regarded as confidential, unless explicitly designated as such.

Following the notification, the concerned Member State must refrain from adopting the draft regulations for a period of three months during which the Commission and other member states vet the effects of these regulations on the Single Market. If the Commission or a member state emit a detailed opinion arguing that the proposed regulation constitutes a barrier to trade, the standstill period is extended for another three months. Furthermore, if the preparation of new legislation in the same area is undertaken at the European Union level, the Commission can extend the standstill for another twelve months. An infringement procedure may be engaged in case of failure to notify or if the member state concerned ignores a detailed opinion.

Similarly, as far as standards are concerned, Directive 83/189 provides for an exchange of information concerning the initiatives of the National Standardisation Organisations (NSOs) and, upon request, the working programmes, thus enhancing transparency and promoting co-operation among NSOs. The direct beneficiaries of the notification obligation of draft standards are the member states, their NSOs and the European Standardisation Bodies (CEN, CENELEC and ETSI). Private parties can indirectly become part of the standardisation procedures in countries other than their own, through their country's NSOs, which are ensured the possibility of taking an active or passive role in the standardisation work of other NSOs.

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lowing the TBT and SPS Agreements, an enquiry point about standards and technical regulations has been established in Spain.

Overall, as the technical regulations are subject to the EU Directives on notification requirements, this acts as an important check and balance feature to minimise the emergence of obstacles to the free movement of goods within the EU. The effectiveness of the notification requirement is likely to be proportional to the amount of information available and the facility with which interested parties can effectively use the three-month period to influence or pre-empt the adoption of trade inhibiting standards. In this respect, two aspects of the notification requirement are worth emphasising. First, only the titles of draft technical regulations are published in the Official Journal of the European Communities but underneath an abstract title important dimensions may miss the attention of observers. Second, the notification process is basically a member-to-member process in which the concerned of private citizens or organisations must first be processed through the government of one EU member or the EU Commission before it is transmitted to the author member of the draft technical regulations. Therefore the access is indirect. The creation of an Internet site by the EU Commission for the dissemination of information about draft technical regulations has the potential to improve further the transparency in the elaboration of technical regulations.

2.1.3. *Transparency in the elaboration of voluntary technical standards*

The only Spanish national standardisation body entrusted with the responsibility to prepare voluntary technical standards (standards) is AENOR (*Asociación Española de Normalización y Certificación*). It is not allowed to subcontract the drawing up of standards. It is required by law to elaborate national standards with the open participation of all interested parties, without any nationality-based discrimination. It is the Spanish member of the European Standardisation Committee (CEN) and the European Committee for Electrotechnical Standardisation (CENELEC).

AENOR participates in the development of European standards and is responsible for the transposition as UNE (*Una Norma Española*) standards of all standards published by other European Standardisation Bodies, as well as for their diffusion, promotion and marketing. It is the national standardisation body in Spain for the European Institute of Telecommunications Standards (ETSI) and is responsible for managing the public consultation process in Spain and for adopting ETSI standards. AENOR is a member of the Pan American Technical Standards Commission (COPANT). At the international level, it is the Spanish member of the International Standardisation Organisation (ISO) and of the International Electrotechnical Commission (IEC). It has also adopted the WTO TBT Code of Good Practice for the Preparation, Adoption and Application of Standards.

The creation of a UNE or voluntary standard takes place in one of AENOR's 136 Technical Standardisation Committees (TSC) in charge of developing standards in specific fields of activity. The TSCs gather manufacturers, consumer associations, government representatives, testing laboratories and certification bodies, and other entities that can be affected by the development of standards. When a draft is under preparation, the firms and other interests, which are considered most affected by the project, are informed and invited to participate in the meetings. AENOR's rules indicate that committees must consider the participation of other standardisation bodies, which are members of CEN/CENELEC. More broadly the participation of foreigners, including from outside the European Union, is not restricted. Decision-making is based insofar as possible on consensus and an attempt is made to avoid resorting to the voting system. Any business or professional organisations, including any manufacturer or individual, can call for the creation of a standard on concrete technical specifications.

Once a draft standard is approved by the concerned TSC, the title of the draft standard is published in the Spanish Official Journal and any individuals and legal entities are invited to submit comments. The time period for public consultation is set on a case by case basis. AENOR's publication, UNE *magazine*, plays a role in raising attention by publishing a list of new works initiated and of projects that will be subject to public consultation. After examining the comments, the TSC prepares a final proposal, which has to be approved by the governing bodies of AENOR.

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Eventually, the finalised standard is notified in the Official Journal and included in AENOR's catalogue. AENOR provides information on all stages of the process, from the initiation of work to publication, in its monthly publication. Its Internet website (*www.aenor.es*) includes a search engine for Spanish standards and draft standards. New or modified voluntary standards are also subject to the notification obligations set up under the EU Directive 98/34. Overall, the preparation of voluntary technical regulations is subject to more stringent transparency and public consultation procedures than official technical regulations.

The European Commission has recently taken further initiatives to promote transparency and facilitate the understanding by market participants of the rules governing the Single Market. In a 1998 report, the Commission called for further efforts to bring standardisation and standards to the attention of market participants, in particular SMEs.[17] The European Commission has created new information points, notably on its Internet website. A one-stop Internet shop for business recently opened on the European Commission Internet website under the name "Dialogue with Business".[18] It provides business with general information on Single Market rules and some key issues, such as technical standards or public procurement. The site is linked to "Euro Info Centres", which are set up all over the European Union and specialise in technical standards. They can provide business with information on the application of standards, conformity assessment procedures, CE-marking or quality initiatives in Europe. The European Commission has also very recently opened a new website in co-operation with the European standardisation bodies, which gives information on European New Approach directives and harmonised standards.[19]

Overall, the elaboration of voluntary technical standards is subject to rigorous criteria in terms of transparency and public consultation. First, the titles of draft standards are published in the Spanish Official Journal. Second, in terms of public consultation, participation in AENOR's Technical Standardisation Committees is not restricted. Third, AENOR provides information on all stages of the elaboration process of voluntary standards, including the availability of draft and finalised voluntary standards through the Internet. These act as major check and balance features to minimise the emergence of obstacles to the free movement of goods within the EU. The world community benefits directly from the application of the transparency procedures and indirectly through the reduced risk of regulatory capture.

Box 2. The structure of AENOR

AENOR was established in 1986. It is a private and independent non-profit association. It is the only Spanish national standardisation body entrusted with the responsibility to prepare voluntary technical standards. AENOR is accredited by ENAC (*Entidad Nacional de Acreditación*), the Spanish accreditation body, as a certification body for quality systems ISO 9000, environmental management system ISO 14001, and quality system QS 9000 for the automobile sector as well as certification products (EN 45011 and EN 45018).

According to its statutes, any individual or any legal entity, public or private, which shows a special interest in the development of standardisation and certification activities can be admitted as a member of the Association. There is no discrimination based on nationality. Among its 937 members, there are 139 corporate members (professional business organisation representing all the economic and industrial sectors as well as national consumers associations), 660 joined members (firms), and 138 individual members.

The structure of AENOR is composed of a Board of Management, a Standing Committee and is headed with a president. The composition of the Board of Management, which cannot have more than 70 members, must guarantee an adequate representation of the different types of members and interested parties. It includes ten representatives of public authorities and eight members chosen by the Assembly from among organisations interested in the activities carried out by AENOR. The remaining members are elected on a sectoral basis. The president, a minimum of six members, and a representative of public authorities form the Standing Committee.

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2.1.4. *Government procurement*

In OECD countries, although government procurement procedures are in principle transparent, the cost of retrieving relevant information can be substantial for small-, medium-sized and foreign enterprises. Specifications with no obvious relationship to the nature of the contract involved can be used to disqualify bids. Appeal procedures may not be clearly established or may be so burdensome that contractors will not even consider recourses in cases of alleged infringement of procedures. In this connection, foreign and domestic participants have legitimate expectations about the appropriate degree of transparency that domestic government procurement procedures should abide to.

The Spanish legal framework on government procurement procedures transposes the guiding principles provided for in the EU Government Procurement Framework, which is based on six substantive Directives.[20] The substantive Directives apply to procurement procedures of all member states and their regional and municipal administrations. They provide for the principles of transparency, non-discrimination and equal treatment, which altogether enhance competition.

In Spain, the "*Ley de Contratos de las Administraciones Públicas*" (Law 13/1995) consolidates the various legislative instruments applied to transpose prevailing EU Directives. Spain benefited from derogation periods to transpose the Remedies Utilities Directive (92/13) and the Public Supplies Directive (93/36) (a similar derogation was granted to Portugal and Greece). Although the Commission has sent some letters of formal notice to Spain for non-transposition of procurement Directives at the required deadlines, the issues were resolved without recourse to the advance stages of the EU infringement procedures (the delivery of reasoned opinion by the Commission or references to the Court of Justice). A draft law was recently submitted to Parliament with the objectives of modifying certain provisions of the Law 13/1995 to incorporate recent amendments to EU Directives that implement the WTO Government Procurement

Box 3. **The EU government procurement framework**

The transparency principle is applied concretely through various requirements. Contracting authorities must prepare an annual indicative notice of total procurement, by product area and exceeding an annual minimum threshold, which they envisage awarding during the subsequent 12 month period. The annual indicative list and any contract whose estimated value exceeds specific thresholds must be noticed in the Official Journal of the European Communities. Contracts must indicate which of the permissible award procedures is chosen (open, restricted, or negotiated procedures) and they must use objective criteria in selecting candidates and tenders, which criteria must be known beforehand. Contracting authorities are also obliged to make known the result of contract procedures through a notice in the Official Journal of the European Communities.

Member states are also obliged to provide appropriate procedures for judicial review of decisions taken by contracting authorities that infringe Community laws or national implementing laws. In particular, they have to provide for the possibilities to implement interim measures, including the suspension of contract award procedures, for setting aside decisions taken unlawfully and for awarding damages to persons harmed by an infringement. The EU Directives require that these procedures shall be effectively and rapidly enforced. The appreciation of these qualitative criteria is likely to be a difficult task in practice due to the diversity of culture and judicial systems among EU member states.

With respect to the twin principles of non-discrimination and equal treatment, the main requirements involve: the use of minimum periods for the bidding process; the use of recognised technical standards, with European standards taking precedence over national standards; and the prohibition against discrimination as provided under the Treaty of Rome. The latter prohibits any discrimination or restrictions in awarding of contracts on the grounds of nationality and prohibits the use of quantitative restrictions on imports or measures with equivalent effect. It also provides for the freedom of nationals of one member state to establish themselves in the territory of another member state and the freedom to provide services from any member state. The EU Directives on mutual recognition of professional services and the New Approach for technical standards (see Box 3 in Section 2.4) further contribute to minimise potential incidences of discrimination.

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Agreement. The draft law also provides for a set of tighter rules to better protect contracting authorities against requests by contractors for additional payments due to unexpected cost overruns on top of the agreed terms spelled out in the contract.

Overall, by virtue of the application of the transparency, non-discrimination and equal treatment principles, firms and individuals from EU member states directly gain significant benefits in terms of equal opportunities to compete for public contracts from Spanish awarding authorities. Non-EU firms and individuals directly gain from the overall transparency of binding EU procurement rules and indirectly through the enhanced competitive conditions conferred by the openness of the Spanish investment rules, the non-discrimination and equal treatment principles. The European Commission also undertook specific commitments in the context of the WTO Government Procurement Agreement (GPA), which lists the contracting authorities of each EU member state, including Spain, that are subject to the Agreement.

2.1.5. *Customs procedures*

In any country, importers can incur significant cost overruns when shipments are held in customs warehouses as a result of inefficiencies in customs procedures. The corruption of customs officials is also encouraged when regulations provide them with wide discretionary powers. As customs tariffs are generally low within OECD countries, cumbersome customs procedures are increasingly perceived by traders as major trade obstacles and are often assimilated as non-tariff barriers. Against this background, achieving greater efficiency in customs procedures, through transparent and even application (non-discrimination) of procedures, is a necessary complement to trade liberalisation initiatives.

Similarly, the lack of transparency or uneven application of customs regulations and procedures between various ports of entry can encourage traders to engage in port shopping to find out which entry ports will provide them more favourable conditions. The implications go far beyond the simple loss of government incomes. Inconsistency and lack of transparency undermine the trade policy framework and provide competitive advantages to traders that have benefited from more favourable treatment. Trade flows may then be diverted from entry ports for reasons other than transportation efficiency.

The Spanish Customs authorities oversee 125 customs entry ports distributed throughout the Spanish territory. They have effectively applied a computerised system based on the United Nations Electronic Data Interchange Protocol and harmonised data-set (UN/EDIFACT) since 1994 for export transactions and 1996 for import transactions.[21] The EDI system enables users to submit their import and/or export declarations to customs authorities and to receive customs permissions through electronic exchange. Spanish authorities estimate that EDI declaration forms are used on about 70% of import declarations and 95% of export declarations. With the proper use of EDI-based declaration forms, goods can be customs cleared within a few seconds. Before the implementation of the computerised EDI-based system for imports, Spanish authorities estimated that the average customs clearance time was four hours per transaction.

The Spanish authorities and other EU authorities apply the principle of risk assessment for the physical inspection of shipments and more in-depth verification of documentary forms. Carrying out a physical inspection of all shipments would result in significant delays for users in entry ports and translate into inefficiency costs for both users and customs authorities. A simplified declaration system is also used, based on periodical entry declarations to facilitate customs procedures for frequent and reliable users. It is estimated that this simplified procedure is now used in Spain on about 30% of the total import traffic.

Overall, ensuring that transparency and non-discrimination are effectively enforced in the application of EU customs procedures is a very complex task given the number of entry ports involved and the cultural diversity of EU member states. Pursuing greater simplification and harmonisation of customs procedures is a necessary complement to trade liberalisation initiatives as cumbersome procedures can hinder trade and translate into high transaction costs for traders. In the light of the efficiency gains for parties concerned, the EU Commission should attach a top priority to the following: the implementation of an EU-wide electronic-based system for customs procedures; the implementation of a new computerised transit system (NCTS) throughout the EU; the development of a comprehensive Internet site; and the preparation of a new consolidation of the EU Customs Code.

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Box 4. The EU customs procedures

There are over 3 000 customs entry ports within the European Union distributed within its 15 member states to respond to air, sea and land border crossing points. EU customs procedures are carried out in the 11 official languages. Customs officials are not only responsible for the administration of trade policy measures, including customs duties, rules of origin and tariff-quotas, but also for the application of respective national value-added taxes, excise taxes, and a whole range of country-specific national regulations, covering pornography, weapons, health and sanitary protection. In total, EU customs authorities estimate that they are responsible for the application of over 400 different regulatory measures. The task of managing in a coherent way which ensures an even application of EU customs procedures throughout the 15 different national administrations is therefore colossal, by any standards.

Within the EU, the administration of customs procedures is decentralised among the member states and the Commission assumes a co-ordinating role. Harmonisation of customs procedures is provided by the application of the Community Customs Code for all member states and a structure of EU committees is set up for ensuring a proper cohesion. One of these committees is the EU Customs Code Committee, which examines necessary amendments to the Customs Code. The latter contains over 250 articles and some 900 amendments were approved since 1996, when the last consolidation of the EU Customs Code was realised. In March 1998, Spain has published a Spanish compilation of the EU Customs Code and its amendments, which are now available on the Internet.

Amendments to the Customs Code must be properly notified in the Official Journal of the European Communities before they are enforced. Keeping track of EU amendments is the day-to-day reality for professional customs brokers and their ignorance can imply significant transaction cost overruns and additional administrative burdens on them or their clients. The EU Customs Code and its amendments are not yet available on the Internet. The Commission is currently considering the creation of an Internet site to disseminate the relevant information.

The implementation of the Single Market in 1993 and the Schengen Treaty, eliminating intra-EU border checking for several EU member states, have stretched the limits of the EU paper-based transit procedures and exposed its weaknesses.[1] A temporary Committee of Inquiry was established in December 1995 by the European Parliament to examine the alleged problems with the Community transit system. The four-volume report of the Committee concluded that transit procedures were indispensable for the functioning of the Single Market and recommended a series of recommendations, including the adoption of a comprehensive computerised transit system and the reform of the guarantee system.[2] The Commission has effectively modified several provisions of its transit system and has invested in the development of a new computerised transit system (NCTS). The Commission hopes to implement its first pilot project on the NCTS in 1999. Spain was selected to be among the first EU member states to implement the pilot project on the NCTS in recognition of the advanced development of its computerised transit system.

1. The transit procedures aim at facilitating trade within a given customs territory or between separate customs territories. Its essence is to allow the temporary suspension of customs duties, excise and VAT payable on goods originating from and/or destined for a third country while under transport across the territory of a defined customs area.
2. For more details, see Committee of Inquiry into the Community Transit System, Final Report and Recommendations, February 1997, European Parliament, PE 220.895.

2.1.6. *Multilateral transparency commitments*

The General Secretariat for External Trade from the Ministry of Economy and Finance (*Ministerio de Economía y Hacienda*) oversees the implementation of transparency provisions relating to Spanish obligations contained in the WTO and other trade agreements. This oversight concerns not only obligations regarding transparency but those concerning non-discrimination and national treatment. The EU Commission also plays a similar role at the EU level for subjects falling within its purview. With regards to the elaboration of domestic regulation, the General Secretariat reviews all draft regulations that may have an impact on trade and investment.

The General Secretariat also participates actively in the Inter-ministerial Commission for WTO negotiations (CIOMC), which has two main functions. The first is to play a co-ordinating role for determining Spanish positions concerning WTO trade negotiations. The second is a co-ordinating role in encouraging

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government-wide awareness of and respect for international obligations relating to domestic regulatory matters, such as the WTO/GATT Article III (national treatment on internal taxation and regulation) and regulatory commitments arising from other WTO Agreements, such as the Technical Barriers to Trade (TBT) and the Sanitary and Phytosanitary Measures (SPS). Units of the General Secretariat act as the contact points for both the TBT and SPS Agreements.

2.1.7. *Autonomous communities in* Spain

In Spain, sub-national and supranational levels are inextricable elements of the regulatory framework, and developments at one level can affect developments at the others. From a highly centralised system in which there were two levels of government, Spain has moved to a three-tier system composed of central, regional, and local governments. The regional level is made up of 17 self-governing or autonomous communities established between 1978 and 1983. The local level is sub-divided into two tiers: 50 provinces and about 8 000 municipalities. Given the important responsibilities of the autonomous regions and large cities, the potential would exist for conflicting regulations that would frustrate the free circulation of goods and services within the Spanish territory. However, to the extent that EU Single Market Directives also apply to the autonomous regions and large cities of Spain, the potential risk of conflicting regulations is considerably reduced.

With a political momentum toward devolution, the central government has concentrated its resources in reinforcing co-operation instruments. A web of intergovernmental boards or "sectoral conferences" has been created since the early 1980s to prevent conflict and improve communication between the national government and the autonomous communities. In mid-1999, 27 sectoral conferences are operating. Chaired by the responsible national minister, each conference specialises in policy areas (education, health, industry and energy, labour, etc.). The meetings cover the subjects of interest to both parties, though the central government decides whether a consultation is necessary. It is through these fora that each national ministry consults with the autonomous communities on legal proposals and European Directives before they are submitted to Parliament.

As a complement to the sectoral conferences, the central government also established in January 1999 new institutions and co-operation instruments. The Bilateral Co-operation Commissions (*Comisiones Bilaterales de Cooperación*) between the central government and individual autonomous communities is intended to permit a more focused and prompt approach to problems. The 1999 reform also established a new form of agreement, "co-operative convenants", that provides an institutional framework to develop joint plans and programmes between the different governments on particular issues. Assessing the application of the efficient regulation principles by the autonomous and large cities is beyond the scope of the current study. Through the co-operation institutions between the central government and autonomous communities, the central government should promote the awareness and encourage respect of the efficient regulation principles. The background report on Government Capacity to Produce High Quality Regulation provides more detailed information about the co-ordination between levels of government.

2.2. Measures to ensure non-discrimination

Application of non-discrimination principles aims to provide effective equality of competitive opportunities between like products and services irrespective of country of origin. Thus, the extent to which respect for two core principles of the multilateral trading system – Most-Favoured-Nation (MFN) and National Treatment (NT) – is actively promoted when developing and applying regulations is a helpful gauge of a country's overall efforts to promote trade and investment-friendly regulation.

Article 1 of the Spanish Constitution includes a general prohibition against discrimination and through membership in the WTO Spain subscribes to the MFN and national treatment principles. It falls upon the General Secretariat for External Trade to act as an oversight agency to ensure that the implementation of non-discrimination and national treatment provisions stemming from the WTO and other international trade and trade-related investment agreements are effectively implemented. Within the WTO dispute settlement process, trading partners have the opportunity to request consultation with Spain and/or the EU Commission, depending on the area of competence, for alleged infringement of any WTO obligations

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including MFN or national treatment obligations. If the consultation does not lead to a mutually satisfactory outcome, trading partners have the right to request the establishment of panels which will examine the case and prepare a report on the compatibility of the alleged measures with WTO obligations.

In early 1999, there were no outstanding consultations or panel deliberations directly targeting Spanish policies. However, given the EU Commission competence on trade issues, there were several outstanding dispute settlement procedures in which trading partners are alleging infringement of WTO obligations by the EU. Since the EU acts on behalf of its member states on trade policies, it is not possible disassociate any member state, including Spain, from EU trade policy stances. The majority of the complaints involved the EU agricultural policies and its import regime for agricultural products covering such products as: bananas, butter, coffee, rice, grains, cereals, processed cheese and meat (hormones). Conversely, the EU on behalf of its member states is pursuing several WTO dispute settlement procedures against alleged incompatible measures by trading partners. The EU is one of the largest trading partners in the world and it has a strong interest in preserving the integrity of the WTO dispute settlement procedures. Overall, it is acting in good faith in responding to complaints by trading partners and in abiding to the WTO Panel decisions.

Overtly discriminatory regulatory content is fairly exceptional when viewed from an economy-wide context and against the wide WTO and regional trade commitments entered into by the EU. Existing measures that discriminate against foreign ownership are the exceptions to an overall liberal investment regime. EU and non-EU foreign investors are still subject to an authorisation requirement for investing in the defence-related sector. These types of exceptions are fairly limited in scope and complete or partial deregulation across many sectors of the economy has already generated attendant pro-competitive effects for international market openness. A few areas deserve some attention, however, such as preferential trade agreements and trade in services. Each of these is reviewed below.

2.2.1. *Preferential trade agreements*

While preferential agreements give more favourable treatment to specified countries and are thus inherent departures from the MFN and NT principles, the extent of a country's participation in preferential agreements is not in itself indicative of a lack of commitment to the principle of non-discrimination. In assessing such commitments, it is relevant to consider the attitudes of participating countries towards non-members in respect of transparency and the potential for discriminatory effects. Third, countries need access to information about the content and operation of preferential agreements in order to make informed assessment of any impact on their commercial interests. In addition, substantive approaches to regulatory issues such as standards and conformity assessment can introduce the potential for discriminatory treatment of third countries if, for example, standards recognised by partners in a preferential agreement would be difficult to meet by third countries.

Since its EU accession in 1986, Spain has *de jure* participated in all preferential trade agreements entered into by the EU. The most relevant ones are the Free Trade Agreements (FTAs) with the European Free Trade Association (EFTA), the European Economic Area (EEA), several European Agreements with Central and Eastern European Countries (CEECs), and several Euro-Mediterranean Agreements.[22] The European Union has entered into preferential non-reciprocal agreements with several Mediterranean countries, in the context of the Lomé Convention and the EU General System of Preferences (GSP) in favour of developing countries.

To the extent that the various FTAs are comprehensive in scope, the likelihood is that these will generate trade creation processes larger than the trade diversion inherent in any FTA. In the context of the increasing number of FTAs entered into by the EU, Spain has gradually been exposed to incremental levels of increased competition and, conversely, gained preferential access to new markets. The EU Commission is currently negotiating a free trade agreement with Mexico.

The attitude of participating countries towards non-members may be assessed against their willingness to extend on a multilateral basis the benefits of their preferential agreements. In this connection, Spain supports the European Commission's position seeking to maintain the momentum in trade liberalisation and for the launching of a comprehensive round of multilateral trade negotiations in the WTO. In particular, the Com-

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mission favours a global approach for WTO negotiations that would seek to improve market access for industrial goods, agricultural products and services. It would also seek improvement in multilateral rules in the areas of trade facilitation, government procurement, investment and competition dimensions.

2.2.2. *Trade in services*

As a member in the WTO General Agreement on Trade in Services (GATS), Spain has undertaken international commitments in the field of services, including in the sectoral annexes to the GATS and more recently the Financial Services and Basic Telecommunications Agreements concluded in 1997. Under the GATS, specific commitments and the list of exemptions from MFN treatment are made according to four modes of supply for each services sector concerned (cross-border supply, consumption abroad, commercial presence, and presence of natural persons). For the then 12 EU member states, a single schedule of specific commitments was decided at the EU-wide level and submitted to the WTO on behalf of the EU. The specific commitments are composed of EU-wide commitments and exemptions as qualified by the additional restrictions attached by individual member states.

To evaluate the level of market access and national treatment afforded by the EU and Spain, in particular, it is necessary to examine the range of activities covered in each services sector and the limitations on market access and national treatment pertaining to the different modes of supply, including any specific additional limitations by Spain. In addition, since the EU has tabled a list of MFN exemptions, this must be examined in order to assess the extent to which the Commission gives preferential treatment to, or discriminates against, one or more trading partners.

While it is not the purpose of this study to examine in detail the extent of EU and Spanish commitments and exemptions under the GATS, the following gives some examples. The EU schedule shows that the EU undertook sector-specific commitments in a large number of sectors. However, it did not offer any commitments in the following sectors: postal services; courier services; audio-visual services; other education services; libraries, archives, museum and other cultural services; maritime transport; internal waterways transport; space transport, and pipeline transport.

By mode, the EU limitations are mostly at member state level for cross-border supply (*e.g.* business and financial services sectors); while consumption abroad is mostly bound as no restrictions. The principal limitations to commercial presence arise from requirements on the legal form of the service provider at both EU-wide and individual member state level; some of these are limitations on national treatment, as they apply only to third country providers. Movement of natural persons is subject to general limitations applying to all sectors; with some additional member state limitations at sectoral level (*e.g.* education services, professional services, financial services). The list of MFN exemptions tabled by the EU shows a number of sectoral exemptions, which apply in Spain, including audio-visual services; road transportation services (passenger and freight); the marketing of air transport services; and direct non-life-insurance.

Spain maintains few additional limitations concerning certain professional services, mainly relate to commercial presence. In telecommunications services, Spain temporarily limited market access to one additional nation-wide licence between January and December 1998, after which full liberalisation was granted. Concerning the movement of natural persons for architectural services and engineering services, Spain limits market access to natural persons and requests the recognition of their professional qualifications.

2.3. Measures to avoid unnecessary trade restrictiveness

To attain a particular regulatory objective, policy makers should seek regulations that are not more trade restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Examples of this approach would be to use performance-based, rather than design standards as the basis of a technical regulation, to use tariffs instead of quantitative restrictions requiring the allocation of import permits, or to consider taxes or tradable permits in lieu of regulations to achieve the same legitimate policy goal. At the procedural level, effective adherence to this principle entails consideration of the extent to which specific provisions require or encourage regulators to avoid unnecessary trade restrictiveness and the rationale for any exceptions, how the impact of new regulations on international trade and

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investment is assessed, the extent to which trade policy bodies as well as foreign traders and investors are consulted in the regulatory process, and means for ensuring access by foreign parties to dispute settlement.

In Spain, the principal tool for measuring the potential effects of proposed regulations is the Evaluation Questionnaire, which is prepared by ministries. As discussed in Section 2.1.1, its quantitative assessment is limited to a budgetary accounting exercise. There are no specific parameters by which to analyse the economic impacts of draft regulations and no explicit efficiency principles to guide officials in deciding which regulatory instruments are best suited in the circumstances. In this connection, no attempts are made to assess draft regulations against the principle of avoidance of unnecessary trade restrictiveness.

It may be argued that this principle is informally taken into consideration when the Inter-Ministerial Commission for WTO Negotiations meets to consider draft regulations that have potential effects on trade and investment. As well, nothing bars the General Secretariat for External Trade from suggesting or promoting alternative regulation that is least trade restrictive. However, since the principle of avoidance of unnecessary trade restrictiveness is not codified in any official manner when draft regulations are elaborated and considered, there is no guarantee that it would effectively be taken into consideration.

There is at least one case that illustrates the absence of consideration of the unnecessary trade restrictiveness principle. It involves the EU banana import regime, which provides for the use of both a quota in favour of selected developing countries and a tariff as regulatory instruments. Given the European Commission's competence in trade issues, the member states are jointly responsible for EU trade stances. This case is directly relevant for Spain, given that it produces bananas on the Canary Islands, which represent about 80-85% of Spanish consumption and about 10% of the EU banana consumption. The allocation of import licences is restraining trade and causing significant trade distortions. It has been the subject of long trade disputes with trading partners within the GATT and the WTO. The issue at stake is not to question the policy legitimacy of the EU banana import regime nor its WTO compatibility. The issue here is whether other regulatory instruments can simultaneously achieve the desirable policy objectives and, at the same time, avoid unnecessary trade restrictiveness. This case illustrates the need to systematically check draft regulations against the principle of avoidance of unnecessary trade restrictiveness, along with the other economic principles, when draft regulations are elaborated. This illustrative case of trade restrictive regulations on banana imports also suggests that the Commission should apply the efficient regulation principles when elaborating trade regulations on behalf of member states.

2.4. Use of internationally harmonised measures

Compliance with different standards and regulations for like products in different markets often presents firms wishing to engage in international trade with significant and sometimes prohibitive costs. Thus, when appropriate and feasible, reliance on internationally harmonised measures (such as international standards) as the basis of domestic regulations can facilitate trade flows. National efforts to encourage the adoption of regulations based on harmonised measures, procedures for monitoring progress in the development and adoption of international standards, and incentives for regulatory authorities to seek out and apply appropriate international standards are thus important indicators of a country's commitment to efficient regulation.

As an EU member state, Spain takes part in the harmonisation process, which was launched in the field of technical regulations and standards to achieve the Single Market. Since 1985, harmonisation has been guided by the "New Approach" adopted by the European Council. Under the New Approach, EU technical regulations no longer seek to define detailed rules, but rather define the "essential requirements" which products placed on the EU market must meet if they are to benefit from free movement within the EU. This more flexible policy approach is applied where possible, instead of harmonisation of detailed technical specifications for products.

Following a mandate issued by the European Commission, the European standardisation bodies have the task of drawing up the technical specifications meeting those essential requirements (such specifications are referred to as "harmonised standards"). Compliance with harmonised standards is voluntary but it grants products a presumption of conformity with the essential requirements. Under the New Approach, manufacturers are free to use any other technical specification they deem appropriate to meet the essential requirements defined by EU Directives. The New Approach benefits European manufacturers, but also non-

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European manufacturers, as they too are not required to use specific technical rules, but simply have to demonstrate compliance with the essential requirements (for further details on the New Approach, see Box 5).

The notification procedure of national draft standards and technical regulations under EU law aims at ensuring the transparency of national initiatives, but it also plays a role in promoting the European harmonisation process. The notification procedure enables the Commission to propose the approximation of laws in areas where barriers are likely to appear and harmonisation is necessary. The Commission can intervene at an early stage and suggest harmonisation before barriers have actually emerged. It can impose a blockage of draft national regulation for twelve months when the regulation deals with a matter covered by a Commission's proposal. The Directive establishing the notification procedure also gives the Commission the possibility to mandate European standardisation bodies with the task of elaborating European standards in a given field. In such cases, national standardisation bodies must observe a standstill period during which they cannot carry out any work on the mandated subject.

The Spanish standardisation body, AENOR, is committed to using international standards as a basis for national standards. This commitment is clearly referred to in the Founding Act which lists as one of its objectives: "*To promote the co-ordination of standardisation work and the drawing up of norms and their harmonisation with the norms and recommendations internationally recognised*". In line with this objective, AENOR signed the Code of Good Practice for the Preparation, Adoption and Application of Standards of the WTO Agreement on Technical Barriers to Trade. It is therefore subject to the obligation to use international standards as a basis for the preparation of its own standards. The Spanish legislation also specifically requires that national standardisation bodies be a member of European and international organisations for standardisation and actively participate in their work.[23] AENOR is thus active in regional and international standardisation organisations and takes part in the development and diffusion of international standards.

Membership in European standardisation bodies implies that AENOR must transpose as Spanish standards all European standards elaborated by the European Committee for Standardisation (CEN) and the European Committee for Electrotechnical Standardisation (CENELEC). When a European standard is approved, AENOR must make a public notice of the code and title of the European standard, transpose it as a national standard within six months following the date from which the European standard is available in the three official languages, and eliminate any national standards technically divergent. This obligation stands even in the cases where AENOR voted against the adoption of the standard. AENOR is also responsible for adopting, publishing and marketing the standards published by the European Telecommunications Standards Institute (ETSI). ETSI standards are available on its internet site (*www.etsi.org*).

Reflecting the harmonisation effort in the EU, Spanish standards increasingly result from the transposition of European standards. In recent years the number of standards in AENOR's catalogue has expanded significantly, as a result of a growing number of European standards which AENOR transposes. This number rose by 50% between 1996 and 1998, a trend confirmed by the high number of current draft standards transposing European standards (over 4 000, accounting for 80% of the overall number of draft standards). Consequently the share of purely national standards in the catalogue of standards is on the wane. Within two years, between 1996 and 1998, it decreased from nearly 50 to 40% of the total number of standards. Purely national standards account for less than 10% of standards currently under preparation, and their number in the catalogue has decreased in recent years, as new standards do not fully replace withdrawn standards.

Transportation of international standards into Spanish standards is mainly achieved through the harmonisation process at the European level. European standardisation bodies increasingly harmonise according to international standards. A growing number of European standards adopted by AENOR are in fact the result of the transposition of international standards. Additionally, AENOR is committed to the adoption of international standards itself, being 5% of the standards currently under preparation result from the direct adoption of international standards. The basic principle underlying the European standardisation is "subsidiarity" with respect to global standards, based on the assumption that conformity of European standards to global standards is likely to facilitate access of European products to world markets.

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Box 5. The New and Global Approaches

The need to harmonise technical regulations when diverging rules from member states impair the operation of the Common Market was recognised by the Treaty of Rome in Articles 100 to 102 on the approximation of laws. By 1985 it had become clear that relying only on the traditional harmonisation approach would not allow the achievement of the Single Market. As a matter of fact, this approach was encumbered by very detailed specifications which were difficult and time consuming to adopt at the political level, burdensome to control at the implementation level and requiring frequent updates to adapt to technical progress. The adoption of a new policy towards technical harmonisation and standardisation was thus necessary to actually ensure the free movement of goods instituted by the Single Market.

The way to achieve this was opened by the European Court of Justice, with its celebrated ruling on Cassis de Dijon,[1] which interpreted Article 30 of the EC Treaty. In effect, the ruling required that goods lawfully marketed in one member state be accepted in other member states, unless their national rules required a higher level of protection on one or more of a short list of overriding objectives. This opened the door to a policy based on mutual recognition of required levels of protection and to harmonisation focusing only on those levels, not the technical solution for meeting the level of protection.

In 1985 the Council adopted the "**New Approach**", according to which harmonisation would no longer result in detailed technical rules, but would be limited to defining the essential health, safety and other[2] requirements which industrial products must meet before they can be marketed. This "New Approach" to harmonisation was supplemented in 1989 by the "**Global Approach**" which established conformity assessment procedures, criteria relating to the independence and quality of certification bodies, mutual recognition and accreditation.

The New Approach calls for essential requirements to be harmonised and made mandatory by directives. This approach is appropriate only where it is genuinely possible to distinguish between essential requirements and technical specifications; where a wide range of products is sufficiently homogenous or a horizontal risk identifiable to allow common essential requirements; and where the product area or risk concerned is suitable for standardisation. Furthermore, the New Approach has not been applied to sectors where Community legislation was well advanced prior to 1985.

On the basis of the New Approach manufacturers are only bound by essential requirements, which are written with a view to being generic, not requiring updating and not implying a unique technical solution. They are free to use any technical specification they deem appropriate to meet these requirements. Products, which conform, are allowed free circulation in the European market.

For the New Approach, detailed harmonised standards are not indispensable. However, they do offer a privileged route for demonstrating compliance with the essential requirements. The elaboration at European level of technical specifications which meet those requirements is no longer the responsibility of the EU government bodies but has been entrusted to three European standardisation bodies mandated by the Commission on the basis of General Orientations agreed between them and the Commission. The CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standards) and ETSI (European Telecommunications Standards Institute) are all signatories to the WTO TBT Code of Good Practice.

When harmonised standards produced by the CEN, CENELEC or ETSI are identified by the Commission, as corresponding to a specific set of essential requirements, the references are published in the Official Journal. They become effective as soon as these are transposed at least in one member state. These standards are not mandatory. However conformity with them confers to the products a presumption of conformity with the essential requirements set by the New Approach directives in all Member States. In this case the product may be CE-marked.

The manufacturer can always choose to demonstrate conformity with the essential requirements by other means. This is clearly necessary where harmonised standards are not (or not yet) available. Each New Approach directive specifies the conformity assessment procedures to be used. These are chosen among the list of equivalent procedures established by the **Global Approach** (the so-called "modules"), and respond to different needs in specific situations. They range from the supplier's declaration of conformity, through third party type examination, to full product quality assurance.

1. Decision of 20 February 1979, Cassis de Dijon, Case 120/78, ECR, p. 649
2. Energy-efficiency, labelling, environment, noise.

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Box 5. **The New and Global Approaches** (*cont.*)

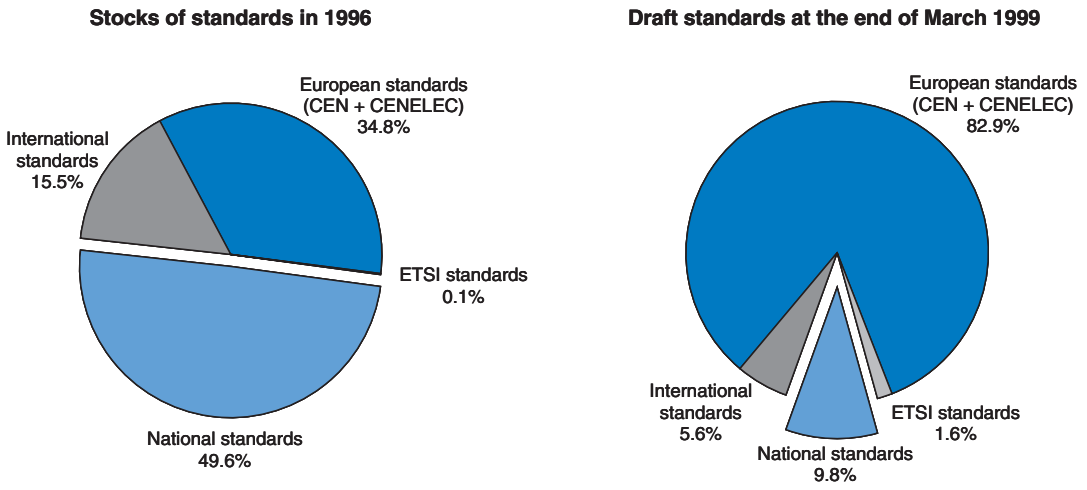
National public authorities are responsible for identifying and notifying competent bodies, entitled to perform the conformity assessment, but they do not intervene in the conformity assessment. When third party intervention is required, suppliers may address any of the notified bodies within the European Union. Products which have successfully undergone the appropriate assessment procedures are then affixed the CE marking, which grants free circulation in all member states, but also implies that the producer accepts full liability for the product.*

The strength of the New Approach and the Global Approach lies in limiting legal requirements to what is essential and leaving to the producer the choice of the technical solution to meet this requirement. At the same time, by introducing EU-wide competition between notified bodies and by building confidence in their competence through accreditation, conformity assessment is distanced from national control. The standards system, rather than being a means of imposing government-decided requirements, is put at the service of industry to offer viable solutions to the need to meet essential requirements, which however are not in principle binding.

The success of the New and Global Approaches in creating a more flexible and efficient harmonised standardisation process in the European Union heavily depends on the reliability of the European standardisation and certification bodies and on the actual efficiency of control by member states. First, European standardisation and certification bodies need to have a high degree of technical competence, impartiality and independence from vested interests, as well as to be able to elaborate the standards necessary for giving concrete expression to the essential requirements in an expeditious manner. Second, each member state has the responsibility to ensure that the CE marking is respected and that only products conforming to the essential requirements are put on its market. If tests carried out by a notified body are cast in doubt, the supervisory authorities of the member state concerned should follow this up.

* See the Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the liability for defective products.

Figure 2. **AENOR standardisation activities**



Source: OECD on the basis of figures provided by AENOR.

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In addition, various initiatives have been developed to promote co-operation in standardisation at the international level. European standardisation bodies have signed co-operation agreements with international standardisation bodies in order to reach the highest possible degree of convergence between European and international standards, and to avoid duplication of standardisation work. In 1991, CEN concluded an agreement with the International Standardisation Organisation (ISO), usually referred to as the "Vienna Agreement". The agreement set up various technical co-operation mechanisms between the two standardisation bodies: exchange of information; possibility for ISO to attend CEN's technical committees as an observer, and conversely; examination by CEN of the opportunity, when a need for a new standard emerges, to ask ISO to undertake the work; parallel approval of drafts by ISO or CEN technical committees; adoption by CEN of existing ISO standards. CENELEC and the International Electrotechnical Commission (IEC) have established a similar co-operation agreement (referred to as the "Dresden Agreement"), and ETSI is a party to various international co-operation agreements, notably with ISO, IEC and the International Telecommunication Union (ITU).

Due to the achievement of the Single Market and the subsidiarity principle, measures to encourage the use of measures harmonised at the international level are mainly related to Spain's membership in the European Union. Integration in the Single Market implies that Spain adopts European Directives, takes part in the harmonisation of technical regulations, and transposes European standards into its own set of standards. By promoting transparency and consultation processes, the EU notification procedures of technical rules provide for safeguards. They put a brake on the elaboration of specific technical rules by national authorities and prevent the emergence of barriers to trade, at least within the Single Market. As for standards, AENOR produces a significant number of purely national standards each year, but it is clear that most of its standards are increasingly European standards (which themselves increasingly rest on international standards).

Harmonisation with Single Market rules is however not total and there are still a significant number of specific national rules produced each year. Over the period 1995-1997, Spain notified 79 technical regulations, which were purely national regulations. Over 75% of these notifications concentrated in four sectors: building and construction, machinery, telecommunications, and foodstuffs and agricultural products (see Figure 3). The persistence of a significant national activity in devising technical rules, which is far from specific to Spain, can be related to the absence of European harmonisation in some areas, but it is also observed in areas where there is EU legislation, but European standards are not available. Member states can thus elaborate new rules in response to quick technological developments, for example in telecommunications. They can consider that safety requires the adoption of detailed rules making the implementation of the essential requirements more precise.

2.5. Recognition of equivalence of other countries' regulatory measures

In cases where the harmonisation of regulatory measures is not considered feasible or necessary, the recognition of other countries' regulatory measures in attaining the same regulatory objective may be the most appropriate avenue for reducing technical barriers related to regulatory divergence. Despite the development of global standards, there are still many specific national rules, which prevent manufacturers selling their products in different countries and from enjoying full economies of scale. Exporters are also increasingly required to demonstrate the compliance of their products with the rules of the country of import through independent testing and certification of the import country, giving rise to additional costs. Reducing trade barriers through recognition of other countries' regulatory measures can be achieved by accepting the equivalence of the standards and technical requirements applicable in other markets, and of conformity assessment results too.

Within the European Union the principle of mutual recognition applies among member states. In its ruling on *Cassis de Dijon* of 1979, the European Court of Justice gave substance to the EU Treaty's principle of free circulation of goods by providing the key elements for mutual recognition. All products lawfully manufactured in one member state must be accepted by the others even when they have been manufactured in accordance with technical regulations which differ from those laid down by existing national legislation, provided they meet the marketing conditions in the originating member state. This benefits

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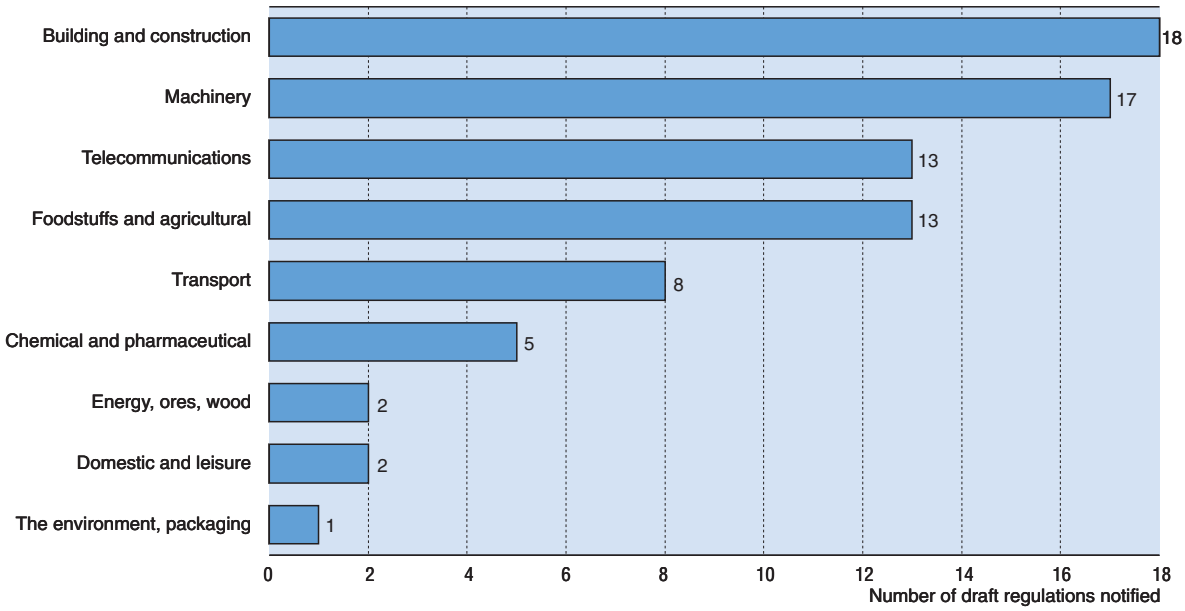
Figure 3. **Draft technical regulations notified by Spain to the European Commission**
Between 1995 and 1997



Source: Official Journal of the European Communities.

Box 6. The EU Mutual Recognition Agreements

The EU has concluded MRAs with Canada, the United States, Australia, and New Zealand, which have recently entered into force.* It has also reached an agreement with Switzerland and Israel and negotiations with Japan are underway. The Community has also launched negotiations on "Protocols on European Conformity Assessment" (PECAs) with the Central and Eastern European Countries (CEECs) in view of these countries' eventual accession to the European Union. The main difference between these PECAs and other MRAs is that PECAs are based on the implementation of the *acquis communautaire* in the area of product regulations in these countries.

Each MRA includes a framework covering general principles and sectoral annexes, which contain provisions for facilitation of trade and the mutual recognition of mandatory conformity assessment procedures (for details on sectoral coverage, see Table 4). The framework agreements specify the conditions under which each party accepts the results of conformity assessment procedures issued by the other party's conformity assessment bodies in accordance with the rules and regulations of the importing party. The results of conformity assessment procedures include studies and data, certificates and marks of conformity. The requirements covered by the agreement are specified on a sector-specific basis in the sectoral annexes.

Under these MRAs, there is no recognition between the parties of the equivalence of their respective regulatory requirements. However, if a conformity assessment body in the exporting country certifies that a product covered by a MRA is in conformity to the requirements set by the importing party, this certification has to be accepted as equivalent by the importing party. In the case of Good Manufacturing Practices and Good Laboratory Practices the parties recognise their manufacturing and laboratory practices respectively. Prospective agreements with the CEECs also provide for the alignment of their legislation with the European legislation to allow for their economic integration into the European Union.

* The MRA with Canada entered into force on 1 November 1998, the MRA with the United States on 1 December 1998 and the MRA with Australia and New Zealand on 1 January 1999.

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EU manufacturers and non-EU countries as well since any product, including a product originating from a third country, marketed in one of the EU country, can circulate freely within the Community (for more details see Box 5 on the New and Global Approaches).

As an EU member, Spain is involved in the Mutual Recognition Agreements (MRAs) negotiated by the European Commission with non-EU countries. Following the adoption of the Global Approach, when the Council stated the need for the Community "*to promote international trade in regulated products, in particular by concluding recognition agreements*",[24] the European Commission has engaged negotiation of MRAs in the field of conformity assessment with trading partners. These agreements intend to promote efficient, transparent and compatible regulatory systems, reduce costs and delays associated with obtaining product approvals in third country markets, and avoid duplication of testing procedures and unpredictability incurred in obtaining approvals.

Box 7. European accreditation

Accreditation is a procedure by which an authoritative body gives formal recognition that a body or person is competent to carry out specific tasks.[1] An accreditation body requires that laboratories, certification and inspection bodies, both in regulatory and non-regulatory spheres, are regularly assessed and audited by a third party as to their technical competence against published criteria. There may be more than one national accreditation body as long as there exists a clear distribution of tasks.

The European Commission has mandated harmonised standards in the EN 45000 series which lay down, inter alia, criteria concerning the technical competence, impartiality and integrity of accreditation bodies. Most are equal to international standards and the remainder are based on them.[2] Accreditation to the relevant EN 45000 standard gives a presumption that a body is competent to carry out conformity assessment according to the Global Approach.

The European Co-operation for Accreditation (EA) (*http://www.european-accreditation.org/*) came into being in 1997. EA aims to promote the international acceptance of certificates and reports issued by organisations accredited by its members. Nationally recognised accreditation bodies in EU and EFTA countries and the EU candidate countries can apply for full membership. Members of EA must fulfil criteria as specified in the relevant European standards published in the EN 45000 series.

EA has established multilateral agreements (MLAs) among its members in the fields of calibration, testing and the certification of respectively products, quality systems, personnel and environmental management systems. EA has also signed bilateral agreements with accreditation bodies in Hong Kong China, Australia, New Zealand, and South Africa. Signatories to the MLAs and to bilateral agreements are subjected to regular peer evaluations.

International co-operation on accreditation is seen as an important supporting measure to promote mutual acceptance of certificates and reports issued by accredited conformity assessment bodies. The International Accreditation Forum (IAF) with members from Europe, Asia and America has established a MLA in the field of quality systems certification and has signatories from 19 countries as of December 1998. The next step may be to expand this MLA to include certification bodies for personnel and environmental management systems.

A corresponding development in the field of laboratory accreditation is underway within the International Laboratory Accreditation Co-operation (ILAC) (*http://www.ilac.org/*). ILAC was formalised as a co-operation in 1996 when 44 national bodies signed a Memorandum of Understanding (MOU). This MOU provides the basis for the eventual establishment of a multilateral agreement between ILAC member bodies. Such an agreement will further enhance and facilitate the international acceptance of test data, and the elimination of technical barriers to trade.

1. The EU Directives are composed of: Terminal Equipment Directive (88/301/EEC); Services Directive (90/388/EEC); ONP Framework Directive (90/387/EEC) and ONP Leased Lines Directive (92/44/EEC). Other EC Directives include: Satellite Directive (94/46/EC); Cable Directive (95/51/EC); Mobile Directive (96/2/EC); Full Competition Directive (96/19/EC) and Licensing Directive (97/13/EC). Finally ONP Interconnection Directive (97/33/EC): ONP Amending Directive (97/51/EC); Telecom Data Protection Directive (97/66/EC); ONP Voice Telephony Directive (98/10/EC).
2. EN 45003, EN 45011, EN 45012, EN 45020 are transpositions of ISO Guides; EN 45001, EN 45002, EN 45004 are based to various degrees on ISO Guides.

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The Spanish accreditation body (ENAC) has signed multilateral agreements (MLAs) sponsored by the European co-operation for Accreditation (EA) in the field of calibration, testing, certification, and environmental management systems. Under these agreements, based on peer evaluation accreditation, bodies accept each other's accreditation systems, recognise and promote the equivalence of each others' certificates and reports issued by bodies accredited under these systems. The need for multiple assessments is thereby reduced or eliminated, as a supplier will only need one certificate or report to satisfy several markets. EA-sponsored MLAs do not only include EU countries, but also non-EU European countries and non-European countries such as Australia, New Zealand, South Africa, or Hong Kong.

Table 4. **Mutual Recognition Agreements concluded or under negotiation by the European Union**

	Mutual Recognition Agreements							Protocols on European Conformity Assessments [4]			
	Australia	New Zealand	United States	Canada	Israel	Japan	Switzer-land	Czech Republic	Hungary	Estonia	Latvia
Construction plant and equipment							✓				N
Chemical GLP[1]			N	N							
Pharmaceutical GMP[2]	✓	✓	✓	✓		N	✓			N	N
Pharmaceutical GLP[1]					✓		✓			N	N
Medical devices	✓	✓	✓	✓		N	✓		N		
Veterinary medicinal products			N								
Low voltage electrical equipment	✓	✓	✓	✓			✓	N	N	N	N
Electromagnetic compatibility	✓	✓	✓	✓		N	✓	N	N	N	N
Telecommunications terminal equipment	✓	✓	✓	✓		N	✓			N	
Pressure equipment	✓N[3]	✓N[3]				N	✓	N			
Equipment and systems used in explosive atmosphere							✓	N			
Fasteners			N								
Gas appliances and boilers							✓	N			
Machinery	✓	✓				N	✓	N	N	N	N
Measuring instruments							✓				
Aircraft	N	N									
Agricultural and forestry tractors							✓				
Motor vehicles	✓						✓				
Personal protective equipment							✓	N	N		
Recreational craft			✓	✓							
Toys							✓				
Foodstuffs										N	N

✓ Concluded.
N Under negotiation.
1. Good Laboratory Practices.
2. Good Manufacturing Practices.
3. The agreement covers simple pressure equipment. Extension to other pressure equipment is considered.
4. In February 1997 the European Commission signed an agreement with Poland regarding preparatory steps on conformity assessment, precursor for a real PECA.

Source: European Commission.

ENAC participates in international fora, which aim at enhancing confidence in the accreditation and certification system. At the European level Spain is involved in the activities of the European Organisation for Testing and Certification (EOTC) which was set up in 1990 following the adoption of the Global Approach. EOTC itself does not certify products but acts as a focal point for conformity assessment in Europe. It promotes mutual confidence between all parties concerned with conformity assessment by assuring that mutual recognition agreements, concluded by testing and certification bodies, comply with agreed criteria and by promoting them. ENAC also participates in the International Laboratory Accredi-

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tation Co-operation (ILAC) and the International Accreditation Forum (IAF). These fora aim at promoting confidence in the accreditation systems and at reducing obstacles to trade by supporting the development and implementation of ISO/IEC standards and guides, exchanging information and establishing multilateral agreements on the equivalence of accreditation programmes operated by their members. A MLA has thus been signed at the international level on quality system accreditation, of which ENAC is a party.

2.6. Application of competition principles from an international perspective

The benefits of market access may be reduced by regulatory action condoning anti-competitive conduct or by failure to correct anti-competitive private actions that have the same effect. It is therefore important that regulatory institutions make it possible for both domestic and foreign firms affected by anti-competitive practices to present their positions effectively. The existence of procedures for hearing and deciding complaints about regulatory or private actions that impair market access and effective competition by foreign firms, the nature of the institutions that hear such complaints, and adherence to deadlines (if they exist) are thus key issues from an international market openness perspective.

In Spain, complaints about perceived business practices that restrict competition may be submitted to the Competition Defence Service (*Servicio de Defensa de la Competencia*), which is part of the General Directorate for Economic Policy and Protection of Competition in the Ministry of Economics and Finance (Ministry). The Competition Defence Service proceeds with a preliminary legal assessment and decides whether or not to refer the complaint to the Competition Tribunal (*Tribunal de Defensa de la Competencia*). The Tribunal, an independent decision-maker, proceeds with an inquiry and may hold hearings but is not required to do so. The background report on The Role of Competition Policy in Regulatory Reform provides greater details about the institutional arrangements.

The Competition Tribunal may issue orders to cease and desist and to eliminate the effects of the violations, and it may impose fines. Since the Tribunal's decisions are administrative, they may be appealed to a special Chamber of the Supreme Court for administrative matters. Criminal proceedings are also possible, in principle, under general provisions of the administrative law. However, in the event of a criminal case, the administrative proceedings in the Competition Tribunal would be suspended. In addition, the Competition Act of 1989 provides that courts can award damages under the civil code, because anti-competitive practices are prohibited *ab initio*. The private remedy through the courts has rarely been used in practice, at least in part, because of the backlog of cases in the courts.

The Competition Defence Service and the Tribunal can exercise a policy advocacy role in the reviewing of legislative and administrative initiatives, *i.e.* privatisation and deregulation. In addition, the Tribunal may on its authority, or upon request, issue reports to any power or organ of the state. However, other regulatory bodies are not required to follow up on the opinion expressed in these reports.

It appears that national treatment applies in the application of the procedures described above, so foreign firms may have effective means of seeking redress for perceived anti-competitive problems. Of course, the fact that a foreign firm and a domestic firm are treated in a like manner does not necessarily mean that the burdens of a complex administrative process might not hamper market access to foreign firms or new entry by domestic firms.

While foreign and domestic firms may receive equivalent treatment in terms of procedures, it is also important to consider the treatment of foreign and domestic firms in substantive legal analysis. A potential problem may arise with the Spanish merger law. The Competition Service is responsible for deciding when to refer a merger to the Tribunal for review of its likely effects in Spain. The Tribunal then recommends to the Council of Ministers what disposition should be applied with respect to the merger. The Tribunal must consider both competition and public interest factors such as industrial or social policies. However, the government makes the ultimate decision. In recent years, Spain has had a fairly lenient approach to mergers. Still, the facts that the government makes the decision and the standards for decision are imprecise and raise a risk that foreign firms may not always be treated equally. It should be underlined that if the Tribunal restricts itself to competition analysis, while leaving to the Council the task of weighing the other public interest factors, this concern would not be eliminated.

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There is a general exemption from Spanish competition law for regulated conduct. While the exemption may apply to both foreign and domestic firms, it may inhibit market access by foreign firms as well as new entry by domestic firms. This may be a particular problem with regard to monopolies authorised by local or regional regulation. For instance, regional governments' limitations on the establishment of new large scale stores and regulation of opening hours may impede the efficient distribution of products offered by new entrants, including foreign entrants, which might require economies of scale in order to access the retail distribution system.

A particular setting for concern is the exertion or extension of market power by a regulated or protected monopolist into another market. The substantive problem, sometimes called "regulatory abuse," is not always reachable by laws about abuse of dominance or monopolisation, or by regulatory laws applied to particular markets. Foreign firms and trade could be implicated in two ways. First, an incumbent domestic regulated monopolist might gain an unfair advantage over foreign products or firms in an unregulated domestic market. Or, an incumbent foreign regulated monopolist might use the resources afforded by its protection at home to gain an unfair advantage in another country.

Recent privatisation and deregulation initiatives have created or strengthened the position of incumbents who might be able to impose strategic barriers that raise the cost of entry to foreign and domestic rivals. Furthermore, the advantage so gained in the domestic market may afford an unfair advantage in foreign markets where such firms compete against their foreign rivals. This might be a concern in network industries, such as telecommunications and electricity. However, recent decisions by the Tribunal against Telefonica for abusing its dominant position and the success of foreign operators in gaining sizeable market shares in the Spanish telecommunications market may help to alleviate this concern. The Tribunal's decisions also demonstrate both that Telefonica may be increasingly subjected to more vigorous competition in its domestic market and that the competition enforcement institutions are willing to take actions to prevent or end the incumbent's anti-competitive practices.

Spain should remain vigilant to ensure that foreign and domestic firms receive equivalent treatment in procedural and practical terms. It also needs to remain vigilant in applying competition policy to newly deregulated sectors and privatised enterprises to ensure that access and entry are not impeded. The background report on The Role of Competition Policy in Regulatory Reform discusses in greater detail competition and competition enforcement dimensions in Spain. It also contains a set of recommendations to further the process of regulatory reform in this area.

3. ASSESSING RESULTS IN SELECTED SECTORS

This section examines the implications for international market openness arising from Spanish regulations currently in place for four sectors: telecommunications equipment, telecommunications services, automobiles and components and electricity. For each sector, an attempt has been made to draw out the effects of sector-specific regulations on international trade and investment and the extent to which the six efficient regulation principles are explicitly or implicitly applied. Electricity and telecommunications are reviewed in greater detail in the background reports on Regulatory Reform in the Electricity Industry and Regulatory Reform in the Telecommunications Industry respectively.

Particular attention is paid to product standards and conformity assessment procedures, where relevant. Other issues addressed here include efforts to adopt internationally harmonised product standards, use of voluntary product standards by regulatory authorities, and openness and flexibility of conformity assessment systems. In many respects, multilateral disciplines, notably the WTO TBT Agreement, provide a sound basis for reducing trade tensions by encouraging respect for fundamental principles of efficient regulation such as transparency, non-discrimination, and avoidance of unnecessary trade restrictiveness.

3.1. Telecommunications services

The Spanish telecommunications market is the fifth largest in the European Union and it is projected to grow from about US$16.5 billion in 1996 to about US$25 billion in the year 2000. Since 1 December 1998, the

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Spanish market is officially fully opened to competition, in conformity with relevant EU Directives.[25] Several foreign competitors are now effectively established in the Spanish market, including France Telecom, Telecom Italia and British Telecom, enhancing competitive conditions and bringing in modern technology.[26] As a result, customer choices and quality of service are improving and long distance prices are declining.

Spain had initially negotiated a five year-grace period with respect to EU Directives to open-up national telecommunications markets to competition by 1 January 2003. The delay was sought to guarantee the achievement of universal telephone coverage and to allow the emergence of another national operator. The delay was subsequently reduced to three years and finally to 11 months.[27] Despite the derogation period, a limited number of operating licences were granted to new competitors prior to 1 December 1998.[28] The official opening of the Spanish market brought an end to the 74-year-old monopoly for fixed telephony retained by Telefonica, the main Spanish Telecommunications Company, although competition was introduced in 1995 for mobile telephony. The former state-monopoly has been completely privatised during a 4-phase process, which ended in February 1997.

Another reason advanced by the Spanish Authority for the derogation period was that Spain was lagging behind the OECD average in terms of teledensity and network modernisation.[29] Table 5 shows the number of access line in Spain in relation to the OECD average between 1985 and 1997.

Table 5. **Access lines per 100 inhabitants, 1985-1997**

	1985	1990	1995	1996	1997
Spain	24.3	32.1	38.1	38.8	39.9
OECD average	32.9	39.2	46.1	47.4	58.9

Source: OECD (1999), *Communications Outlook* 1999, Paris.

The starting point of the Spanish market liberalisation came in December 1987 with the Telecommunications Regulation Act, which was the first basic statute to provide a legal framework specific to telecommunications. However, the dynamic changes in this sector combined with the liberalisation process prompted by EU Directives and the 1997 WTO Agreement on Basic Telecommunications Services made this Act outdated. In April 1997 and April 1998, Spain promulgated respectively the Telecommunications Liberalisation Act and the General Telecommunications Law.

The main objectives of the 1998 General Telecommunications Law are the unification of the legal framework in accord with EU Directives. The latter requires the promotion of competition among service operators, the equality of opportunities through the abolition of exclusive or special rights and the promotion of development and use of new services, networks and technologies. The EU Commission has therefore played a major role in driving the regulatory reform in Spain and in other EU member states as well and it continues to be responsible for guarding against abuse of a dominant position and anti-competitive behaviour at the EU level.

The *Secretaría General de Comunicaciones* of the Ministry for Development has traditionally assumed all the regulatory responsibilities over the Spanish telecommunications sector. In 1998, a new commission with various regulatory responsibilities over the sector was established, the *Comisión del Mercado de las Telecomunicaciones* (CMT).

The CMT Commission is constituted as an independent national regulatory authority for telecommunications, as required by EU Directives, and began its operations in 1997. The instruction, resolutions, decisions, and requests for information issued by this Commission are binding and, if ignored, will be considered a serious breach of the telecommunications law. It is not financed by the government but by contributions levied on telecommunications operators.

The 1998 General Telecommunications law has granted the Commission for Economic Affairs (*Comisión Delegada del Gobierno para Asuntos Económicos*) (CDGAE) some role in the area of price regulation. The CDGAE discuss and approves, based on a proposal by the Ministry of Development, and following a report from the CMT, provisionally set maximum and minimum prices or lay down the criteria for the

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setting and mechanisms for price control in the light of actual costs. For this objective, network and service operators shall be obligated to furnish detailed information on their costs subject to whatever criteria and conditions shall be established by regulation. Currently, price regulation is applied only to Telefonica's basic services and analogue mobile services.

Enforcement of competition policies in Spain is within the purview of the Competition Defence Service and the Competition Tribunal. If the CMT detects signs of practices liable to restrict competition, it is required to inform the Defence of Competition Service of these practices along with factual details. When the Defence Competition Service considers the issue to be serious, it refers the case to the Competition Tribunal for enquiry, judgement and penalty, as the situation may dictate. Telefonica has been sanctioned several times by the Competition Tribunal and was imposed fines amounting to some 854 million pesetas for resisting new entry.

Spain maintained some investment restrictions on non-EU telecommunications companies. These could not hold more than 25% of the equity in a company granted an individual licence. This regime is currently maintained for non-WTO countries. However, under the WTO Fourth Protocol on the Basic Telecommunications Agreement, the 25% limit is lifted for foreign companies originating from other members to the Agreement. Since January 1997, any individual or corporation, whether national or foreign, is required to obtain a government authorisation to gain control of 10% or more of the capital of Telefonica.

Market entry has been liberalised for both fixed wire-line and mobile services with several new licenses already awarded, especially since December 1998. Several new entrants have plans to develop technologically advanced network facilities, and this will enhance the prospects for infrastructure competition. There is clear recognition from the Spanish government of the need for effective pro-competitive regulation with an increasing role for competition law as the number of service providers increases and competition intensifies. In particular, some pro-competition measures have already been taken. For example, the CMT has scored an early success in achieving a pro-competitive initial reference interconnection offer from Telefonica that resulted in the interconnection charge falling by more than 30%. This provides increased scope for new entrants to reduce prices in competition with Telefonica.

Another example of pro-competitive measures is the 16-month *moratorium* imposed by the Spanish government, which prevents Telefonica from providing cable, Internet access and telecommunications services to homes and businesses. The reason was mainly to make sure that the new companies could have time to establish themselves before Telefonica enters the industry. In the light of difficulties confronting the efforts of new entrant cable operators to establish operations, CMT sought successfully an extension of the *moratorium* to 24 months. While discrimination between providers must not exist with regard to the granting of "rights of way", new entrants are encountering significant difficulties in obtaining permits from local governments for the construction of cable network infrastructure. Delays in obtaining construction-related permits are highlighting the diverse nature of regulatory obstacles that new entrants are confronted with.

Another area of concern is the division of regulatory responsibilities between the CMT and the Ministry for Development. The latter continues to advise the government on telecommunications policy and retains a major role in the new regulatory regime. There appears to be a reluctance to transfer real decision-taking authority to the independent regulator CMT in important areas (*e.g.* price regulation and licensing of mobile operators). It is important for effective regulation that the relationship between CMT and the government is transparent and that CMT materialises its potential to be an independent national regulatory authority.

The regulations of interconnection charges are a critical factor in the development of effective competition. Effective competition in telecommunications services should also result in lower prices, network development and modernisation, improved quality of service, services based on leading edge technology and infrastructure, increased product range, and increased customer choice. Telefonica's strong incumbent position also continues to restrain competition.[30] There have been complaints that Telefonica has been slow to provide the new interconnection conditions to new entrants. Delays in providing number portability and carrier pre-selection have also slowed the development of effective competition. If Telefonica's competitors offer only a small range of telecommunication services, customers are less likely

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to switch to another operator (*e.g.* long distance calls), if they still depend on the dominant operator for several other services.

Overall, Spain has opened its telecommunications markets to competition, including to foreign competitors, and an independent Commission, CMT, has the regulatory authority to pursue pro-competition objectives. The opening of the Spanish telecommunications market was initiated in the context of the implementation of the EU Single Market to which Spain is committed. There are sings that the market opening has achieved some success in permitting competitors to establish themselves. Telefonica recently discloses that as of May 1999, it has lost 14% of market shares for intercity calls, 11% for international calls and 4% for provincial calls. In the mobile telephony, Telefonica is estimated to have a 70% market share with Airtel and Retevision sharing the remaining 30%. There are signs also that the Spanish regulatory reform is generating benefits for Spanish consumers even though liberalisation is only recent. Taking into account the experience of other OECD Members that have liberalised their communications market previous to Spain, Spanish consumers should expect an additional decrease in telecommunications prices and an improvement in services.

– Terminal equipment such as telephone hand sets, answering machines and fax machines.

– Wireless communications equipment relating to cellular, pagers and personal communications systems.

– Satellite communications system and satellite-related ground equipment.

– Fibre optics products including optical fibre and fibre optic cable.

– Search and navigation equipment such as radar and sonar systems and surveillance equipment.

– Radio and television broadcasting equipment including closed circuit and cable television transmission equipment, and studio (audio and video) equipment.

– Microwave communications equipment.

With respect to the elaboration of technical standards for satellite earth station equipment and terminal equipment, the EU Directive (98/13) provides for harmonised European standards and mutual recognition of their conformity. CEN, CENELEC or ESTI develops these technical standards. As indicated in Section 2.1.4, AENOR must transpose as Spanish standards all European standards elaborated by CEN and CENELEC. AENOR is also responsible for managing the public consultation process in Spain and for adopting ETSI standards. With respect to the elaboration of technical standards for other telecommunications equipment, there are no telecommunications-specific procedures. The generic elaboration procedures for technical regulation and standards apply and are subject to the EU notification requirements (see Section 2.1.2) and EU harmonisation as guided by the New Approach (see Section 2.4). At the international level, AENOR is the Spanish member of the International Standardisation Organisation (ISO) and of the International Electrotechnical Commission (IEC). A number of mutual recognition agreements are also applicable to telecommunications equipment (see Table 4 in Section 2.5).

Table 6. **Spanish trade in telecommunications equipment in 1996**
Thousand US$

Telecommunications equipment	Imports	Exports
Telephone sets	131 952	117 472
Switching equipment	194 189	92 015
Transmission equipment	663 904	94 721
Receivers	11 141	6 438
Television receivers	531 725	850 380
Radio broadcasting receivers	459 423	44 103
Other equipment (line telephony)	1 081 558	515 757
Other equipment (wireless/broadcasting)	355 269	127 747
Total	3 429 161	1 848 633

Source: OECD (1999), OECD *Communications Outlook* 1999, Paris.

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3.2. Automobiles and components

Concerns about market openness and domestic regulation of automotive industries around the world are not new. Due to the historic dynamism of global economic activity in the sector and traditionally interventionist policies of some governments aimed at protecting domestic automotive industries, trade tensions related to domestic regulatory issues in general and standards and certification procedures in particular have long figured on bilateral and regional trade agendas. This reflects the fact that automobiles remain among the most highly regulated products in the world, primarily for reasons relating to safety, energy conservation, and the environment. Divergent national approaches to the achievement of legitimate domestic objectives in these key policy areas are therefore likely to remain a significant source of trade tension as global demand for automobiles continues to rise.

The Spanish automobile industry is now highly integrated in the EU automobile market. With EU accession in 1986, Spain attracted significant investment in production facilities designed to supply the whole EU market. Exports of motor vehicles, parts and accessories are the largest export sector of the Spanish economy, accounting for 25.3% of total exports in 1997. Harmonised EU safety standards for motor vehicles based on a type approval system and, more recently, the mutual recognition of certification of conformity procedures among EU member states, have also been instrumental in this integration process. Between 1980 and 1998, the export propensity (exports expressed as a percentage of domestic production) of the Spanish automobile sector jumped from 45.7 to 78.6% for passenger vehicles and 29.8 to 81.2% for commercial vehicles, with the overwhelming majority of exports destined to EU partners. During the first quarter of 1999, sales of automobiles jumped by 21.6% relative the same quarter in 1998 back by strong economic conditions.[31] Spain has steadily increased its imports of motor vehicles since 1980, as reflected by the levels of apparent imports shown in Table 7. Measured in terms of import propensity ratio (apparent imports divided by production), the import propensity ratio of passenger vehicles increased from 8.7% in 1985 to 32.4% in 1998.

Within the EU, technical requirements for motor vehicles have been fully harmonised since 1993 – they are not elaborated on the basis of the New Approach (see Box 5). Detailed technical requirements are specified in various EU Directives and applicable throughout the EU and EFTA countries. Draft

Table 7. **Production, exports, domestic registration, and apparent imports of motor vehicles in Spain between 1980 and 1998**

	1980	1985	1990	1995	1997	1998
Production						
Passenger vehicles	1 028 813	1 230 071	1 679 301	1 958 789	2 010 266	2 216 571
Commercial vehicles	152 846	187 533	374 049	374 998	551 213	608 247
Export						
Passenger vehicles	470 170	761 887	1 066 009	1 537 182	1 640 396	1 742 234
Commercial vehicles	45 515	77 193	183 550	275 105	451 138	493 599
Export Ratio						
Passenger vehicles	45.7%	61.9%	63.5%	78.5%	81.6%	78.6%
Commercial vehicles	29.8%	41.2%	49.1%	73.4%	78.0%	81.2%
Shares of World Exports						
Passenger vehicles	–	–	7.8%	10.6%	9.8%	12.5%
Commercial vehicles	–	–	7.5%	10.1%	12.5%	13.8%
Domestic Registration						
Passenger vehicles	504 051	575 051	988 270	834 369	1 014 077	1 192 843
Commercial vehicles	105 934	131 941	262 629	185 447	242 424	284 181
Apparent Imports*						
Passenger vehicles	–54 592	106 867	374 978	412 762	644 207	718 506
Commercial vehicles	–1 397	21 601	72 130	85 554	142 349	169 533

* The level of apparent imports is obtained by subtracting the difference between production and export from the level of domestic registration. Due to change in stocks, the level of apparent imports can be negative.

Source: Comité des constructeurs français d'automobiles (1995), *Analyse et statistiques* ; *Annuaire Statistique Juin* 1998 and *Brochure de statistiques février* 1999.

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Directives or amendments are submitted by the Commission and published in the Official Journal. During a consultation period, the Commission consults a Working Party on Motor Vehicles composed of representatives of member states and the EU industry. Following the consultation, the Commission proposes the new Directive or an amendment to the EU Council for approval. The new Directive comes into effect after it is published in the Official Journal.

The certification of these requirements is done through a system of type-approval of motor vehicles. Under the type-approval system, a national Regulatory Body certifies that a type of vehicle or separate technical units satisfy technical requirements as specified in relevant EU Directives. Each vehicle type, whether domestically produced or imported, must be brought to a Regulatory Body testing facility, tested and certified that it meets relevant technical regulations. Each member state grants the type-approval to any vehicle, which meets the technical requirements of the 54 separate basic Directives for passenger cars. There are also some 100 modifications to the basic Directives. In its Framework Directive (70/156) as amended, the EU has deemed several UN-ECE Regulations to be equivalent to relevant EU technical Directives – in 1999 35 UN-ECE Regulations are recognised as equivalent as well as those listed in Annex II of Directive 97/836.

A multistage type-approval process can be followed in which the technical requirements of the relevant Directive must be met separately - this means that if type-approval has been granted for a braking system, the type-approval is valid for other vehicle models using the same braking system. Since 1996, when a passenger vehicle was granted EU type-approval certification in one member state, the conformity of the type-approval certificate is valid in all other member states and the vehicle can be registered or permitted for sale in all EU states. Before 1996, the EU type-approval certification was optional as manufacturers had the choice of obtaining either a national type-approval or the EU type-approval for that country. Since 1998, mutual recognition of EU certification of conformity is extended to all vehicles belonging to category M1 (passenger and light commercial vehicles). Vehicles produced in small series, less than 500 units, can be exempt from certain administrative requirements and member states have to decide within a three-month period whether to grant the type-approval.

Certain EU Directives or measures have competition and transparency implications for the automobile sector. In some cases, they have been designed in an attempt to mitigate any anti-competitive effect. Conversely, the export monitoring arrangement for motor vehicles between the EU and Japan (referred to as "Elements of Consensus") has the opposite effect on competition within the EU. These are discussed below.

Within the EU, motor vehicle distribution must conform to specific legislation as a condition of its exemption from anti-competitive proceedings. The regulation is known as the block exemption Regulation on the Selective and Exclusive Distribution of Cars, which was renewed in 1995 and extended until

Box 8. Global technical regulations for wheeled vehicles

In recent years, support was voiced for strengthening the legal and administrative capacity of the 1958 Agreement of Working Party 29 of the United Nations – Economic Commission for Europe (UN-ECE) as the principal body for common development of technical standards and regulatory requirements for motor vehicles. As a result of multilateral negotiations, a new agreement was reached on 25 June 1998 on Global Technical Regulations for Wheeled Vehicles which shall facilitate the full participation of countries operating either the type-approval or the self-declaration systems of conformity of standards. The UN-ECE Global Agreement is entitled "Agreement concerning the establishment of global technical regulations for wheeled vehicles, equipment and parts, which can be fitted and/or be used on wheeled vehicles".

The Agreement opens up the possibility for establishing "global technical regulations" proposed by its contracting parties and which must be approved by consensus. The USA has already ratified the Agreement and the adhesion of Canada, Australia and Japan is expected. The European Community became a contracting party to the 1958 Agreement in March 1998 and accession to the Global Agreement is under consideration – the Commission has recently submitted a proposal for approval by the EU Parliament.

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September 2002.[32] This regulation seeks to safeguard consumers' access to vehicle and parts supply in any EU member state at favourable terms. It provides dealers with enhanced freedoms to acquire additional franchises and to resist the imposition of sales targets by manufacturers. Although the franchise agreement can provide for exclusive geographical zones, it is prohibited for dealers to reject sales to a consumer who is a resident of another EU member state, the so-called prohibition against parallel imports. In 1997, Volkswagen was sanctioned for preventing its distributors to sales vehicles to EU residents of other EU states. It was fined a 101 million ECU penalty.

In June 1998, the European Commission declared illegal the Spanish Industrial Renovation Plan enforced between 1994 and 1996, by which the government was subsidising the acquisition of replacement industrial vehicles by private companies. As the grants were restricted to the acquisition of vehicles made in Spain, the plan was sanctioned for its anti-competitive effects. Spain has appealed against this decision. The plan was recently reintroduced in a modified version, in which special grants are offered for the acquisition of replacement industrial vehicles, irrespective of their fabrication sources.

As a competition enhancement measure, Directorate-General IV (Competition) carries out a survey of retail car prices for 76 identical models within 12 EU member states every six months. The survey shows the price of individual models in local currencies and in ECU and indices are calculated for each country (the lowest car price has the reference index of 100%). It enables to readily identify price differentials for the 76 models being surveyed. The last survey for 1 November 1998 shows that price differentials among member states generally vary within a range of 20% for most models and exceeding 50% on certain models, *i.e.* the Rover 214 in the UK has an index of 151.9%. The survey reveals that car prices in Spain are relatively low within the EU – 21 models are at 2% or less than the cheapest EU prices, 64 models are at 10% or less than the cheapest EU prices and the highest price differential is 17% for one model. The price differentials reflect several factors, including national retail taxes, but are also indicative of regional market segmentation.

In the 1980s and 1990s, several countries sought to limit competition from imports through either the negotiation of formal voluntary restraint arrangements (VRAs) or by persuading the exporting country to impose unilaterally a voluntary export restraint (VER). In 1991, the EU and Japan reached a bilateral solution, the so-called Elements of Consensus, providing that individual VRAs between Japan and respectively France, Italy, Spain, Portugal, and the United Kingdom would be formally terminated in January 1993. It also stipulated that Japan would monitor its vehicle exports (vehicles of less than five tonnes) to the Community and the five member states until the end of 1999. The Japanese share of the EU market is expected to reach 8% in 1999. Under the Elements of Consensus, forecasts of Japanese exports are adjusted every six months according to fluctuations in the market. This vehicle VRA is the only vehicle VRA still in force among WTO Members. It is specifically mentioned in the WTO Safeguards Agreement that this VRA will be terminated on 31 December 1999.

One particular dimension of the Elements of Consensus for Spain is that the level of Japanese exports is specified in two Spanish regions, mainland Spain and the Canary Islands. This was negotiated to prevent the potential disappearance of non-Japanese vehicle distributors from the small Canary Islands' vehicle market. Table 8 shows the agreed and realised levels of imports for both regions and for Spain as a whole. It appears that some flexibility was applied in respect of the allocation of realised import levels between the mainland and the Canary Islands as realised import levels for the mainland have exceeded the agreed levels in 1993 and 1998.

Table 8. **Imports of motor vehicles in Spain from Japan**

	1993		1996		1998		1999
	Agreed	Realised	Agreed	Realised	Agreed	Realised	Agreed
Mainland	15 800	17 615	30 400	26 170	54 200	55 273	
Canary Islands	13 500	7 476	15 800	6 233	15 800	10 874	
Total	29 300	25 091	46 200	32 403	70 000	66 147	79 000

Source: Ministry of Economy and Finance.

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Overall, Spain has attracted significant foreign investments in this sector, which have boosted its export propensity significantly. However, this success was achieved against the background of a relatively high tariff protection by OECD standards, *i.e.* the EU import tariff is 10%.[33] The harmonised EU safety standards for motor vehicles and the mutual recognition of certification of conformity procedures among EU member states have brought benefits to EU consumers. As a result, a member state can no longer refuse the registration of any passenger vehicle on the grounds that its certification of conformity was agreed to into another EU member state. Nevertheless, significant price differentials still persist on motor vehicles among EU member states. It is therefore crucial for the Commission to tightly monitor the application of the EU block exemption on car distribution to ensure that manufacturers and distributors are not hindering the capacity of consumers to enter into parallel imports within the EU. The Commission has already sanctioned a large manufacturer and the Spanish Industrial Renovation Plan on the grounds of anti-competitive practices. These sanctions attest to the pro-competitive stance of the Commission. Conversely, the Elements of Consensus between the EU and Japan have the opposite effect on competition within the EU.

3.3. Electricity

Spain is engaged in a long process of reforming the electricity sector, spurred by the objective to restructure public enterprises providing critical inputs to the rest of the economy and EU Directives on the Single Market in electricity. The main legal instrument is the Electric Power Act of 1997, which is built on a decade of reforms. The Act provides for the creation of an open wholesale market, the choice of suppliers to the largest electricity customers and mandated price decreases to those remaining under regulated tariffs. Further legislative amendments and Royal Decrees brought in December 1998 and April 1999 have widened the choice more quickly to medium-sized consumers, cut regulated prices more deeply than originally planned and encouraged greater activity in the wholesale market by lowering access tariffs.

In 1998, the Spanish electricity generation capacity was composed of coal generation for 35%, nuclear (31%), hydroelectric (20%) and smaller contributions from gas, oil and renewables, accounting respectively for 7, 6 and 1% of total capacity. Peak demand in mainland Spain was 29.5 GW against an overall capacity of 49 GW, implying a significant excess capacity. Total import interconnection capacity is estimated at about 1.7 GW with links to France, Portugal, Morocco and Andorra. As an EU member state, Spain has the power to impose reciprocity requirements on utilities wishing to import electricity into Spain (Article 19 of the EU Directive 96/92). Unlike other countries, Spain has chosen not to enforce this provision for the time being. National utilities in France, Belgium, Portugal, and Morocco are licensed to import electricity into the Spanish market.

In 1990, the Spanish electricity sector was composed of a dozen independent electricity firms, with Endesa, then a state-owned generation and transmission enterprise, controlling about a quarter of the market. Through acquisitions and consolidation, the number of main firms was reduced to four by 1998, two of which supply over three-quarters of the electricity produced in Spain. Endesa produces 48% of the Spanish electricity production, Iberdrola produces 26%, Union Fenosa 10%, and Hidrocantabrico 4%.

The privatisation process of Endesa began in 1988, when 20% of its capital was sold, and was completed in 1998 (see Table 3). In electricity transmission, *Red Eléctrica España* (REE) operates a high voltage transmission network and controls about 30% of the 220 kV lines in Spain and the rest of the network is owned by the four utilities. In early 1999, the government controlled 60% of REE and each of the four utilities held 10% – the maximum permissible share of total capital per individual owner. In May 1999, the government announced its plan to sell a tranche of 35% to small shareholders and institutional and foreign investors. The government will maintain the remaining 25%.

Electricity prices for industry in Spain are in the middle range of price levels among OECD countries but they are among the highest for household consumers before taxes (see the background report on Regulatory Reform in the Electricity Industry). As in many countries, the price structure provides for important cross subsidies. There are also several compensatory charges and taxes paid by Spanish consumers which altogether account for about 15 to 20% of total electricity prices in Spain. These include sup-

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port for the domestic coal industry, compensation to the utilities for the nuclear moratorium, subsidies for the special regime production, demand management and quality of service enhancement, and the extra-peninsular system as well as the transitional competition transition charge and capacity payment.

The Ministry of Industry and Energy assumes policy responsibilities for the reforms and it also has the most significant regulatory functions. In particular, it is responsible for setting regulated retail tariffs, network access tariffs and various charges. It authorises new generators and approves transmission projects. The *Comisión Nacional del Sistema Eléctrico* (CNSE) is an independent regulatory commission established in 1994 whose principal functions are advisory and dispute-related resolution. It approves mergers and acquisitions into transmission and distribution companies. It also plays a role in instances of anti-competitive practices in the sector. In October 1998, the National Commission for Energy (*Comisión Nacional de Energía*) was established and took over the responsibilities for the energy sector and the hydrocarbon fuels.

Enforcement of competition policies in Spain is the purview of the Competition Defence Service and the Competition Tribunal. If the CNSE detects signs of practices liable to restrict competition, it is required to notice these practices along with factual details to the Competition Defence Service. When the Competition Defence Service considers the issue to be serious, it refers the case to the Competition Tribunal for enquiry, judgement and penalty, as the situation may dictate. Finally, the European Commission has EU-wide jurisdiction over competition issues.

Several competition cases have already arisen in this sector. The Competition Tribunal is reviewing a joint venture between a Spanish and a Portuguese firm to build a transmission line. The joint venture between Gas Natural (the privately-owned gas transportation monopoly) and Endesa was referred to the Competition Tribunal for investigation of potential market foreclosing effects. Complaints about access have been filed with the Competition Defence Service and reviewed by the Competition Tribunal, which has decided on at least three cases in this sector so far.

Overall, the Spanish government has shown a strong commitment to the liberalisation of the electricity market and is moving further and more quickly than required by EU Directives on the Single Market in electricity. The reform has already materialised in concrete benefits in terms of lower electricity prices, higher labour productivity, and new foreign entrants have announced plans to invest in gas generating capacity. On the institutional regulatory side, an independent Commission (CNSE) although having primarily an advisory role, has greatly enhanced transparency of the industry's regulation.

Despite these reforms, the short- and medium-term prospects for added competition from imported electricity are considered fairly limited given Spain's current excess generation capacity and the specificity of its geography. A more immediate concern lies with the current duopoly that has emerged through acquisitions during the 90s with Endesa and Iberdrola now controlling three-quarters of the market. This situation raises the concern about the potential abuse of their position, which could impinge on the expected benefits from enhanced competition through trade and foreign investment. The background report on Regulatory Reform in the Electricity Industry discusses in greater detail regulatory- and competition-related dimensions and market developments. It also contains a set of recommendations to further the process of regulatory reform in this sector.

4. CONCLUSIONS AND POLICY OPTIONS FOR REFORM

4.1. General assessment of current strengths and weaknesses

Not all of the six efficient regulation principles examined in this review are expressly codified in Spanish administrative and regulatory oversight procedures to the same degree. However, the weight of available evidence suggests that the principles of non-discrimination, use of international standards and recognition of equivalence be given ample expression in practice. Integration in the EU Single Market implies that Spain adopts EU Directives and takes part in the harmonisation of technical regulations.

The quality of the public consultation carried out during the elaboration of domestic regulations can be improved by providing more widely access to the information contained in the Normative Dossier for

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consulted parties. Similarly, the transparency of the process can be improved by publishing in the Official Journal the text of draft regulations and in making them available through the Internet along with the respective Normative Dossier.

The Spanish elaboration process lacks in the application of modern policy evaluation tolls, such as cost and benefit analysis or the OECD-sponsored Best Practices. The application of these tools throughout the ministries would act as consistent guiding principles for elaborating regulations and reinforces the desirable attribute of a rigorous analytical culture in respect of elaborating regulations.

With regards to the Spanish government procurement regime, which transposes the requirements of EU Directives, the transparency and non-discrimination principles take concrete applications. Firms and individuals from EU member states directly gain significant benefits in terms of equal opportunities to compete for public contracts from Spanish awarding authorities. Non-EU firms and individuals directly gain through the enhanced competitive conditions conferred by the openness of the EU investment rules, the transparency and non-discrimination principles.

Ensuring that transparency and non-discrimination are effectively enforced in the application of EU customs procedures is a very complex task given the number of entry ports involved and the cultural diversity of EU member states. Pursuing greater simplification and harmonisation of customs procedures is a necessary complement to trade liberalisation initiatives as cumbersome procedures can hinder trade and translate into high transaction costs for traders. Higher priority should be assigned by the EU Commission to the implementation of an EU-wide electronic-based system for customs procedures, including the new computerised transit system, and the development of a comprehensive Internet site and of a new consolidation of the EU Customs Code.

Considerable efforts were made to reduce the role of government in economic activities through a comprehensive privatisation programme and by exposing previously sheltered firms to competition forces. Efforts were made to establish an institutional competition infrastructure with the Competition Defence Service, the Competition Tribunal and two specialised commissions to regulate the telecommunications and electricity sectors respectively. Although the Spanish government has demonstrated a strong commitment in liberalising these two sectors, there are still concerns about the potential abuse of dominant position by certain firms and the adverse effects that this situation may cause on the ability of foreign firms to compete in Spain.

In the automobile sector, Spain has attracted significant foreign investments, which have boosted its export propensity significantly. However, Spain has achieved this success against the background of a relatively high tariff protection (the EU common external tariff) and a contradictory competitive stance by the EU Commission, albeit recent Commission's positions have definitively been pro-competitive.

4.2. The dynamic view: the pace and direction of change

Globalisation has dramatically altered the world paradigm for the conduct of international trade and investment, creating new competitive pressures in Spain and elsewhere. At the same time, the progressive dismantling or lowering of traditional barriers to trade and increased relevance of "behind the border" measures to effective market access and presence has exposed national regulatory regimes to a degree of unprecedented international scrutiny by trade and investment partners, with the result that regulation is no longer, if ever it was, a purely "domestic" affair. Trade and investment policy communities have generally kept pace with these twin phenomena. Concrete steps to increase awareness of and effective adherence to the efficient regulation principles and deepen international co-operation on regulatory issues are encouraging trends in this context.

The accession of Spain into the European Union in 1986 and its subsequent participation in other EU-based integration initiatives, *i.e.* the Single Market and the European Monetary Union, have fundamentally changed the trade and investment environment of Spain. As an EU member state, Spain has effectively moved away from a managed approach of foreign competition towards full participation in the EU Single Market and more open trade relationships with non-EU countries, as attested with the elimination of some 4 500 quantitative restrictions on imports. The Single Market Directives, themselves

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aimed at eliminating internal obstacles to trade, have acted as strong policy anchors against the temptation to backtrack.

Trade and investment liberalisation measures were also complemented in 1985 with initial efforts in restructuring loss-making public enterprises providing critical inputs to the rest of the economy. These were strengthened in 1996 when the decision was taken to privatise all except a few selected enterprises over a five year period. This opening process has yielded significant opportunities for foreign traders and investors. With its qualification for the European Monetary Union, the Spanish government recognises the increasing importance of removing domestic obstacles to growth in order to assist Spanish citizens and firms in competing domestically and internationally.

4.3. Potential benefits and costs of further regulatory reform

The need for all governments to address market failures through sound regulatory action is an undisputed sovereign prerogative. Nonetheless, ill-conceived, excessively restrictive or burdensome regulation exacts a heavy price on commercial activity, domestic or foreign, and places a disproportionately heavy burden on small-and medium-sized enterprises. Foreign firms established in the Spanish market face the same regulatory burden as domestic firms.

Trade and investment friendly regulations need not undermine the promotion and achievement of legitimate Spanish policy objectives. High-quality regulations can be trade-neutral or market-opening, coupling consumer gains from enhanced market openness with more efficient realisation of domestic objectives in key areas such as the environment, health and safety. However, it is doubtful that this can be achieved in the absence of purposeful, government-wide adherence to the principles of efficient regulation.

Market-opening regulation promises to promote the flow of goods, services, investment and technology between Spain and its trading partners. Expanded trade and investment flows generate important consumer benefits in terms of greater choice and lower prices, they raise the standards of performance of domestic firms through the impetus of greater competition and boost GDP.

The scope and depth of the EU integration-based initiatives has modified significantly the geographical composition of the Spanish trade flows (Table 9). The share of total imports coming from the EU-15 jumped from 39.1% in 1985 to 62.7% in 1990 and continued to increase, albeit at a slower growth rate, throughout the 90s, with a share of 67% in 1998. France, Germany and Italy, the largest three trading partners, have increased their import shares significantly, in particular the share of Italy more than doubled between 1985 and 1998. Conversely, the import share from NAFTA countries dropped from 17.1 to 6.9%, with imports from Mexico being particularly affected..

Table 9. **Regional composition of Spanish trade**
US$ million and percentages

	1985	1990	1995	1998
Total exports	24 267	55 517	91 043	109 178
OECD (29)	71.9%	83.9%	82.2%	82.7%
EU (15)	54.3%	71.6%	71.0%	69.9%
NAFTA	12.0%	7.5%	5.3%	5.6%
Asia-Oceania	2.0%	1.8%	2.4%	1.9%
Non-OECD Total	28.1%	16.1%	17.8%	18.5%
Non-OECD America	4.9%	2.9%	5.2%	5.6%
Total imports	30 002	87 551	113 316	132 960
OECD (29)	62.9%	81.2%	80.7%	81.6%
EU (15)	39.1%	62.7%	64.9%	67.0%
NAFTA	17.1%	10.6%	7.9%	6.9%
Asia-Oceania	4.3%	5.5%	4.6%	4.5%
Non-OECD Total	37.1%	18.8%	19.3%	18.4%
Non-OECD America	5.7%	3.0%	3.5%	3.2%

Source: OECD Trade Statistics.

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On the export side, the share of total exports to EU-15 countries increased from 54.3 to 71.1% between 1985 and 1998. Portugal, which also acceded to the EU at the same time as Spain, became the fourth largest export destination of Spanish exports, increasing from 2.2 to 9.1% of total exports in 1997. The share of exports to NAFTA countries dropped sharply between 1985 and 1990 and has remained relatively stable since 1995, hovering between 5.3 to 5.7%.

Changes in the product composition of foreign trade usually provide potentially interesting indications about the relative competitiveness of sectors of the country concerned. In the case of Spain, the share of manufactured goods in total exports increased from 59.9 to 65.2% between 1988 and 1997, with simultaneously slight reductions in the shares of other categories, *i.e.* agriculture and food, oil and mineral products, and semi-manufactured goods.

Within manufactured goods, the share of transport equipment, electric and electronic goods in total export increased significantly reflecting the competitiveness of these sectors. Exports of motor vehicles, parts and accessories now represent the largest sector of exports and the second largest sector of imports, equivalent to 25.3% of total exports in 1997. These exports almost tripled in value during the period as a result of large investment in motor vehicles and parts production facilities. Between 1988 and 1997, the share of textiles, clothing and footwear exports declined from 9.1 to 7.4% and the share of electric and electronic goods in total exports jumped from 4.2 to 7.2%.

Table 10. **Product composition of Spanish trade**
US$ million and percentages

	1988	1990	1995	1997
Total exports of goods	40 221	55 517	91 043	106 241
Agriculture and food	17.8%	15.5%	15.9%	16.3%
Oil and mineral products	5.5%	5.6%	2.9%	3.4%
Semi-manufactured goods	16.7%	15.2%	15.8%	15.1%
Manufactured goods	59.9%	63.7%	65.4%	65.2%
Total imports of goods	60 144	87 551	113 316	124 418
Agriculture and food	11.8%	11.3%	14.5%	12.3%
Oil and mineral products	13.0%	13.4%	9.8%	10.4%
Semi-manufactured goods	16.6%	16.7%	19.8%	18.8%
Manufactured goods	58.5%	58.6%	55.9%	58.5%
Commercial services				
Exports of services	12 600	27 600	39 700	43 700
Imports of services	4 200	15 200	21 700	24 200

Source: OECD Trade Statistics and World Trade Organisation, Annual Reports.

Spain is also a large exporter of commercial services and has systematically maintained a high trade balance surplus in commercial services. Spain is particularly successful in exporting travel services, which account for more than half of its total exports of commercial services.

The gradual implementation of the electronic-based system (UN-EDIFACT) for import and export transactions by Spanish Customs Authorities has already resulted in tangible benefits in terms of a drastic fall in the average time required to complete customs procedures. The full-computerised integration of EU Customs operations raises the prospects of additional savings in terms of quicker response time among parties in completing forms or retrieving them for their correction or modifications and the potential elimination of all paper forms.

4.4. Policy options for consideration

This report is not a comprehensive review of regulation and market openness in Spain. Despite the progress made in recent years in the areas reviewed, recurring weaknesses also appear in Spain's regulatory regimes. This section identifies actions that, based on international consensus on good regulatory practices and on concrete experiences in OECD countries, are likely to be beneficial to improving regu-

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lation in Spain. They are based on the recommendations and policy framework in 1997 OECD Report to Ministers on Regulatory Reform.

1. *Enhance transparency through the publication in the Official Journal of the text of draft regulations, including draft technical regulations and draft ministerial orders with information about the period of public consultation and the sponsoring ministries; and through the availability of draft regulations on the Internet.* These steps would improve the transparency of the elaboration process of new regulation and provide information more rapidly to potentially affected parties.
2. *Adapt the preparation of the Normative Dossier and approval of draft regulations to include explicit references to the "efficient regulation principles"; expand the analytical content of the "Economic Memorandum" to make sure that the anticipated economic costs and benefits of draft regulations are measured; and make the Normative Dossier, including the Economic Memorandum, widely available to consulted parties, possibly through the Internet.* The Spanish elaboration process currently makes insufficient use of modern policy evaluation tools, such as cost-benefit analysis or the Regulatory Impact Analysis (RIA) in the sense of OECD Best Practices. Although some of the efficient regulation principles, such non-discrimination, the use of international standards and the recognition of equivalence are fairly extensively applied in practice, the six principles could more rigorously be applied in respect to elaborating regulations.
3. *Heighten awareness of and encourage respect for the efficient regulation principles by the autonomous regions and large cities in their regulatory activities.* Through the co-operation institutions between the central government and autonomous communities, the central government should promote the awareness and encourage respect of the efficient regulation principles.
4. *Enhance the transparency and the uniform application of customs procedures by assigning higher priority to faster implementation of an EU-wide electronic-based system that responds more efficiently to the requirements of the EU Single Market, including transit operations; prepare a new consolidation of the EU Customs Code; and create a comprehensive Internet site providing access to the EU Customs Code, all its amendments, formulas and official communiqués.* Pursuing greater simplification and harmonisation of customs procedures is a necessary complement to trade liberalisation initiatives as cumbersome procedures can hinder trade and translate into high transaction costs for traders. Significant efficiency gains can be realised for both users and customs authorities through enhanced use of electronic-based systems.
5. *Continue to encourage the use of international standards as a basis for national standardisation activities and to promote international harmonisation in the European and international fora.* A strong commitment to an efficient and reliable standardisation system not only enhances market opportunities for Spanish firms but also greatly contributes to the consolidation world-wide of efficient and transparent markets for industry and consumers.
6. *Encourage stronger enforcement of competition policy, recognising its increasing importance for market openness; and implement the measures recommended in the background report on The Role of Competition Policy in Regulatory Reform, including an increase in the professional staff for the Competition Tribunal and to maintain the Tribunal's independent advocacy function.* With the recent privatisation of a large number of state enterprises and sectoral reforms exposing previously sheltered firms to competition forces, concern remain about potential anti-competitive practices, including the potential abuse of dominant positions. Therefore, strong enforcement of competition policy is needed to prevent regulatory or private actions that would impair market access and effective competition by foreign firms.

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NOTES

1. When the difference between the Spanish and the EU duties in absolute terms was less than 15%, the EU common external tariff was applied from the accession. When the difference was larger, the Spanish tariff would approach the EU tariff in a seven-year transitional period.
2. Excluding quantitative restrictions applied in conformity with the WTO Agreement on Textiles and Clothing, few quantitative restrictions were converted into Community-wide quotas, including products such as bananas, automobile import arrangement with Japan, certain consumer products from China and steel products from the former Soviet Union.
3. In 1986, Spain had a number of bilateral agreements concerning fish and fishing rights, which were then adopted by the EU following its accession. Spain also lost its developing country status and it was no longer able to obtain the benefits of GSP treatment on some of its exports from various developed countries. Before accession, Spain was not providing GSP treatment on its imports from other developing countries. Following its accession, imports from developing countries were entitled to the benefits of the EU common external policy, including the prevailing GSP preferential import treatment.
4. See, Trade Policy Review, European Union (1997), World Trade Organisation, page 14.
5. In 1997, the EU simple average tariff rate across all products stood at 10%. The average rate for agricultural products (HS 1-24) stood at 20.8% in 1997. See, Trade Policy Review, European Union, 1997, World Trade Organisation, page 44-45.
6. In 1991, residents from EU member states were exempted from the prior authorisation requirements for the special sectors with the exception of the defence-related sector.
7. For a more detail discussion of the reform of the Spanish pubic sector see, OECD *Economic Surveys*, 1997-1998 Spain, pages 82-132 Chapter on Reforming the Public Enterprise Sector.
8. See, in particular OECD "Open Markets Matter. The Benefits of Trade and Investment Liberalisation", Paris 1998, OECD "The Environmental Effects of Trade", Paris 1994 and the 1995 Report on Trade and Environment to the OECD Council at Ministerial level.
9. See related discussion in OECD (1997), Chapter 2: "Regulatory Quality and Public Sector Reform", *The* OECD *Report on Regulatory Reform*, *Volume* II: *Thematic Studies*.
10. The opinion of the MPA is required when the proposal has an impact on the distribution of responsibilities between the central government and autonomous regions; it contains administrative procedures, or it has an effect on the human resources policies of the administration.
11. See OECD (1997), *Regulatory Impact Analysis*, *Best Practices in* OECD *Countries*, Paris.
12. The minimal consultation period can be reduced to seven working days if the sponsoring body provides "motivated" reasons in its final written statement on the consultation process.
13. As provided by Directive 98/34/EC of 22 June 1998. The Directive codified and replaced Directive 83/189/EEC, which had established the procedure and had been subsequently amended.
14. "CIA Security International *vs.* Signalson SA and Securitel SPRL", Decision of the European Court of Justice of 30 April 1996 (Case C-194/94).
15. The procedure was established by a December 1995 Decision of the EU's Council of Ministers and the European Parliament (3052/95) and came into effect on 1 January 1997.
16. See *Single Market Scoreboard*, European Commission, October 1998.
17. European Commission (1998), *Efficiency and Accountability in European Standardisation Under the New Approach*, *Report from the Commission to the Council and the European Parliament*, SEC(98)291, May.
18. *http://europa.eu.int/business/en/index.html*.
19. *http://www.newapproach.org*.

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20. The Public Supplies Directive (93/36/EEC); the Public Works Directive (93/37/EEC); the Public Services Directive (92/50/EEC); the Public Remedies Directive (89/665/EEC); the Utilities Directive (93/38/EEC); and the Remedies Utilities Directive (92/13/EEC).
21. The United Nations rules for Electronic Data Interchange for Administration, Commerce and Transport comprise a set of internationally agreed standards, directories and guidelines for the electronic interchange of structured data, and in particular that related to trade in goods and services between independent, computerised information systems. For more information consult the Internet site (*www.shedi.net.cn/edi-stand*).
22. In early 1998, the EU had the following free trade agreements: Europe Agreements with Hungary, Poland, Czech Republic, Slovakia, Romania, Bulgaria, Romania, Estonia, Latvia, Lithuania, Slovenia; and Euro-Mediterranean Agreements with Cyprus, Malta, Israel, Tunisia, Morocco and Palestinian Authority.
23. This obligation is provided by the Royal Decree 2200/1995, which set up the conditions for recognition as a national standardisation body.
24. See European Council (1989), *Council Resolution of 21 December 1989 on a Global Approach to Conformity Assessment* (90/C 10/01).
25. EN 45020 (1988) Standardisation and Related Activities – General Vocabulary Corrected 1998-02-26 = ISO/IEC Guide 2:1996.
26. In 1999, the major operators in the Spanish telecommunications fixed line are:
Telefonica (*Telefónica de España*): Spain's largest telecommunications company. Retevision: it is a former TV and radio transmission company and is building its own network. Retevision is free to set prices lower than those stipulated for Telefonica. Lince: is the third telephony operator with France Télécom and Cableuropa as main shareholders. Euskatel: it is the first regional phone company operating in the Basque region since January 1998 and is associated with Telecom Italia. Jazztel: it is investing heavily in deploying a broadband network, as well as the installation of a submarine cable between Bilbao and United Kingdom. BT Tel: it is a subsidiary of British Telecom and it has for several years operated Spain's second largest data communication network.
In mobile services, the main companies are:
Telefonica: it has about 70% of the Spanish mobile phone market with its two subsidiaries Movistar and Moviline. Airtel: a private consortium using GSM 900 technology, has been competing with Telefonica since 1995. In March 1999, it had about 30% of the Spanish mobile market. Retevision Movil: it was awarded Spain's third mobile phone license in May 1998.
27. Extension periods were also accorded to Luxembourg (1 July 1998), Ireland and Portugal (1 January 2000) and Greece (31 December 2000).
28. A licence was granted to *Retevision*, which began operations in January 1998 and a third licence was granted to the *Lince* Consortium in May 1998.
29. The number of mainlines per capita is still much below the OECD average. Although in 1995 only 56% of the fixed network were digital compared with an OECD average of 82%, in 1998 the percentage had increased 86.2%.
30. While the Reference Interconnection Offer, RIO, has been concluded, interconnection conditions are still problematic for new entrants. Telefonica has evidently been reluctant to provide interconnection in these terms to some operators.
31. See, *El Pais* of 21 May 1999, "Seat, Renault y Nissan invertiran 600 000 milliones hasta el 203 en sus plantas en España".
32. The Commission Regulation (EC) No 1475/95 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements was adopted in June 1995 and applies until September 2002.
33. In the EU post-Uruguay Round tariff on passenger cars is 10%, unchanged since 1974. Post-UR tariff (2000) in the USA will be 2.5%; zero in Japan and 6.1% in Canada. See, OECD (1997), "Market Access Issues in the Automobile Sector", Paris.

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BACKGROUND REPORT ON REGULATORY REFORM IN THE ELECTRICITY INDUSTRY*

* This report was principally prepared by **Peter Fraser** of the International Energy Agency and **Sally Van Siclen**, Principal Administrator, of the OECD's Division for Competition Law and Policy. It has benefited from extensive comments provided by colleagues throughout the IEA and OECD Secretariats, by the Government of Spain, and by Member countries as part of the peer review process. This report was peer reviewed in October 1999 by the Standing Group on Long Term Co-operation of the IEA and the Competition Law and Policy Committee of the OECD.

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1. HIGHLIGHTS

The Spanish government has had a strong commitment to liberalisation of the electricity sector. The Spanish electricity reform law passed in November 1997, which built on previous reform efforts over the past decade, created an open wholesale market, introduced choice to the largest electricity customers, and required separation into distinct corporations – albeit with some common ownership and management, for generation, distribution and retail supply. It also mandated price decreases to those remaining under regulated tariffs. Amendments in December 1998 and a further Royal Decree in April 1999 widen choice more quickly to medium-sized consumers and cut regulated prices more deeply than originally planned, and encourage greater activity in the wholesale market by lowering access tariffs. Compared with the minimum requirements of the European Union Directive on the single market in electricity, liberalisation of consumer choice is wider and quicker and the vertical separation of activities is deeper. The government has also sold all its shares in the country's largest utility, Endesa, and has reduced of its shareholding in Red Electrica, the national transmission company, from 60% to 25%.

In response, there are some positive early signs that the reforms will improve efficiency. Incumbent utilities are implementing plans to trim staff, large foreign companies have announced their intentions to build new generating stations in Spain, and despite a slow start, increasing numbers of customers are opting to purchase power from the market.

There are four main issues regarding Spanish electricity market reforms that the government may wish to consider to get the maximum benefit from its efforts to date. The most important of these is the prospect for slow development of competition particularly in the generation market. The largest two utilities, Endesa and Iberdrola, produce 76% of the power in Spain and there are limited prospects for importing electricity, given the technical constraints on the French border. Entry by new competitors is expected to reduce this share only gradually. Market competition concerns conflict with industrial policy considerations that favour strong Spanish electricity companies of larger size. Vertical integration with distribution-supply companies further attenuates competition, though legal and accounting separation might be helpful.

The second issue is the role of independent regulation. The Ministry of Industry and Energy is the primary regulator, as it carries out both energy policymaking and the main regulatory activities of setting tariffs and negotiating with the utilities on matters such as the payment of transition costs. The independent electricity advisory body, the CNSE, has primarily contributed to the reform process through its analysis and outspoken advocacy for the consumer. Business, labour and consumer organisations thought highly of it. However, both the CNSE and its replacement, the CNE, have few regulatory powers.

The third issue is the extent to which regulated prices reflect costs. There are apparently significant price distortions with some costs incurred for the benefit of industrial consumers being paid for by residential consumers. These price distortions have reduced the effect of the liberalisation because the government has set regulated tariffs for some very large industrial customers below market prices. These very large users, normally enthusiasts for access to competitive wholesale electricity markets, have instead preferred to remain with regulated tariffs.

The fourth issue is the level of energy policy costs that the electricity consumer is required to support. Significant premiums are paid for electricity from renewable energy and small cogeneration. Taxes and charges on electricity customers go to subsidising the restructuring of the domestic coal industry. The size of the payments to utilities for the so-called costs of the transition to competition has been controversial and is currently under review by the European Commission. These costs – for energy policies, costs of transition to competition and so-called capacity payments – constitute about one-third of the total cost of power in Spain.

Finally, the fifth issue is the liberalisation of the gas market and its links with electric power. To increase competition in the electricity sector, more should be done to diversify the gas industry given the fact that Gas Natural operates as a de facto monopoly and owns the transportation system and the long-term supply contracts.

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This report is structured as follows. Section 2 outlines the current features of the electricity sector, including infrastructure, industry structure, prices and costs. Section 3 gives a context and overview of the latest reforms. Section 4 describes the regulatory framework and identifies the four main issues (described above). Section 5 is a detailed critique of these issues. Section 6 states the conclusions and specific recommendations.

2. CURRENT FEATURES OF THE ELECTRICITY SECTOR

2.1. Capacity and generation

Growth in demand for electricity has been accelerating in Spain in recent years after a lull in the early 1990s (see Figure 1). Peak demand in mainland Spain in 1998 was 29.5 GW, an increase of 2.1 GW in one year, and energy supplied increased by 6.5%.

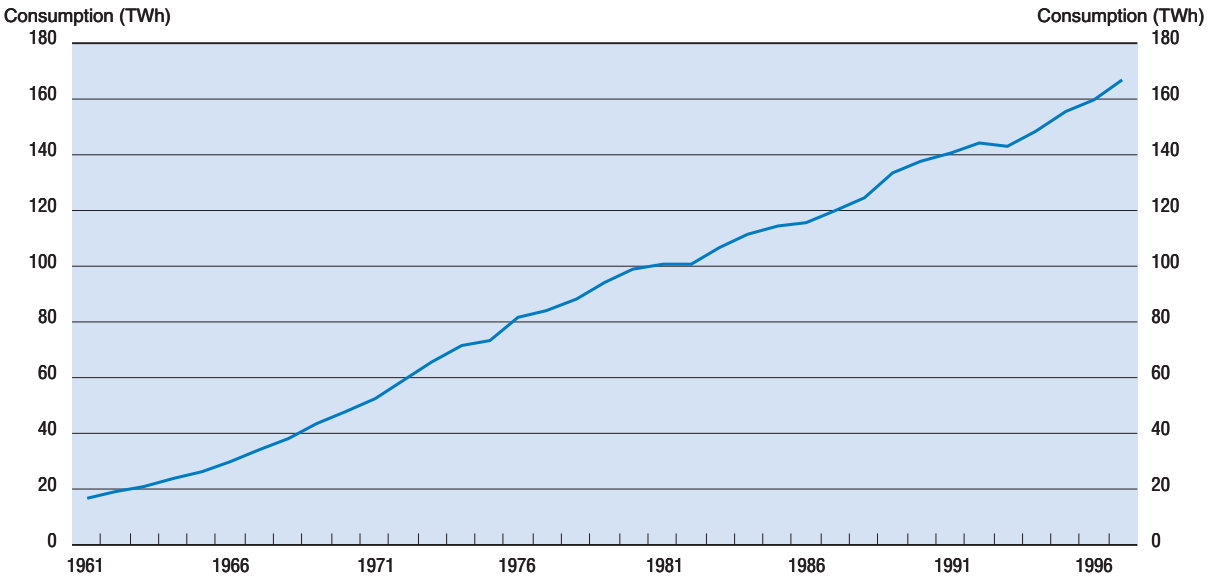
The capacity available in 1998 to meet this peak demand on mainland Spain was nearly 51 GW. This implies a reserve margin of over 50%. This represents a sizeable surplus over normal planning requirements of 20-25%, even accounting for fluctuations in available capacity from hydroelectric power, which accounts for about one third of total capacity.

Fuel mix for domestic electricity generation in 1998 shows a mix of coal (35%), nuclear (31%) hydroelectric (20%), oil (6%), gas (7%), and renewables (1%) (see Figure 2).

Coal supplies 35% of all power generated and is used for baseload and midload operation. Over 80% of coal used for power generation comes from domestic sources of hard coal or black lignite (*lignito negro*) and brown coal (*lignito pardo*).

Hydroelectric generation is important for meeting peak demand but highly variable, depending on annual rainfall. Production in 1998 of 36.6 TWh represented a 12% decrease over 1996 but was still 50% higher than in 1995. Electricity production from fossil fuels is increased or decreased to accommodate these changes.

Figure 1. **Electricity consumption in Spain**



Source: IEA/OECD (1999), *Energy Balances of OECD Countries 1996-1997,* Paris.

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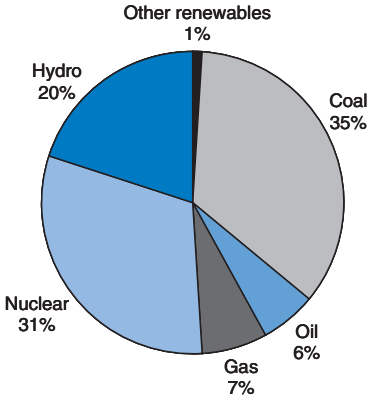
Figure 2. **1998 fuel shares in Spanish power generation**



Source: Ministry of Industry and Energy.

Nuclear power produced 31% of all electricity requirements in Spain in 1998 and is used for supplying baseload power. The performance of current plants (as measured by capacity factor) is among the best in OECD countries (see Table 1).

Most of the nuclear plants are jointly owned by the utilities in varying shares. The utilities are currently considering options for separating the ownership of each plant.

Natural gas and oil-fired plants generate most of the remaining power. Natural gas generating capacity has been expanded in the 1990s as existing gas infrastructure has been enlarged. Independent producers have built gas-fired cogeneration facilities to supply base load generation. Utilities have modified some of their oil-fired capacity to burn natural gas for peaking loads. Oil-fired generation has consequently decreased and is primarily used to supply non-mainland Spain and some peak demand in mainland Spain.

Table 1. **Nuclear power production in Spain**

Plant	Began operation	Capacity (MW)	1998 Production (TWh)	1998 Capacity factor (%)
J. Cabrera	1969	160	1.167	83.8
Garoña	1971	466	3.952	96.9
Almaraz I	1981	974	8.29	97.2
Ascó I	1983	973	7.628	89.5
Almaraz II	1983	983	6.070	70.5
Cofrentes	1984	1 025	8.473	95.1
Ascó II	1986	976	7.691	90.3
Vandellós II	1988	1 009	8.716	98.6
Trillo I	1988	1 066	7.015	75.1
Total		7 633	59.002	88.4

Source: Ministry of Industry and Energy.

2.2. Transmission

Red Electrica de España S.A. (REE) operates the high voltage transmission network in Spain. Created in 1985 and majority owned by Endesa until 1997, it owns 95% of 400 kV lines in Spain and about 30% of the 220 kV (the rest is owned by the utilities). REE is 25% owned by the government; each of the four utilities holds 10%, the maximum now permitted by law. The government has begun the process of privatising REE and sold 35% in 1999 and plans to sell its remaining shares by 2003.

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2.3. International trade

There are limited interconnections with Portugal, France, Morocco and Andorra. Total import capacity is approximately 1700 MW, about 6% of peak load. Spain is normally a net importer from France and a net exporter to the other countries. Imports in 1998 of 4.7 TWh, principally from France, amounted to 3% of gross demand, about one third of maximum potential annual transfer capability.

Table 2. **Spanish electricity interconnections and 1998 trade**

	Capacity (MW)	1998 imports (TWh)	1998 exports (TWh)	Net (TWh)
France	900 im-700 ex	4.568	0.119	4.449
Portugal	650 im-750 ex	0.031	0.308	–0.277
Morocco	300 im-350 ex	0.003	0.706	–0.703
Andorra		0	0.115	–0.115
Total	1 850 im-1 700 ex	4.687	1.283	3.404

Source: Red Electrica.

2.4. Industry structure

Electricity production and distribution in Spain is dominated by two privately-owned utilities, Endesa and Iberdrola, that together produce about 76% of all electricity generated and have 81% of the sales. In 1998, Endesa plants provided the marginal capacity 59.2% of the time whereas Iberdrola supplied the margin 23.7% of the time.

Grupo Endesa was originally a government-owned generation company (created in part to use domestic coal resources). It has acquired other electric utilities over the past decade to become the largest utility in Spain. Endesa's generating capacity of 23 GW produced 85 TWh in 1998 and gave it a 48% share of all electricity production in Spain (Endesa is the fourth largest utility in the European Union as measured by generating capacity). Endesa's generating capacity is principally coal and nuclear, with a smaller portion of hydroelectric and gas-fired generation. It sells power to 9.3 million customers, giving it a 42% share of the Spanish market. Endesa is also diversifying its investments into electricity in Portugal and Latin America, as well as other network industries in Spain such as telecommunications and water distribution. In 1998, the government's remaining shares in Endesa were sold. The government retains a "golden share" which protects Endesa from takeover until 2005.

Iberdrola is a privately owned company and produces 26% of all electricity. Most of its generating resources are hydroelectric and nuclear power with relatively small contributions from fossil fuel. It serves 8.8 million customers selling 39% of all electricity sold in Spain.

The other two utilities are Union Fenosa, which generates 10% of the total and Hidrocantabrico with 4%.

Independent power generation now provides 11% of all energy generated, up from less than 2% in 1990. IPP development has been encouraged through the so-called "special regime", which requires utilities to purchase energy produced from cogeneration and renewable energy sources at premium prices fixed by the government. Approximately two thirds of independent power generation is from cogeneration using fossil fuels; the remaining third use renewable energy principally hydropower but also wind and energy from waste. As a result of the "special regime", IPPs choose to sell to utilities, thus do not affect market prices.

Distribution (the low voltage physical transportation of electricity) to 21 million electricity consumers occurs through the utilities operating under a concession granted by the autonomous regional authorities or the national government, in the case of distributors serving more than one autonomous community. There are also 516 small distributors supplying about 200 000 customers through co-operatives, purchasing power from the surrounding utility.

UNESA is a utility association that has traditionally played a substantial role in co-ordinating the activities of the utilities, including co-ordinated planning, negotiation of fuel purchases with suppliers, analysis of economic and financial issues, and research and development. It has represented the utilities before national bodies such as the CNSE. Liberalisation of the electricity market requires the utilities to

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Table 3. **1998 Electricity production and sales**

Producer	Capacity (GW)	Net generation (TWh)	Share of generation market (%)	Customers (Millions)	Sales (TWh)	Retail market share (%)
Endesa Group	22.9	85	48	9.4	74	44
Iberdrola	16.3	47	26	8.3	62	37
Fenosa	5.2	19	11	2.8	22	13
Hidrocantabrico	1.7	8	4	0.5	7	4
Total central production/sales	46.2	159	89	20.8	165	98
IPP ("special regime")	5.5	20	11	–	–	–
Small distributors	–	–		0.2	3	2
Total	51.7	179	100	21	168	100

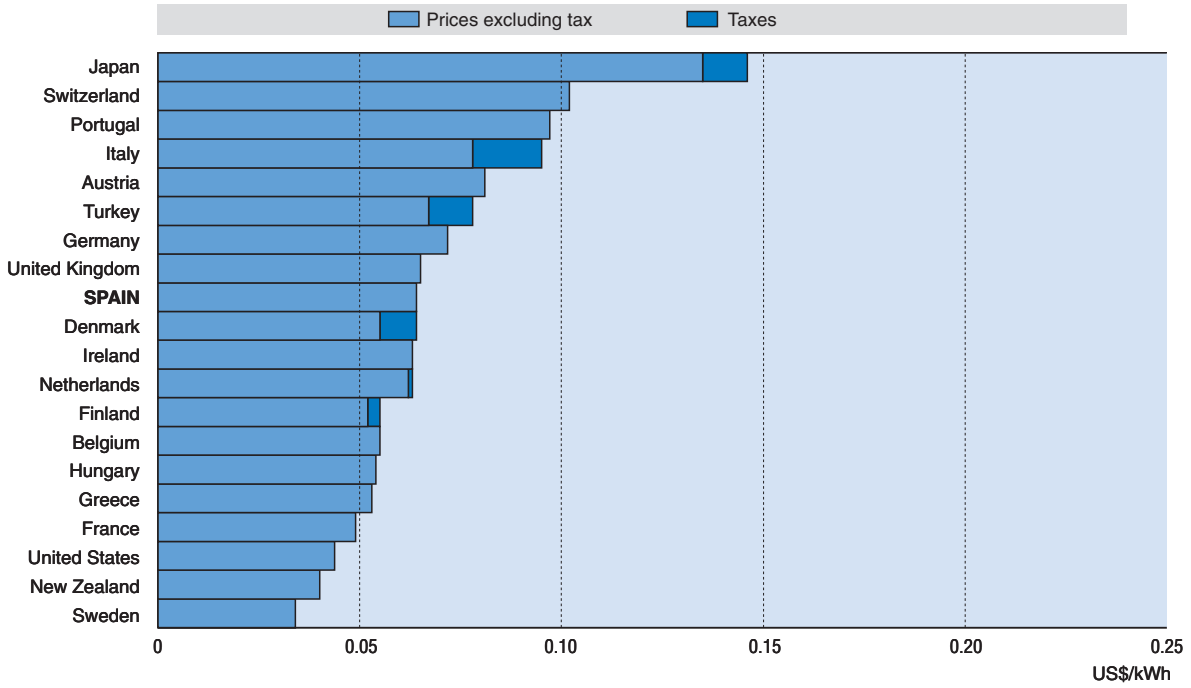
Notes: These totals includes 2.7 GW and 8.645 TWh extrapeninsular generation on the Canaries, Baleares Islands, Ceuta and Melilla generated by Endesa and 0.155 GW and 0.61 TWh extrapeninsular generation by autoproducers. These totals also include 9 TWh sales by Endesa to 1.3 million extrapeninsular customers.
Sources: Company annual reports, Ministry of Industry and Energy.

undertake commercial activities such as fuel purchasing separately. Due to such changes UNESA has been required to redefine its activities and change from a corporation to a non-profit association with the potential for much broader membership. UNESA has reduced staff by two thirds.

2.5. Electricity prices and costs

Industrial electricity prices in Spain are in the middle among OECD countries (Figure 3). By contrast, domestic prices before tax are among the highest in the OECD (Figure 5).

Figure 3. **Industrial electricity prices in selected OECD countries 1997**



Source: IEA/OECD (1998), *Energy Prices and Taxes*, Paris.

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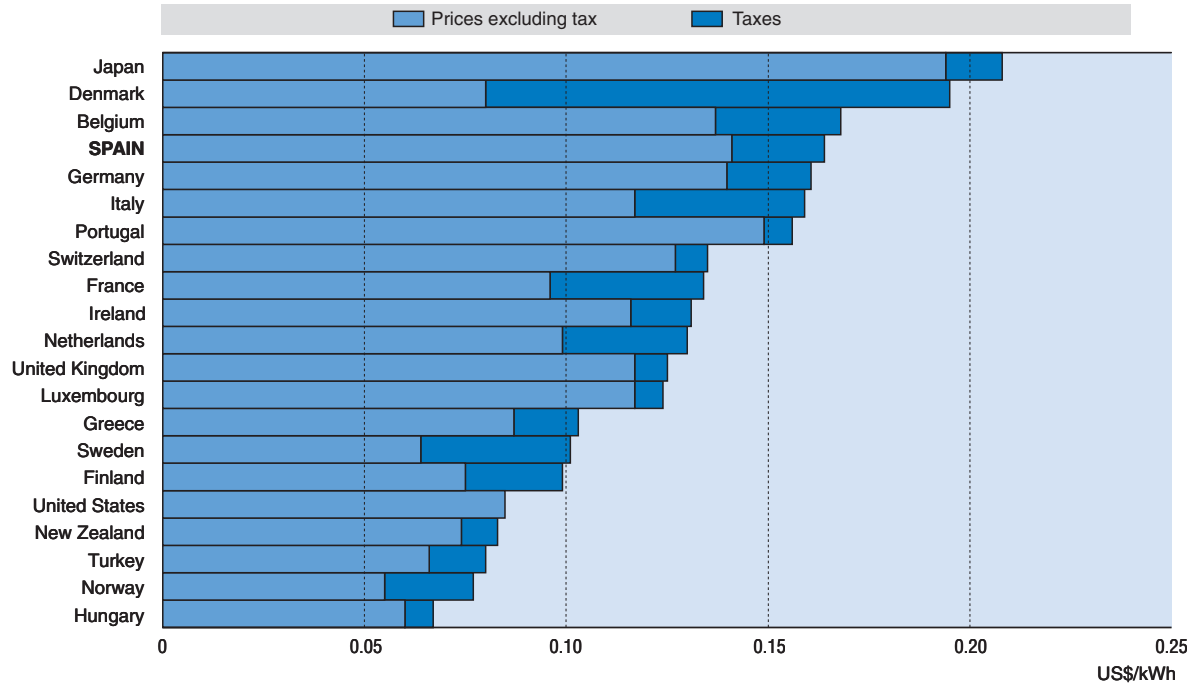
Figure 4. **Domestic electricity prices in selected OECD countries 1997**



Source: IEA/OECD (1998), *Energy Prices and Taxes,* Paris.

A breakdown of components of 1999 estimated electricity costs, before taxes, is shown Table 4.

Table 4. **Components of projected 1999 electricity costs for Spain**

Items	Costs (Ptas billion)	Share (%)
Production and related	**1 113**	**56.5**
Production and imports	695	35.5
Special regime production (payments to independent producers)	222	11
Capacity payments	196	10
Transmission and related	**117**	**6**
Ancillary services	30	1.5
Transmission	87	4.5
Distribution and related	**473**	**24**
Distribution	418	21
Retailing	40	2
Quality of service enhancement	10	0.5
Demand management	5	0.25
"Permanent costs"	**169**	**9**
System and market operators, CNSE	3	0.15
Costs of the transition to competition (coal related see Section 4.9)	58	3
Costs of the transition to competition (technology related see Section 4.9)	88	4.5
Extrapeninsular system	20	1
Diversification and security of supply costs	**87**	**4.5**
Nuclear moratorium (see Section 4.6)	69	3.5
Nuclear fuel cycle	17	1
Other	1	0.1
Total	1 960	100

Source: Ministry of Industry and Energy.

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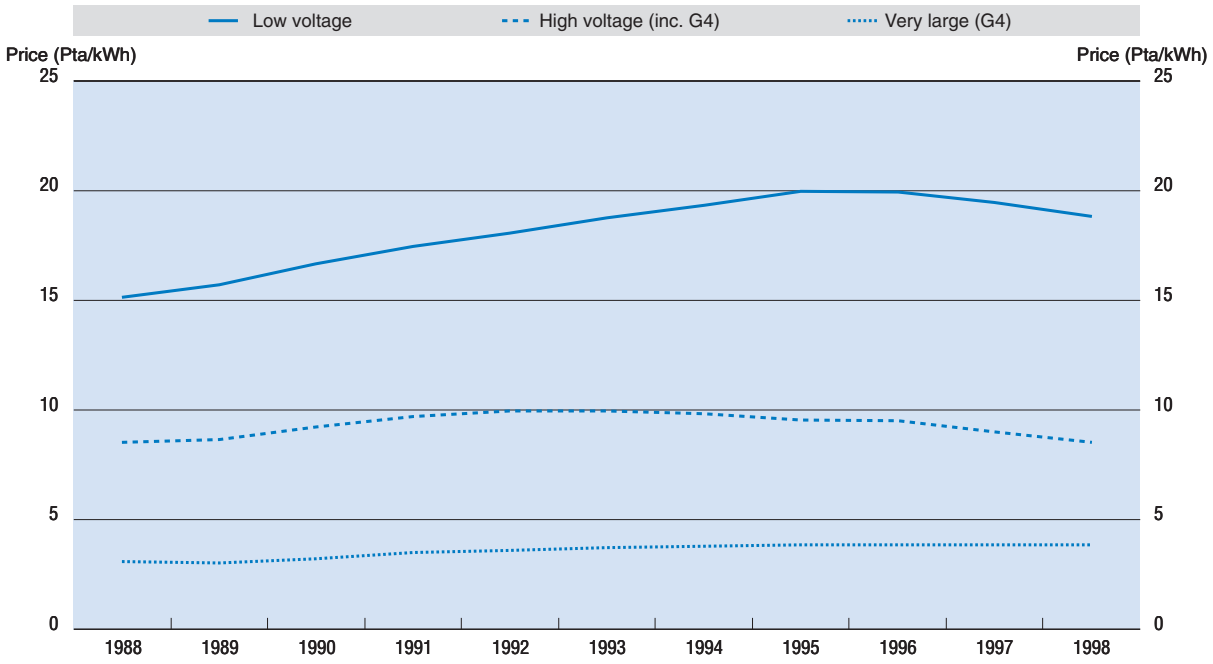
Energy policy-related costs have been important in pushing electricity costs and prices higher in Spain. These include support for the domestic coal industry through an *ad valorem* tax of 5.113%, compensation to the utilities for the nuclear moratorium and for the costs of transition to competition, subsidies for the special regime production, demand management and quality of service enhancement, and subsidies for the extrapeninsular system, payments for the nuclear fuel cycle and other diversification costs, and the so-called capacity payments. The above factors together constitute one-third of total power costs in Spain and are discussed in more detail in Section 4 below.

Two other factors also have contributed to higher prices. Fuel costs have been relatively high because of high cost domestic coal and because natural gas has until recently only been available as relatively expensive liquefied natural gas (LNG). Spain's nuclear power program has also been relatively expensive.

Prices rose more slowly than inflation in the early 1990s and have decreased about 11% from mid-1996 to mid-1999. There are large variations in price by voltage: very large consumers pay less than 4 Ptas/kWh vs. small consumers who pay approximately 20 Ptas/kWh (see Figure 5).

Figure 5. **Electricity prices 1988-1998**



Source: UNESA.

Regulated prices have declined in line with falling unit costs. These reflect the resumption of robust growth in demand and a fall in interest expenses due to falling debt levels (because of a much lower level of utility borrowing) and a decline in interest rates. The fall in industry price is quite significant compared to other OECD countries (Figure 6).

Electricity tariffs are the same throughout Spain including the islands. Customers pay different retail electricity tariffs depending on the voltage at which they receive electricity. The basic tariff structure is a two-part tariff. Customers pay for capacity (in kW) and for energy (kWh). In order to increase economic

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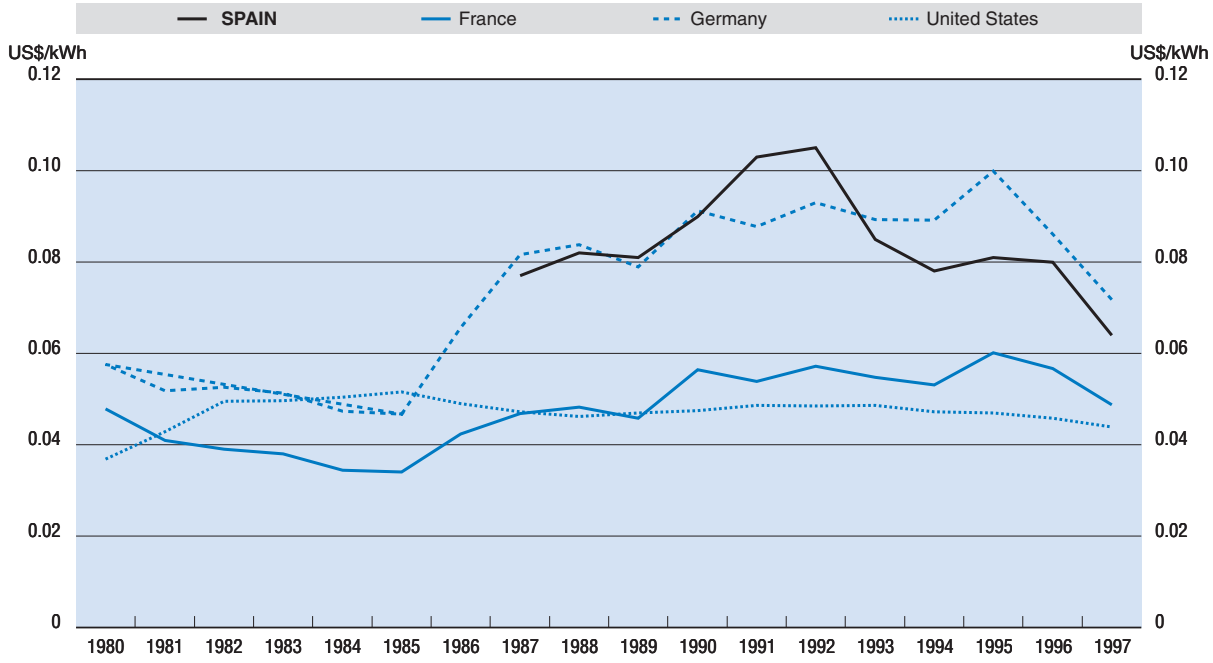
Figure 6. **Industrial electricity prices in selected OECD countries 1980-1997**



Source: IEA/OECD (1998), *Energy Prices and Taxes,* Paris.

efficiency, electricity tariff options have been introduced that allow low-voltage customers to pay lower prices at night time than in the day time and also to vary by season (with higher charges in the winter and summer seasons). Approximately 11% of low voltage customers have taken advantage of this tariff option. Large customers can opt for a tariff that varies hourly according to the market price. Tariffs for use of the network vary by voltage, but not by location or by time of use.

Medium-voltage and high-voltage customers will also be able to benefit from interruptibility discounts until 1 November 2000. Approximately 37% of the Spanish electricity load benefits from such discounts. These discounts were worth Ptas 49 billion in 1997.

2.6. Environmental protection

Acid gas emissions

Existing regulations in Spain regulate SO_2 and NO_x emissions in line with the EU Large Combustion Plant Directive (88/609/ECE) through Royal Decree 646/91. Power companies have been reducing their emissions to meet these regulated limits through a combination of substitution of natural gas for oil and to a lesser extent coal, increased use of lower sulphur imported coal, investments in flue gas desulphurisation units at several plants, uprating and improving nuclear power plant performance, and utility demand-side management programs. As a result, SO_2 emissions have fallen by 20% and NO_x by 9% since 1990. The Royal Decree limits for 1998 and 2003 are compared to actual production in 1990 and 1997 in Table 5.

While SO_2 emissions are well below regulatory limits, NO_x emissions are not. Utilities have made investments in low-NO_x emission burners for the coal-fired power plants to reduce emissions in 1998 by

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Table 5. **Spanish SO_2/NO_X emissions and 1998/2003 emissions limits**

Emissions	1990	1997	1998 Limit	2003 Limit
SO_2 (kt)	1 550	1 231	1 730	1 440
NO_X (kt)	300	274	277	277

Source: CNSE.

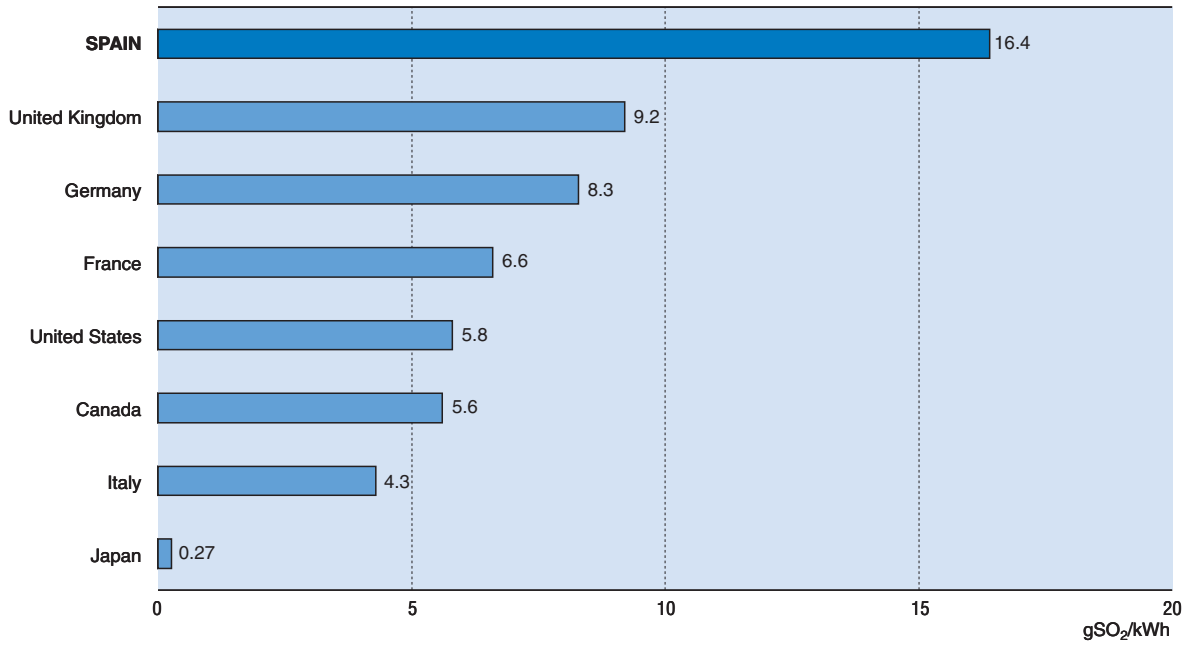
17% over 1997 despite an increase in fossil-fired generation. As a result, the large combustion plant limits set out by the EU directive are likely to be met.

Emissions of SO_2 and NO_x per kilowatt-hour produced are very high compared to other OECD countries (see Figures 7 and 8). The lack of emissions control systems on most plants, combined with the poor quality and high sulphur content of domestic coal are primary reasons for these relatively high figures.

Greenhouse gas emissions

Spain's target for reduction of all greenhouse gases under EU agreements amounts to an increase in the emission of the basket of greenhouse gases of 15% over 1990 levels during the period 2008-2012. In the shorter term, the Ministry of Industry and Energy had set a target of a 15% increase in energy sector CO_2 emissions over the period 1990-2000. Power sector emissions account for 25-30% of total carbon dioxide emissions from fuel combustion. Emissions from the power sector in 1998 are slightly below that of 1990, despite a 23% increase in power production, owing to increased generation from hydropower (which was unusually low in 1990), increased nuclear output and increased independent power production much of it using natural gas which displaced utility oil-fired generation. However, increases in emissions from other sectors have boosted total energy-sector CO_2 emissions 15% above 1990 levels.

Figure 7. **Average SO_2 emissions per kWh of thermal power generation in selected OECD countries**



Source: OECD/IEA, *Federation of Electric Power Companies of Japan,* CNSE.

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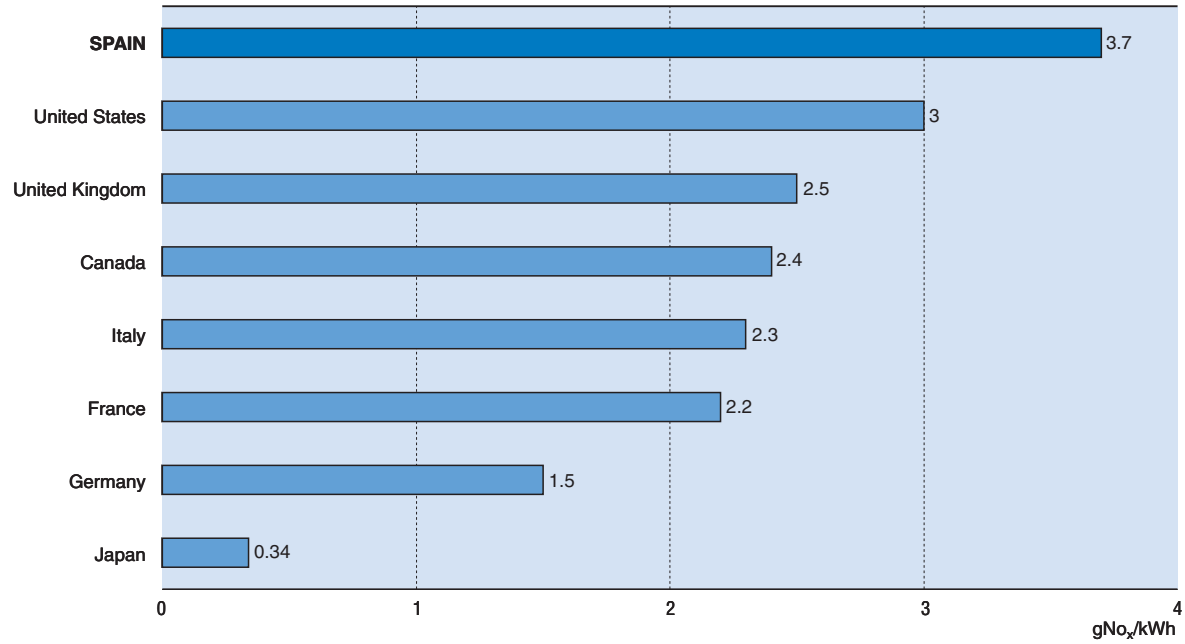
Figure 8. **Average No_x emissions per kWh of thermal power generation in selected OECD countries**



Source: OECD/IEA, *Federation of Electric Power Companies of Japan,* CNSE.

The government is currently developing its national climate change strategy. As part of that the development, the National Climate Change Council, a government advisory body, has identified a number of policy options for combating climate change that would affect the power sector. These options include increased energy efficiency, substitution of natural gas for coal or oil in power generation, and greater use of nuclear power and renewable electricity generation.

Renewable energy

The government has ambitious plans for the development of renewable electricity generation. The *Energy Savings and Efficiency Plan* aims to increase capacity of renewable electricity generation to 1188 MW (and annual energy production to 4.2 TWh) by 2000 and a further objective of 12% of all energy demand in 2010 be met by renewable energy. Renewables are promoted by direct government subsidies and a "special regime" which requires the utilities to purchase renewables and cogeneration from independent producers at premium prices. About 30% of total production under the "special regime" comes from renewable energy, and the rest from cogeneration. The subsidy cost was Ptas 5.1 billion in 1998. Special regime payments to renewable energy producers (excluding large hydro producers) amounted to Ptas 40 billion in 1997.

As a result, there has been a substantial increase in renewable electricity production. Between 1990-96, renewable energy production from non-hydro sources increased at an annual rate of 17.6%. In 1997, special regime generation by small hydro, wind and wastes produced 3.5 TWh. Endesa and Iberdrola own about a third of the 1718 MW of renewable power generating capacity through subsidiaries.

Wind-generated electricity capacity has doubled in the past two years to nearly 1000 MW and is expected to continue to increase its contribution to Spanish electricity generation as a result of the favourable subsidies and availability of suitable sites. The Ministry's Institute for the Diversification and

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Conservation of Energy (IDAE), whose functions include the promotion of renewable energy, estimates up to 15 000 MW of additional capacity could be constructed under the special regime.

3. REFORM OF THE ELECTRICITY SECTOR

The current Spanish electricity reforms have developed in a policy context where industrial policies, security of supply and public service objectives have shaped the efforts to reform the sector. Industrial policy and security of supply, or more specifically energy self-sufficiency, manifest themselves primarily through the support of the domestic coal mining sector, but also through support of nuclear power and the special regime. The main public service objectives are to ensure universal service at a common price with a high standard of reliability throughout the country. These public service objectives reflect the fact that full electrification in Spain has arrived somewhat later than in other European Union countries.

Against these long-standing public policy objectives, the main objectives of the 1997 Electricity Act are to lower Spanish electricity prices and improve the quality of service by increasing operational freedom, in a manner compatible with security of supply and environmental protection.

Against these public policy objectives, the government of Spain has been engaged in a long process of reforming the electricity sector using a combination of regulation, privatisation, and liberalisation. An early step was the creation of Red Electrica in 1985 as an operationally separate national transmission system and system operator, the first country in the OECD to do so. The 1987 law (*Marco Legal Estable* – MLE) set out a new scheme for regulating the electricity sector based on standard costs that would provide companies incentives to improve their efficiency. The MLE also introduced a new pooling mechanism to account for highly divergent electricity generation costs among the different companies and reformed the financing of the coal and other subsidies. In 1988, Endesa was partially privatised.

By 1994, the government recognised the need for liberalisation and greater transparency to further improve efficiency and reduce the cost of electricity. The electricity sector restructuring law (*Ley de Ordenación del Sistema Electrico Nacional* - LOSEN) would have created an independent system, as a parallel system of electric supply that would have operated along with the integrated utility system. Under the independent system, producers and consumers would have been able to have access to the transmission and distribution networks and would have been able to contract freely including imports and exports for the supply of electricity although backup services would have had to have been provided by the integrated system. An important proviso of the law was that the independent system could not have led to price increases in the integrated system, *e.g.*, through loss of customers.

The law also required that new generation transmission and distribution assets for the integrated system be procured through an open tender process. Utilities were also required to undertake accounting separation of the generation and distribution activities, to have been followed by legal separation (*e.g.*, putting these activities in a separate subsidiary) by 31 December 2000.

The law also established an independent electricity consultative body, the predecessor to CNSE. Its main responsibilities were to act as a consultative body to the government on energy policy matters, make reports on the tender process, determine the allocation of revenues among the companies, act as an arbitration body on quality of service matters, and protect competition through giving advise on mergers and acquisitions. The majority of the regulatory functions such as rate setting remained with the government.

The law also set out the amount of compensation electricity consumers would be required to pay utilities for the nuclear moratorium and defined the recovery mechanism.

However, the key market-based reform, the independent system, was never actually put in place. A new government elected in 1996 favoured more ambitious reforms consistent with the EU Electricity Directive that was under negotiation at that time. In December 1996, the same month the EU Directive was agreed, the government and utilities reached agreement on a new package of reforms that formed the basis of a new Electricity Law that was passed a year later.

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The 1997 Act provides the basis for the current system that will lead to a fully liberalised electricity market, with new market institutions, and a mechanism for recovering costs for the transition to competition. Following a further negotiated agreement with the utilities in September 1998, the government made amendments to the legislation that will lead to a more rapid liberalisation of the market and a change in the maximum and minimum costs of the transition to competition. A further tariff reduction and acceleration of the liberalisation was set by Royal Decree in April 1999. These amendments came a few months after the government had disposed of its remaining shares in Endesa. These reforms are discussed in Section 4.

4. MARKET STRUCTURE AND REGULATORY FRAMEWORK

4.1. Institutions

Regulation of the electricity sector is concentrated at the national level, with important additional functions carried out by the autonomous communities and by the European Commission. There are three regulatory bodies that are competent at the national level. The Ministry of Industry and Energy is the principal regulator of the electricity sector. The CNSE (National Electricity Regulation Commission) is an independent body whose principal functions are advisory except for those related to dispute resolution and some mergers. The Spanish Tribunal for the Defence of Competition has the power to apply antitrust rules to the electricity sector. At the regional level, the autonomous community governments have specific regulatory functions with respect to distribution, quality of service and development of independent generation. The European Commission's competition directorate (DG IV) and energy directorate (DG XVII) also have the ability to intervene on certain issues.

The Ministry of Industry and Energy is the most important authority in electricity regulation. In addition to having overall policy responsibility for reforms the Ministry:

- Sets tariffs and charges such as:
  - Network access tariffs;
  - Regulated retail tariffs;
  - Prices paid for generation under the special regime.
- Allocates revenues among utilities for different cost components such as:
  - Costs for the transition to competition including size of payments for using domestic coal.
  - Permanent costs of the system including the cost of market and system operators and the CNSE.
  - Costs of demand management and service quality improvement programs.
  - Supply diversification costs.
- Regulates the operation of the power market. The Ministry issues licenses to participants, provides authorisations for new generators and exercises authority in the planning process.
- Approves transmission projects.
- Establishes minimum quality and safety standards.

By contrast, the sector regulator, the *Comisión Nacional del Sistema Eléctrico* (CNSE) initially created in the 1994 Act, has few powers. Rather, it plays a more important role as advisor and as consultative body. According to the 1997 Act, the principal functions of the CNSE are to:

- Respond to the requests for consultation by the Ministry on any electricity matter.
- Participate through proposal and reports, in the determination of tariffs and remuneration of activities within the electricity sector.
- Participate through proposals and reports, in the development of regulations by the Ministry, electricity planning, authorisation of new generation and transmission facilities.

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- Carry out the settlement of costs of transmission and distribution and other regulated costs, and, when requested to do so, inspect "the economic conditions of agents as these affect tariffs and the effective unbundling of the system".
- Arbitrate disputes between agents.
- Resolve disputes on access to the transmission and distribution networks.
- Approves mergers and acquisitions of transmission and distribution companies. CNSE is empowered not to authorise them or to impose conditions when there may be a negative impact on the performance of the industry.
- Reports to the Fair Trading and Restrictive Practises Services (*Servicio de Defensa de la Competencia*) when it detects the existence of evidence of restrictive practises affecting competition under the Competition Act 1989.

A Board composed of a Chairman and 8 commissioners governs the CNSE. The Chairman and commissioners are appointed based on "acknowledged technical and professional ability" by the government after a review by the parliament. Once appointed, the Chair and Commissioners cannot be removed by the Ministry. The Commission and its staff of 73 are financed through a levy on electricity tariffs whose size (0.56% in 1999) is set by the government.

To carry out its duties, the CNSE has significant powers to require information to be given to it by the various market participants. Market participants have the ability to appeal these requests to administrative courts. Decisions of the CNSE other than requests for information and dispute resolution rulings are appealable to the Ministry.

The CNSE has several mechanisms to ensure the transparency of its activities. First, it has a Consultative Council that acts as an advisory body, with representatives from Autonomous regions, the government, the Nuclear Safety Council, the electric power companies, the market and system operators, consumers and users and other social organisations, and environmental groups. Second, all its decisions are published. Third, the Commission and particularly the Chair has been very active at making the views of the Commission known through other publications put out by the Commission and its staff and other means. Fourth, the Commission maintains an Internet website where many of its publications are available.

A new energy advisory body (*Comision Nacional de Energia* - CNE) has been created with jurisdiction over electricity and natural gas and hydrocarbons and has superseded CNSE in the year 2000. The CNE has much the same legal capability as CNSE had with a few additions. The government is obliged to seek the views of the CNE for all energy laws and regulations proposed but is not obliged to follow this advice. The CNE will also have the power to authorise activities of regulated companies who wish to diversify into other business lines.

As noted above, the Spanish competition authority (the Tribunal for the Defence of Competition) does have competence with respect to application of antitrust rules. The CNSE plays a monitoring role in this regard in two different areas. When the CNSE detects restrictive trade practices, it has the duty to notify the Fair Trading and Restrictive Practices Service and provide a report on the matter. The Service must then decide whether to bring it to the attention of the Tribunal. Conduct that is authorised by other law or regulation is excluded from the Competition Act. In the case of mergers generally, the Ministry has complete discretion regarding the referral of to the Tribunal on competition grounds. Nevertheless, in the case of involving electricity companies, the CNSE is required to produce and submit a report to the government on the competition implications. The government can then refer the report to the Tribunal.

Several competition cases have already arisen in this sector. The EU is reviewing a joint venture between a Spanish and a Portuguese firm to build a transmission line. The Servicio is supporting the venture, because it creates a new supplier. The competition authority and energy regulator are co-operating in evaluating another joint venture matter. Complaints about access are being filed with the Servicio and reviewed by the Tribunal, which has decided at least three cases in this sector so far. The Gas Natural-Endesa accord was referred to the Tribunal for second-phase investigation into its potential market foreclosing effects. The merger of Gas Natural Endesa's gas distribution assets in Aragón and Andalucía was

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forbidden by the Government due to its potential market foreclosing effects on the gas distribution market of these two autnomous communities.

Autonomous communities have competencies in several areas, including the approval of distribution facilities and other electric facilities "when their use does not affect other regions" (*e.g.*, small generation facilities), the concession rights for electricity distribution, and development of regulations with respect to connection of supply, and the enforcement of regulations with respect to quality of service. The regions are also represented on the consultative council of the CNSE. The autonomous communities also play an important role in supporting the development of independent generation, and have the right to put additional charges on the bills of electricity customers in their region to recover the costs of such support.

The European Commission's Competition Directorate (DG IV) also has the ability to intervene on competition issues affecting the Spanish electricity sector. First, it has a role in ensuring that the non-discriminatory open access requirements of the electricity directive are actually being respected, particularly in regard to international access to the Spanish market. Second, it has competence over mergers and acquisitions and their possible competition impacts, when such mergers and acquisitions are international in scope. Third, it has competence over transition costs awarded to utilities by governments and whether such awards constitute state aids and in this regard, it can determine whether such state aids are consistent with Community rules and can require such aids be modified.

The Energy Directorate (DG XVII) is responsible for ensuring that provisions of the EU Electricity Directive are being respected.

4.2. Framework for competition

The main elements of the Spanish electricity reforms are:

- Phased in access to the power market of electricity customers, starting with the largest customers in 1998 and extending to domestic consumers in 2007.
- Competition in the generation of electricity through an electricity market and contracts between customers and suppliers.
- Non-discriminatory access to transmission and distribution networks.
- Free entry into the generation of electricity.
- Legal separation of network businesses (transmission and distribution) into distinct operationally separate companies from commercial businesses of generation and retail supply.
- Regulation of the network and end-user tariffs by the Ministry.

Liberalisation of retail supply

The government plans to liberalise supply to electricity customers in mainland Spain over a 10 year period. Approximately 500 customers above 15 GWh constituting 27% of total electricity demand have been able to choose supplier since January 1, 1998. As a result of an agreement between the government and the electricity companies, the original timetable for larger customers was accelerated. In January 1999, the eligibility limit fell to 5 GWh (1 926 customers purchasing 33% of total electricity sales). As of October 1999, all consumers with annual average demand exceeding 1 GWh are eligible to choose supplier, 4 years earlier than previously scheduled.

In April 1999, the government announced a further acceleration of the electricity liberalisation schedule as part of an inflation-fighting program. As a result all high voltage consumers (using supply above 1 kV) will be eligible to choose supplier as of 1 July 2000. All other customers are scheduled to be able to choose suppliers in 2007, although the Minister has indicated this date could be advanced to 2004 (see Table 6). At this time there is no plan to liberalise extrapeninsular customers because of the limited scope for competition. The schedule for liberalisation is considerably more extensive and more rapid than required by the EU directive (Figure 9).

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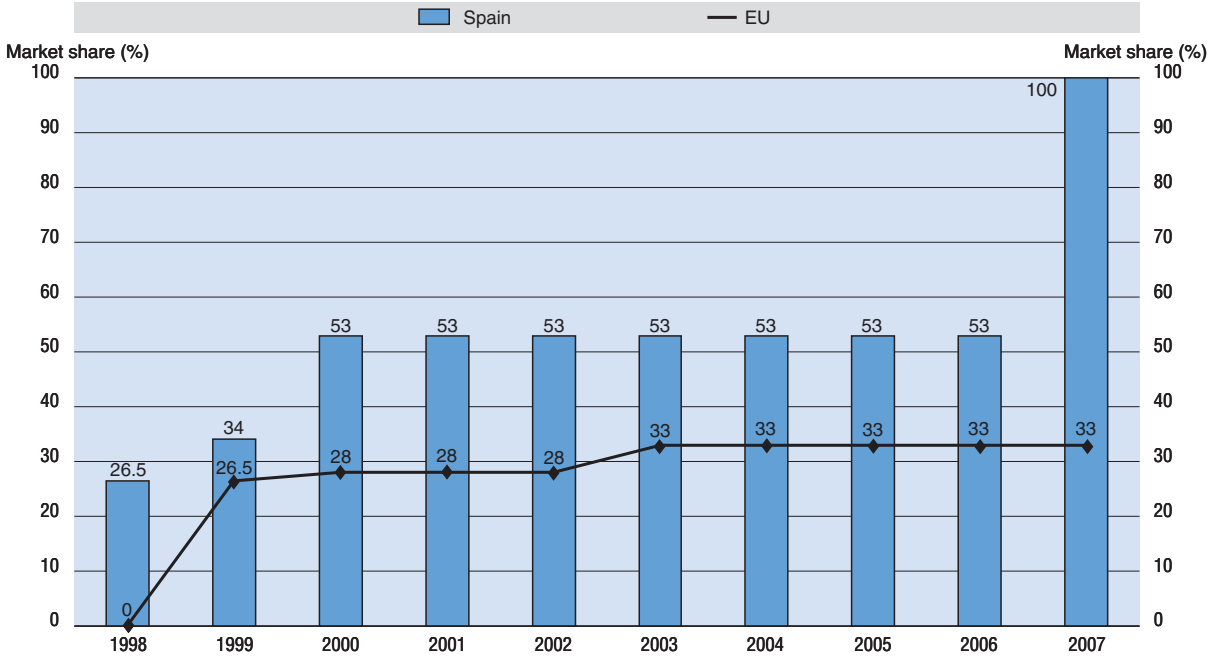
Table 6. **Schedule for liberalisation of electricity consumers**

Date	Annual energy use (GWh)	Number of consumers	Eligible energy sales (GWh)	Share of market (%)
1 January 1998	> 15	558	40 235	26.5
1 January 1999	> 5	1 926	51 380	34
1 April 1999	> 3	3 254	56 549	37
1 July 1999	> 2	4 706	60 011	39
1 October 1999	> 1	8 274	65 011	43
1 July 2000	> 1 kV	61 000	78 880	53
1 January 2007	All	19.7 million	168 000	100

Source: OECD.

Figure 9. **Electricity market opening in Spain *vs* EU directive**



Source: OECD.

Access to networks

All generators are entitled to have access to transmission and distribution networks and compete to sell electricity either through a spot market or through bilateral contracts with customers. Generators operating under the special regime have priority dispatch.

The system operator (REE) is required to provide access to the high voltage system and corresponding distribution network managers are required to provide access to the low voltage systems to agents and qualified customers. The system operator or distribution network managers can only refuse access on the grounds of lack of available capacity. Tariffs are regulated by the Ministry. Disputes over the terms of network access contracts are to be settled by CNSE

The system operator also has statutory responsibility for transmission system expansion planning and managing expansion of the network. Projects within a single autonomous region require the approval

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of the regional government (following the receipt of a report prepared by the national government) based on satisfying legal, technical, financial and environmental requirements. Interregional or international projects require approval of the national government. Construction of the transmission lines by competitive tender is permitted.

Market operation

The *Compania Operadora del Mercado Espanol de Electricidad*, S.A. (COMEESA) has been created to operate the national electricity market. COMEESA performs its functions under the monitoring and control of a Market Agents Committee. The committee, composed of market participants, monitors the operations of COMEESA and may propose rule changes to the Ministry.

Market operation is based on a day-ahead market. The market operator accepts the bids in order of price, modifies the accepted bids in consultation with the transmission network manager (REE) to relieve technical restrictions, and then runs a secondary market for backup power for the day. In addition, there is an intraday market, with up to 6 sessions, which allows further adjustments to the schedule by producers and customers to smooth supply by individual generators and to deal with events on the day such as generator unavailability. In December 1998 the intraday market was about 6% of the size of the day-ahead market. Ancillary services are acquired by bidding and auction mechanisms managed by the system operator.

The main participants in the market are the utilities, the qualified customers, agents authorised to trade electricity, and importers of electricity. The utilities play several roles, acting as generators, distributors, suppliers purchasing power for customers remaining on regulated tariff, and agents acting for liberalised customers with whom they have a contract. Qualified customers can opt to enter as market participant but can also remain with a regulated supplier on a regulated tariff. Ninety retailing companies have been created. Distributors are also eligible to purchase from the market and, to date, 185 distributors have registered to do so. National utilities in Portugal, Morocco, France, and Belgium, as well as the four Spanish utilities, are all authorised importers into the Spanish market The U.S. company Enron and the Norwegian firm SKS Energy Brokers, Eastern Group of the UK and the Swiss firm Aare-Tessin are also authorised to import and trade.

All market participants must register with the Ministry after demonstrating they meet criteria for qualification. For customers the only material criterion is that they purchase enough electricity to qualify. Customers can then purchase power directly from the market, through a contract for differences arrangement with a retailer, or through a physical bilateral contract with a supplier.

Entry

Permission to build new power plants is granted under an authorisation procedure consistent with the EU Electricity Directive. Authorisation for new generation plants is required and it is based on technical, safety, environmental, energy efficiency and demonstrated financial, technical and legal capability to carry out the project. Depending on the scope of the generating project, authorisation may be required from either the national or regional government. "Special" electricity generation projects, which include those under 50 MW using cogeneration, renewables or wastes are subject to a separate authorisation by the Autonomous Communities. Hydroelectric projects are subject to additional requirements under the 1985 Water Resources Act.

New companies can enter into distribution of electricity, in principle, as distribution networks are allocated by concession. New companies are able to enter the transmission business as construction of new transmission lines has been opened to tender. Customers or generators are permitted to construct and operate their own lines for their facilities.

Companies can also enter the retail supply of electricity to liberalised customers under authorisation from the appropriate level of government. Approval of the autonomous community government is required for regional/local retailing. The national government must approve retailers operating in more than one region or internationally. Supply to captive customers is the responsibility of the distribution

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companies. Statutory obligations on retailers for liberalised customers and distributors for captive customers include the requirement to purchase sufficient electricity to meet their obligations. Distributors are further required to plan for future needs and to secure necessary contracts to meet these needs.

Vertical and horizontal separation

Spain's electricity sector has built in vertical separation thanks to the creation of REE in 1985. REE has a significant experience as an operationally independent entity both as a transmission network manager and as a system operator. Under the 1997 Act, utility shareholdings in REE are limited to 10% each. Each of the four utilities owns its 10% limit, for a total of 40%. As the law limits total share ownership by utilities or other agents carrying out electricity sector activities to 40%, new entrants into the electricity sector wishing to purchase shares in REE will only to be able to do so if one of the utilities sells some of its shares. There is a similar share structure and limitations in place for the market operator.

The 1997 Act requires the four utilities to "legally" separate generation from distribution activities by 31 December 2000. Furthermore, utility companies who wish to enter the market as retailers may do so only through separate subsidiaries or affiliated companies. Endesa has created a holding company with legally separate subsidiaries for generation, distribution and retailing. Iberdrola and Hidrocantabrico are expected to undertake a similar restructuring. Union Fenosa has already spun off of its generating business and sold a 25% share of the new company to the U.K. generating company National Power.

4.3. Development of the market

Market activity

There was very limited switching of electricity suppliers in Spain in 1998: only about 1% of all energy sold was sold to customers through the open market rather than under regulated tariffs even though 26.5% could have switched to the market. The principal reason, according to CNSE analysis, is that prices for many of the qualifying consumers under the regulated tariff are lower than the prices that could be obtained in the market.

The government, through its agreement with the utilities in September 1998, decided to encourage increased activity in the market in two ways. First, the timetable for increasing the number of eligible customers was accelerated, enabling more customers paying higher average prices to enter the market. Second, the government has lowered charges to customers accessing the market by cutting network charges by 25% and reducing the capacity payment by 1 Pta/kWh.

The short-term impact of the reduction in access tariffs and capacity payment and accelerating consumer choice appears to have had the desired effect. By October 1999, liberalised customers were purchasing approximately 16% of total electricity demand, about 60% of the liberalised load, through the market rather than under regulated tariffs.

Activity in the daily market itself was dominated by the two main generators although in slightly different roles. Endesa is largest generator and supplies over half the fossil-fired generation to the market important for both mid- and peaking-load operation. Iberdrola, by contrast, has relatively little coal-fired generation but has the largest share of hydroelectric output which is critical for peaking load. Between them, the utilities control about 85% of the hydroelectric output on mainland Spain and 100% of the oil/gas capacity that is used for peaking as well. According to analysis carried out for the CNSE, Endesa plants provided the marginal capacity 59.2% of the time in 1998, whereas Iberdrola supplied the margin 23.7% of the time.

New entry

There have been many proposals for new gas-fired power plants in the newly liberalised electricity market. Electricity pool prices have been high enough and the costs of power generation by combined cycle gas turbines low enough at current natural gas prices, to encourage these proposals. All four utilities, Bizcaia Electrica based in northern Spain, and foreign companies, including Enron, AES and Edison

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have all announced plans to construct a total of 14.45 GW gas turbine power plants in Spain. Endesa and Iberdrola are proposing to build over half of the proposed capacity (see Table 7). Endesa has stated that its capacity expansion will be accompanied by closure of some older fossil-fired capacity.

Table 7. **Proposed power generation projects (as of October 1999)**

Firm	Number	Type	GW	Share (%)
Endesa	5	CCGT	4.32	30
Iberdrola	6	CCGT	4	22
U. Fenosa	2	CCGT	2.4	8
Hidrocantabrico	1	CCGT	0.45	3
Enron	1	CCGT	1.2	8
AES	1	CCGT	0.8	6
Edison	1	CCGT	0.4	3
Bizcaia Elec.	1	CCGT	0.8	6
Bizcaia Energia (ESB/Nat.Power)	1	CCGT	0.8	6
Nueva Generación del Sur	1	CCGT	0.73	5
Abengoa y PSEG Europe	1	CCGT	0.375	3
CONUCO	1	CCGT	0.175	1
Total	22		14.45	100

Note: Endesa figures include 0.8 GW project with Gas Natural at San Roque. One Endesa project is a gas-fired cogeneration project rather than CCGT.
Source: Ministry of Industry and Energy.

4.4. Industry ownership

The Spanish electricity sector has greatly consolidated over the past decade. In 1990, the Spanish electricity sector was characterised by over a dozen independent electricity firms. The largest, Endesa, which was majority publicly owned, served less than a quarter of all customers. However, a number of firms experienced financial difficulties in the 1980s because of investments in nuclear power that made them vulnerable to takeovers. In 1991, Iberdrola, was created out of the merger of two companies. In the same year, Endesa acquired significant shareholdings in two of the other three large firms (Sevillana and FECSA). By 1996, Endesa had acquired 75% of the shares in these companies, as well as a 15% stake in the third largest utility, Union Fenosa.

The CNSE's predecessor published a report in 1996 on the proposed acquisitions by Endesa of the majority shareholdings in FECSA and Sevillana. The report warned of potential anticompetitive effects of the concentration of ownership in the generating sector and asked that the proposed acquisitions be referred to the competition tribunal for review before a decision was made on the acquisitions. However, the government, weighing these and other arguments, decided that such a review was not necessary.

The government privatised its two-thirds holding in Endesa in two tranches in 1997 and 1998. The newly-privatised firm has moved to consolidate its operations by acquiring the outstanding shares in Sevillana and FECSA. It has reorganised itself into functional business lines. While the government had required Endesa to sell its holding in Union Fenosa, Endesa's acquisition of Sevillana and FECSA had made it the fourth largest utility in the European Union. As a consequence of these changes, the dozen independent firms have decreased to four, two of which supply over three-quarters of electricity produced in Spain. The result is a generation sector that is highly concentrated compared to some (but not all) other OECD countries that have liberalised their electricity markets (Figure 10).

In addition to consolidation within the sector, there has been a diversification of the two large companies into other Spanish network industries particularly natural gas and telecommunications. Both companies have also been very active in investing in electric utilities abroad.

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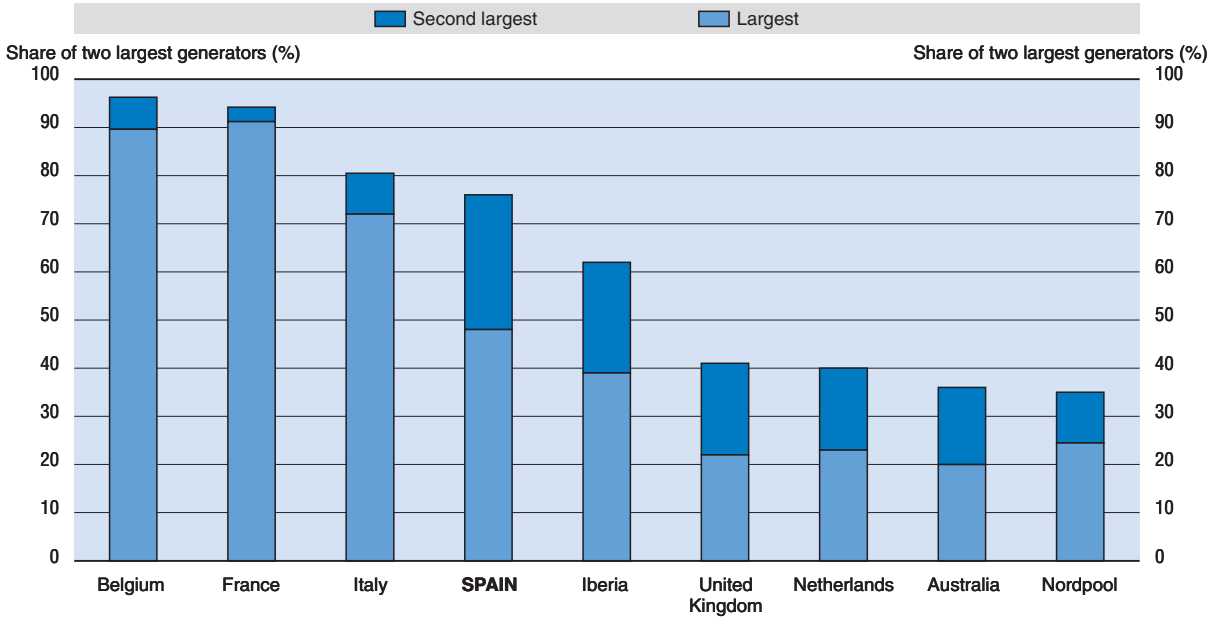
Figure 10. **Concentration of generation ownership in Spain *vs* other OECD countries**



Notes: 1998 data. Iberia includes Portugal. UK market England and Wales only. Australia includes Victoria, New South Wales, ACT, and South Australia.
Source: IEA and company annual reports.

The major players in the natural gas and electricity sectors in Spain are forming alliances. The link with the natural gas industry is particularly important as natural gas is expected to be the predominant fuel for new power plants in Spain over the next decade. Endesa has entered into an agreement with Gas Natural whereby the two will co-operate on the construction of 3 000 MW of new gas-fired generation. Gas Natural will supply the gas for these projects to Endesa. As well, both Endesa and Iberdrola have taken a 3.64% stake in Repsol, the petroleum company that owns 45% of Gas Natural. Iberdrola is working in partnership with Repsol on a number of new generating projects and on the development of a new liquefied natural gas import terminal near Bilbao in northern Spain. Iberdrola has also entered into a co-operation agreement with EDP, the Portuguese electric utility.

The CNSE has characterised the extensive cross ownership between the different network firms as a common "web of interests" and is concerned that this web may dampen interest by new entrants in challenging the two incumbent utilities. Spanish banks and savings institutions also have significant minority interests in several of the firms (Figure 11). The government has recently implemented new rules to limit cross shareholding by financial institutions in the utility sector. Banks are to hold no more than 3% in any utility company, or be present on the board of two companies in the same sector. As a result, the merged Banco Santander Central Hispano has been required to sell some of its shares in Endesa to comply with this new rule.

4.5. End user pricing

Tariff setting

The 1987 law revised the tariff setting and price regulation systems and introduced a cost pooling mechanism to compensate for the widely divergent costs between companies. "Standard" costs have

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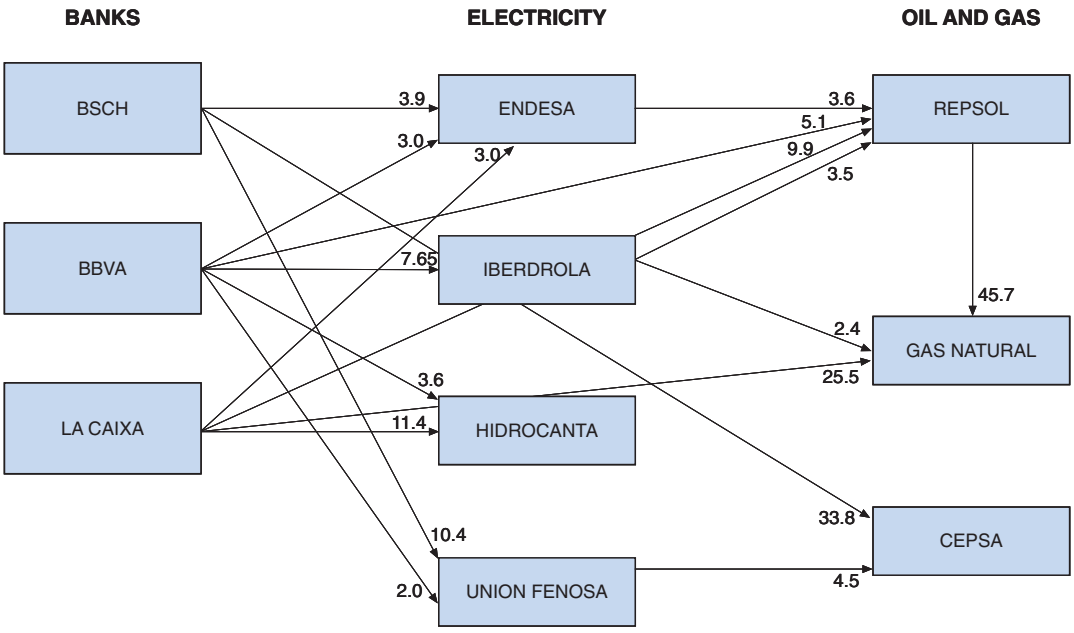
Figure 11. **Ownership relationships affecting the Spanish electricity sector**



Source: CNSE and press reports.

been calculated for the overall system, including depreciation, operating costs, fuel costs, interest costs, etc. The costs were calculated every year by the Ministry based on a set of assumptions about economic and financial parameters such as the return on capital, inflation and operating costs. The Ministry calculates a tariff for all end users, which results in some utilities receiving more revenue than their standard costs, others less.

As revenues received by a particular utility are not matched to the costs of the utility, there is a complex revenue rebalancing process using a method set out by the Ministry and administered by the CNSE. This process ensures that utilities receiving excess revenue transfer this excess to those utilities receiving insufficient revenues. It is also is used for revenue reallocation related to energy policy costs.

The use of standard costs gives companies incentives to reduce their costs as the revenues they are entitled to receive are fixed by the standard cost formula and they are allowed to keep any cost savings they can make. As generation is no longer regulated since the 1997 law, only network tariffs are based on standard cost formulae.

Retail and network electricity tariffs are set by Royal Decree. The process of consultation with the CNSE has varied. Normally, the CNSE is given a draft proposal for review and advice before the Ministry finalises it. On one occasion, the CNSE was asked to issue its own proposal. The rate reduction in April 1999 was a decision of the government done without consulting the CNSE, although the decision did require subsequent ratification in the parliament. Tariffs are to be the same throughout the national territory. The law imposes separate charges for "permanent costs of the system" and supply diversification and security. Electricity purchases are subject to value added tax as well as local or regional taxes. The customer's electricity bill must include a breakdown of these costs.

Rate reductions were initially set out in the 1996 Protocol between the utilities and the government but rates have been reduced further. Rates were reduced 3% in 1997, 3.6% in 1998, and 2.5% in January

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1999. The government announced in April 1999 that rates in 1999 would be reduced by a further 1.5% as part of a plan to reduce measured inflation.

Price distortions

Large electricity consumers in Spain benefit from a number of price distortions:

– Large consumers on regulated tariffs will be eligible to sign "interruptibility contracts" only until November 2000 that give them discounts on their regular electricity price if they agree to be interrupted should there be a shortfall of electricity supply compared to the total demand. As there is substantial surplus of supply in Spain, most large consumers have been willing to accept this discount. UNESA has estimated that these discounts were worth Ptas 49 billion in 1997.

– Large consumers purchasing from the market do not have to pay for the additional costs associated with independent power production (the so-called "special regime"). The above-market costs of this power in 1998 was Ptas 88 billion, paid for by all customers under regulated tariff. In 1999, total energy production under the "special regime" reached 23 868 GWh, at a cost of Ptas 233 billion.

In 1998, few customers switched because the discounts available under the regulated tariff were often better than market prices, even without having to contribute to the costs of the special regime costs and the lower contribution to the nuclear moratorium costs. As a result, the Spanish government has amended the access tariffs for 1999. This was done in two parts:

– The capacity charge for customers purchasing from the market was reduced from an average 1.3 Ptas/kWh to 0.3 Ptas/kWh. This effectively reduced the cost of generation by 25%.

– The network access tariffs for purchasing from the market were reduced by 25%.

Revenues foregone by reducing these charges to customers purchasing from the market (approximately Ptas 53 billion, according to CNSE estimates) are to be recovered from customers on regulated tariffs. The new price distortion reduced the size of the rate cut for the regulated customers.

The electricity law guarantees that all consumers shall have the right to receive electricity at the same tariff regardless of location. Government regulations set the same quality of service and reliability standards throughout Spain, regardless of differences in the cost of providing it. The cost structure therefore must include a number of price distortions so that equalised rates can be maintained. There is also a mechanism for subsidising extrapeninsular customers, valued at Ptas 20 billion for 1999, as well as an additional charge to fund expansion and improvement in rural electricity service.

4.6. Energy policy costs

As noted earlier, costs for support of energy policies such as support for the domestic coal industry, "special regime" for cogeneration and renewable power generation, and the nuclear moratorium add significantly to the cost of electricity in Spain. The support mechanisms are described here in more detail.

The Electricity Act allows, consistent with Article 8.4 of the EU Electricity Directive, up to 15% of total primary energy required for power generation to come from domestically produced fuel. In practice, this means domestic coal production is subsidised. Electricity consumers support the use of Spanish coal both directly through a tax on electricity consumption and indirectly in the form of premiums paid to the utilities to use the coal. As a result, the Spanish coal industry receives one of the largest subsidies per tonne of coal among OECD countries (see Figure 12).

Electricity consumers support the coal industry directly through an *ad valorem* tax on electricity consumption. This tax raised approximately Ptas 100 billion in 1998. The money raised is paid into general government revenues, rather than directly to the coal industry. Nevertheless, the amount raised corresponds to the budget available to the coal industry to pay for further restructuring and downsizing under a plan approved by the European Commission. The current restructuring plan, the third since 1989, will cut production by about 28% to the year 2005.

Electricity consumers support the use of Spanish coal indirectly (Ptas 51 billion in 1998) through part of the competitive transition charge (CTC) which is allocated for premiums paid to the utilities to pur-

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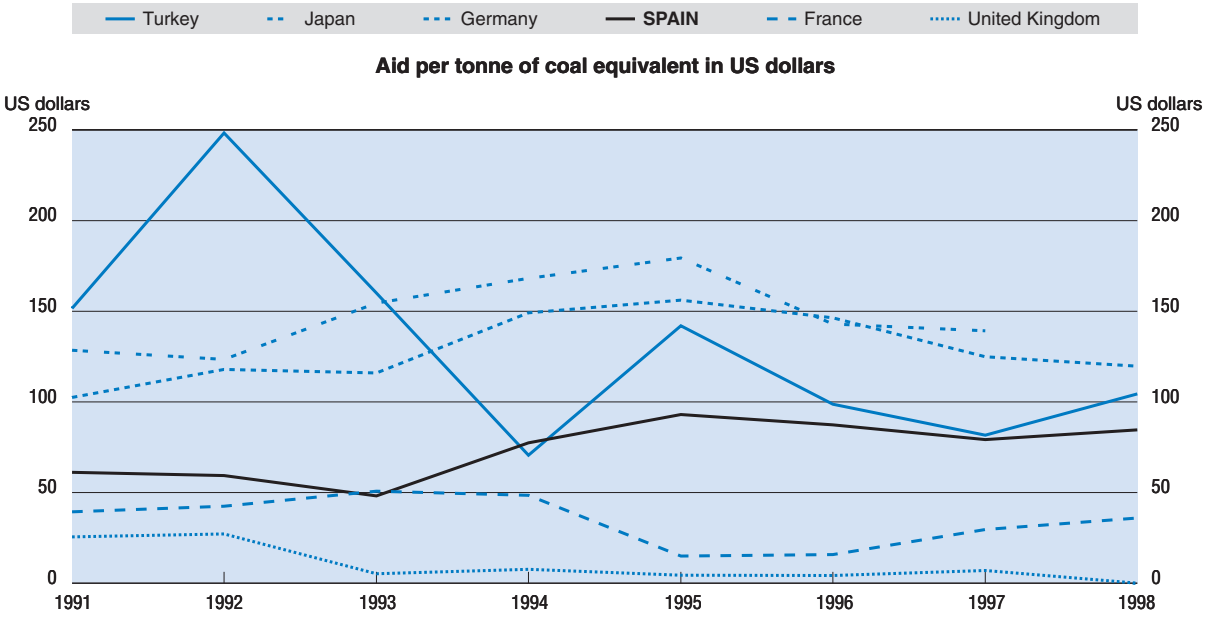
Figure 12. **Coal subsidies per tonne of coal equivalent in selected IEA countries**



Note: France: loans taken out by Charbonnages de France have increased since 1994, as have production costs. Aid for France 1997 and 1998 has not been approved by the European Commission.
Source: IEA Secretariat.

chase domestic coal. The utilities are required to purchase this coal through legal obligations under the Electricity Act, based on agreements between the Ministry of Industry and Energy and the coal mining unions[1] which sets out quantities of hard coal to be purchased by power plant. In 1998, 26% of power supplied in 1998 came from domestic coal. While prices for coal are freely negotiated between the utilities and the coal companies based on conditions prevailing in the world market, the utilities are paid a premium through the revenue rebalancing process for using domestic coal at particular plants and for maintaining stocks of domestic coal. The government also pays incentives to use brown coal, lignito pardo, to be consistent with the treatment of hard coal.

Electricity consumers under regulated tariff purchase special regime power generation by cogeneration and renewable sources at government-regulated premia above normal power prices. Eligible power plants and premiums for new plants are given in Table 8. Many of the projects have also received subsidies from the national government, the European Union, and autonomous communities. Furthermore, the government does not limit the quantity of power to be accepted in total. As a consequence, there has been a boom in "special regime" generation: it has grown from 2% of all generation in 1990 to 20% in April 2000. More special regime generation has been installed in the past five years than additional utility generation and continues to grow significantly despite substantial overcapacity. Some autonomous communities levy surcharges on the electricity bill to pay for their subsidies to independent generators.

Prices for special regime generation average approximately 10.2 Ptas/kWh compared to a market price in 1998 of 5.8 Ptas/kWh. Premiums paid depend on type of technology and size. The government has no cap on the amount to be acquired from each category, but can change the premia for operating plants. Premiums for renewable energy are among the highest in the EU (see Figure 13).

Electricity consumers are also paying for the decision of the Spanish government in 1984 to order the utilities halt construction on five nuclear power plants. In 1994, total compensation to the companies for

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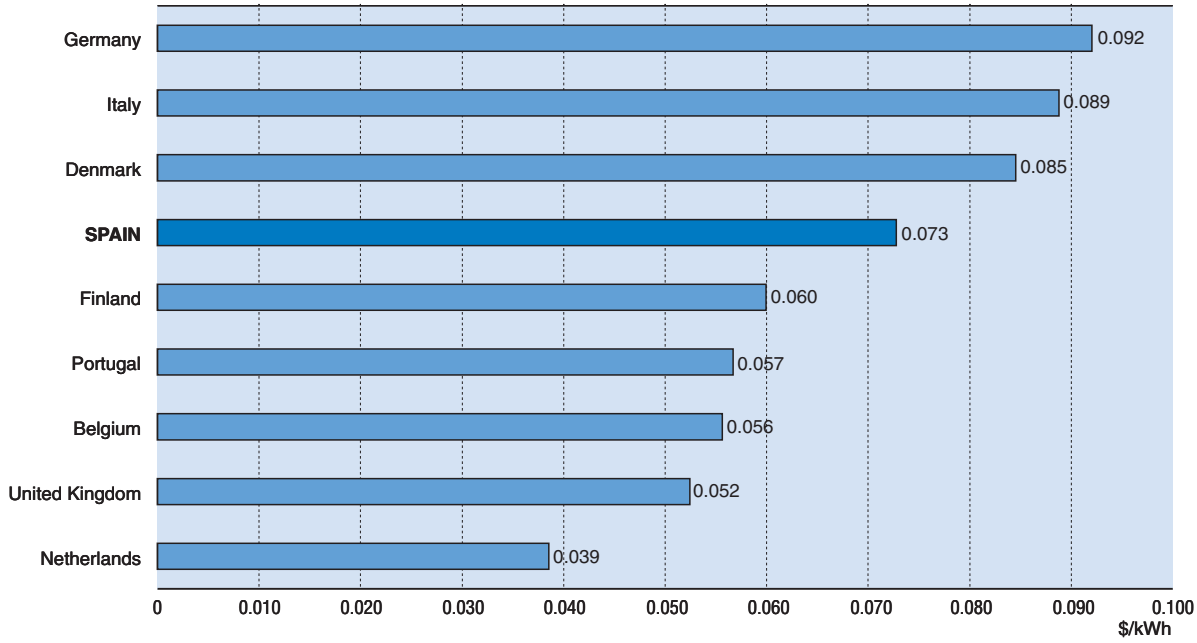
Table 8. **1999 premiums for special regime generation**

Type of installation	Size limit (MW)	Premium (Ptas/kWh)
Cogeneration	25	3.2 (under 10 MW)
Solar (photovoltaic)	None	60 (under 5 kW) 30 (over 5 kW)
Wind	None	5.26
Geothermal	None	5.45
Hydraulic	50	5.45 (under 10 MW)
Biomass (primary/secondary)	None	5.07/4.70
Wastes	50	3.7 (under 10 MW)
Farm wastes and other	25	2.5-3.9 (under 10 MW)

Note: Premium is defined as a differential above average market price.
Source: Ministry of Industry and Energy.

Figure 13. **Renewable energy prices in EU countries, 1997**



Source: European Commission.

this moratorium was set at Ptas 729 billion to be recovered through electricity rates over 25 years. In 1999, a charge of 3.54% recovered from all customers will recover Ptas 69 billion.

4.7. Natural gas market

The Spanish government has encouraged the increased use of natural gas as a means of encouraging economic growth and increasing energy security and diversity in the power sector. Spain uses relatively little natural gas compared to most other OECD countries, largely because until 1993, natural gas was only imported as relatively high cost liquefied natural gas (LNG) through three terminals. The completion of the relatively small 2 billion cubic metre (bcm) capacity pipeline from France in 1993 and the much larger 8.5 bcm Maghreb-Europe pipeline in 1996, of which 2.0 bcm is allocated to Portugal, has greatly increased

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Spain's import capacity and made a more economical supply available. The result has been a 53% increase in demand for natural gas in 1998 over 1995.

The natural gas industry is Spain is dominated by Gas Natural, a privately owned gas company operating as a de facto monopoly that owns the transportation systems through Enagas and 90% of all gas distribution systems. Gas Natural also controls much of the existing capacity of the import pipelines under long-term supply contracts. Gas Natural is owned 45% by Repsol, who is also involved in production.

Long-term availability and deliverability of natural gas is important to new entrants using gas-fired power generation. Enagas expects demand for natural gas to reach 19 bcm by 2005, and already has 17.5 bcm under contract for that year, comparable to existing delivery capacity. However, a more rapid expansion of gas-fired power generation could mean a much larger demand. Each GW of baseload power generation by combined cycle gas turbines requires approximately 1.1 bcm of gas annually, implying that current gas-fired power generation proposals would require a total of 14.4 bcm, more than 1998 natural gas consumption in Spain of approximately 12.9 bcm. Thus additional natural gas capacity could be needed.

There is significant potential for expanding the import capability to meet this additional demand, some of which is underway (see Table 9). The LNG terminal expansions at Cartegena and Barcelona will increase annual capacity by 2.1 bcm. A project to develop a fourth liquefied natural gas terminal in Bilbao, in the Basque country, is linked to parallel development of new gas-fired power generation that would consume 1.3 bcm. An additional terminal is being studied for Northwest Spain. Pipeline expansion could come from an upgrading of the Mahgreb pipeline capacity, which could add 4 bcm with limited new investment. Doubling the existing pipeline would add an additional 5.5 bcm. The capacity of the pipeline from France could also be increased, adding 1.3 bcm.

Table 9. **Natural gas import capacity**

Source	Current capacity (bcm)	1998 deliveries (bcm)	Potential expansion (bcm)
Mahgreb-Europe pipeline	6.5	5.0	9.5
France pipeline	2.7	2.3	1.3
LNG	9.9	6.1	3.4
Total	19.1	13.1	14.2

Source: Ministry of Industry and Energy.

The Hydrocarbons Law passed in 1998, has liberalised supply to large customers and power generators and provides regulated third-party access to pipelines and LNG terminals. Separation requirements are less stringent than for electricity and are based on accounting separation of functions. Gas Natural will remain the dominant supplier for the foreseeable future because of its existing long-term supply contracts for which it has already booked nearly all of the existing pipeline capacity and a significant fraction of the existing LNG capacity. Power generators needing natural gas supply will either enter into a supply contract with Gas Natural as Endesa has done, purchase gas from Algeria and negotiate an expansion of the pipeline with Gas Natural's transportation subsidiary Enagas, or purchase LNG and arrange delivery through existing LNG terminals.

Diversity of natural gas supply sources is also a concern for Spain and could have an impact on power generation. In 1998, two thirds of total gas was supplied by Algeria. The Hydrocarbons law requires that contracts for supply of gas from any one country should not exceed 60% of total imports. An exception for power generation is permitted provided that the company has dual-firing capability. Endesa and Iberdrola already have constructed dual-firing boilers. If new entrants into power generation wish to use Algerian gas, they will be required to ensure that their facilities will be capable of using a second fuel. In practise, this means that new entrants would equip their combined cycle plant so that petroleum distillate could be used.

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4.8. Security of supply

The Spanish government holds security of supply as an important policy objective for the Spanish electricity sector. In the past, national energy plans (PENs) identified security of supply, enhancement of domestic energy sources, and energy diversification as major objectives. Electricity generation played an important role in meeting these objectives. Policies to support the use of domestic coal in power generation have been in place for many years, and are combined with substantial subsidies, as outlined previously. In line with the 1975 national energy plan, Spanish electric utilities invested heavily in nuclear power as well in the 1970s and 1980s to make this a significant source of supply. More recently, the 1991 PEN identified renewable energy sources and cogeneration as priorities and supported these in order to increase security and diversity of supply. As a result of all these actions, domestic coal, nuclear power, hydropower and other renewables now provide 85% of the electricity supply.

A second aspect of supply security is the reliability and quality of electricity supply. These are regulated by the national government and the autonomous communities. Spain has lagged behind other European Union members in reliability and quality of electricity supply but has improved markedly. One measure of reliability, average interruption time, has improved 65% since 1989.

A third aspect of security of supply is the availability of adequate levels of generating capacity. As noted previously, there is ample generating capacity in the Spanish system.

4.9. Market transition issues

With significant overcapacity and falling costs, the move to liberalised markets in Spain should lead to much lower electricity prices for both liberalised and captive customers. However, in order to be able to move to liberalised markets quickly, the government reached an agreement with the utilities (the 1996 Protocol) that included the payment of "Costs of the Transition to Competition" (CTC). These charges are primarily designed to compensate the utilities for the impact of lower electricity prices on their expected revenues over the period 1998-2007. The government has also implemented a "capacity payment" mechanism to pay a premium to companies who supply energy to the electricity pool. Finally, an important transition cost is the cost associated with restructuring the utilities, particularly the costs associated with voluntary staff reduction programs.

Costs of the transition to competition

It was recognised in the negotiation of the Protocol in 1996 that electricity prices in the Spanish electricity market might be lower than the values implied by the standard cost methodology established under the 1987 law. For example, the 1998 standard cost for the Trillo nuclear power plant was 12.06 Ptas/kWh, far higher than the expected market price. In the 1996 Protocol, the Spanish government agreed to acknowledge the existence of the "*costes de transición a la competencia*" (CTCs) and to permit these costs to be included in the electricity tariff for a maximum of 10 years. In return, the utilities agreed that the maximum size of such compensation could be reduced compared to the values implied by the old "standard cost" methodology.

The calculation of the annual amount of the CTCs was based on the difference between the expected revenues from generation under the standard cost methodology and the anticipated revenues from generation (including the capacity payment and the ancillary service payments) in the market. To calculate the maximum size of this compensation over the ten year period, the following approach was used., The standard costs of the plants were projected out to the end of the economic lifetime, along with a forecast of power production from each of the facilities. The revenues were then estimated assuming a market price for power of 6 Ptas/kWh (based on an estimate of the long-run marginal cost of power). The annual net cash flows were then discounted at a rate of 5%. Following some adjustments, the net discounted cash flow for all the plants was reduced by 32.5% to account for assumed efficiency improvements. This yielded the maximum allowable CTCs that could be recovered from electricity consumers of Ptas 1 693 billion. Adding in the allowance of Ptas 295 billion for domestic coal consumption incentives, yielded a total maximum CTC recovery of Ptas 1 989 billion.

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The actual CTC to be paid to the utilities depended upon actual prices in the market. Thus if market prices were higher than expected, the CTC would be reduced and vice versa. Thus, the CTCs also ensured against the risk that consumers would face high prices.

In September 1998, the Government and the utilities negotiated a new agreement, ratified by the Spanish parliament in December 1998, that changed both the maximum to be recovered and the procedure for recovery. The new procedure involved four new elements:

- A reduction in the maximum amount to be collected by Ptas 250 billion (to a net value of slightly more than Ptas 1 300 billion plus the Ptas 295 billion for coal).
- Approximately Ptas 1 000 billion is to be guaranteed to be paid to the utilities that they will receive by 2007 regardless of circumstances. This guarantee will allow utilities to issue highly rated securities against this guaranteed cash flow. Hence this guarantee is often referred to as securitisation.
- Approximately Ptas 250 billion will be available to "top up" the CTC compensation if circumstances warrant it.
- If by 2007, it is determined that the utilities have received more compensation through the securitisation than the total stranded cost, the government will establish a procedure to ensure customers are compensated.

The CTC payment mechanism for the coal-related items was not affected by these changes.

The CNSE has issued a report that was highly critical of the securitisation. The report criticised the process leading to the new agreement as secretive and that the amount granted in securitisation was excessive with consumers paying too much compensation to the utilities: it suggested that a figure of Ptas 480 billion was more appropriate. In addition to the excess costs to consumers, the CNSE noted that excess payments might damage the prospects for competition by providing a financial weapon to the utilities to defend themselves against new entrants. The CNSE also argued that the government did not get sufficient compensating benefits for electricity consumers in return. The report suggested that the government should have used the offer of securitisation to induce the two large utilities to take steps to reduce their market power, for example by selling some of their generating assets. The report points to some U.S. states where this leverage has been used.

The revision was subject to a very vigorous political debate before being passed by the Parliament in December 1998. The new legislation requires approval by the European Commission competition directorate, which has indicated that they are reviewing the eligibility of this payment under state aid rules.

Capacity payments

The Protocol and the Electricity Act make provision for a capacity payment. The capacity payment is a payment to generators by electricity customers for electrical energy made available to the market. The stated purpose of a capacity payment is to raise revenues for generators and thus encourage early new entry into generation, which it is felt might not otherwise have occurred in time to avoid capacity shortfalls. The government has indicated in the Protocol that the measure is transitional, and the need for it should be studied after 2001.

The size of the payment to generators is set by the Ministry and was calculated on the basis of a engineering estimates of the costs of production, which indicated that short-run marginal costs would be lower than long-run marginal costs by 1.3 pesetas per kilowatt-hour. In 1998, costs for the capacity payment were recovered equally from all consumers through tariffs. In effect each consumer paid an average of 1.3 Ptas/kWh for capacity although the actual charge depended upon time of use. The system was revised for 1999. Customers purchasing from the market pay 0.3 Ptas/kWh. The average payment for the regulated customers will be increased to make up for the loss in revenue.

Payments are made to the four utilities according to the energy supplied to the market during peak and mid-demand periods. No payment is made for energy supplied during low demand periods. The

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capacity payment has the same effect as the CTC – it provides financial support to the existing generators to offset risks of lower revenues from low market prices. In 1998, average revenue to generators including the payment was 5.8 Ptas/kWh, close to 6 Ptas/kWh level used in estimating the CTCs.

Employment implications

Labour productivity improvements have occurred, perhaps more the result of industry consolidation than liberalisation. Between 1990 and 1996, staff levels of the utilities declined by 15%, despite a 5% increase in energy production and a 10% increase in number of customers served. Utilities are continuing to trim staff – Endesa has reduced staff from 24 500 in 1996 to 19 500 in 1998 and has plans to reduce staff to 15 500 by 2002. As a result of an agreement negotiated between the utilities and the key labour unions, downsizing is to be achieved through voluntary programs, principally early retirement packages. Endesa has a target to reduce operating costs by 2006 to one-half of 1996 levels.

The reforms put additional pressure on the coal mining sector as all output from the coal mines is used by the electric power sector. The current agreement between the unions and the coal companies will reduce mining employment from 24 500 to 17 500 by 2005.

5. CRITIQUE

5.1. Development of competition

At first glance, the transition to a fully competitive electricity market in Spain appears to be going well for all concerned. Liberalisation of high voltage customers continues to accelerate. In response eligible consumers are taking advantage of the reduced access tariffs and moving into the market to benefit from lower prices (more than 15% on average under their regulated prices, according to a Ministry estimate). Small consumers are seeing lower regulated tariffs. The utilities remain profitable, are making efforts to improve their efficiency through restructuring, and have announced plans to expand their investment in new generating capacity. While the number of employees may be falling, those departing are receiving relatively generous severance benefits. New foreign entrants have also announced plans to invest in gas-fired generating capacity in Spain.

However, this series of events is not the result of a well-functioning competitive electricity market. Spanish electricity system unit costs are falling primarily because of the increase in demand, the fall of interest rates and the relatively low new investment by the utilities in recent years. The first two factors depend on the business cycle and could be reversed.

During the transition, the Ministry as regulator is in a position to ensure that costs savings are in fact shared out among utilities (and their employees) and consumers. The government determines how these savings are to be shared through negotiations with the utilities. Once the end of the transition period is reached, however, competitive market mechanisms will be needed to ensure that consumers are receiving the benefits of cost reductions by the firms.

The acceleration of the liberalisation will be a positive force for the development of competition. It is expected that as a larger share of consumers become eligible, far greater numbers will wish to move into the market as current market prices are lower than regulated tariffs. Potential numbers of participants could be further increased by allowing groups of low voltage customers to become eligible if they purchase power together. Conversely, if consumers do not find that prices are lower in the market, there will be increased focus on whether there is adequate competition in generation.

Unfortunately, the structure of the Spanish electricity industry makes the development of competition in generation very difficult. Two firms, Endesa and Iberdrola, control 76% of the production and even larger share of mid-range and peaking capacity. Furthermore, existing independent power generators (11% of the market) are selling power at regulated premium prices, and hence are not in a position to influence market prices. Such a substantial market share give Endesa and Iberdrola effectively a duopoly over the power market, raising concerns that the two utilities could abuse their position and raise prices above competitive levels.

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The duopoly character of the Spanish system resembles the duopoly of National Power and PowerGen in the England and Wales electricity pool, although the U.K. duopoly currently has a much smaller share of their overall market, but a majority share of the critical mid-range and peaking capacity market. The U.K. experience shows that prices have probably been set higher than under fully competitive conditions sheltering the entry of new combined cycle gas turbines, the so-called "dash for gas" (see the IEA in-depth review for United Kingdom). The U.K. experience also showed that new entrants tended to aim for the baseload market, leaving price setting in the mid-range and peaking capacity in the hands the incumbents.

The market power of the two firms could be mitigated either by competition from imports, by new entrants into the Spanish market, by further liberalising the gas sector, or by structural reforms of the two dominant firms. While the Spanish government's decision not impose reciprocity requirements for the time being on utilities in neighbouring countries will be helpful, the very limited interconnections between Spain and other countries means that imports currently have limited competitive influence on prices. Existing contracts further reduce the available capacity for competitors. A report[2] released by the CNSE in 1999 identified a potential problem with access to the interconnection with France, as a substantial fraction of the interconnection capacity is already allocated to an existing contract between Electricité de France and REE for 550 MW until 2010. The likelihood of a substantial increase in the interconnection capacity between Spain and France depends on the corresponding network expansion investments in France, which to date have not been possible due to local environmental opposition. As prices in Portugal and Morocco are higher than in Spain, the prospects for competition from these countries are limited. In other words, the geographic scope of the Spanish market is limited to Spain or, at most, the Iberian peninsula.

Market power could also be mitigated by substantial new independent entry into the Spanish electricity market. As noted above, several firms from outside the Spanish power sector have proposed over 40% of the 14.45 GW of new capacity over the next few years. However, the two dominant firms have proposed the majority of the new capacity, meaning that their share of the market would still exceed two-thirds of the total when all these new stations are completed. Given the excess capacity in the Spanish system, the large amount of proposed new capacity could be the result of higher prices that do not reflect the demand and supply conditions.

An analysis of the Spanish electricity market prepared for the CNSE, which took into account competition from imports, suggests that market power in the Spanish market could be exercised either by Endesa or Iberdrola operating on their own or in collusion.[3] The analysis concludes that there would be, in principle, nothing to limit the joint exercise of market power by the two firms until substantial new capacity is built that would reduce the market share of these two firms. Similarly, under particular conditions either Endesa or Iberdrola could be in a position to raise prices in the market. A separate analysis by CNSE[4] suggested that such behaviour could lead to an average price markup of 39% above marginal costs. Prices in the electricity market, about 5.8 Ptas/kWh with the capacity payment, are well above marginal fuel costs of approximately 3 Ptas/kWh.

More recent work for the CNSE has studied actual Spanish market operation and identified some market power problems. A study done for the CNSE by London Economics[5] for CNSE reached similar conclusions after studying the behaviour of the Spanish market in 1998. In July 1999, the CNSE released two reports identifying specific generation market power problems in 1998 where Endesa and Iberdrola offered very high prices to the market for generators located in areas of high consumption and low generation.[6]

While it is clear that regulatory authorities are monitoring the situation, what remedies would be available? The most effective means of addressing the problem of a concentrated generating sector is the divestiture of generating assets into several independent generating companies. In some countries where publicly-owned electricity systems have been reformed, such as the United Kingdom (England and Wales), New Zealand, and Australia (three largest states), governments have decided to divide the generating capacity of large publicly-owned utilities into several generating companies to create more effective competition. In the United Kingdom and the United States, privately-owned utilities have, in

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response to incentives, agreed to sell generating assets to address regulatory concerns about the concentration in the generation market.

However, should either the CNSE or the competition tribunal recommend that divestiture is needed it is not clear how the government will balance these competition concerns against the impact of divestiture on Endesa and/or Iberdrola. Considerations about divestiture can be influenced by the situation in neighbouring countries. What is clear is that divestiture is not an option currently under consideration. There are other possible remedies to reduce the concentration in the generating sector without divesting generating assets. One possibility is to limit the construction of new generating capacity by the two largest firms. This would allow smaller utilities and new entrants to increase their market share more quickly than now expected. Such an approach was tried in New Zealand, where the largest firm (ECNZ) was restricted from building new capacity.

A second nonexclusive alternative is to require the large utilities to lease some of their capacity to independent firms as was done in the UK market. Given an appropriate portfolio of capacity, the new firms would help create a market that would be workably competitive. Furthermore, the revenues gained from such leases would guarantee the continued financial strength of the two large utilities.

One variant of a leasing arrangement is known as the auctioned biddable contract. Under such a system, the existing generation owners would continue to operate their generating plants but would auction off the rights to the output into portfolios of auctioned bidding contracts. The holders of these contracts would be able to dispatch the plants and bid the energy into the market in return for a fixed upfront payment and a monthly variable payment based on output. The holders of these contracts then compete against each other to supply the market. This theoretically ensures an active competitive wholesale market without requiring utilities to give up title to their generating assets as long as new competitors can be created that own assets as well as these rights. This system is currently being implemented in the electricity market of the province of Alberta, Canada in order to deal with a situation where the largest two utilities controlled over 80% of the power capacity. It may be a worthwhile option for Spain to consider.

The development of competition may also be affected by capacity payments. In the Spanish market, the capacity payment acts as an additional payment to the utilities, in effect another CTC. Over the medium term, the capacity payment can be effective in encouraging new generation investment if there is a firm commitment to keep it in place for a number of years. This would encourage new entrants to build new plant on the expectation that they would receive revenue from the payment once their plant is in operation. At present, there is no such commitment to retain the capacity payment as the need for it will be reviewed after the year 2001.

The alliances between major players in the natural gas and electricity sectors raise important concerns. The first is that the two electricity firms, by working with the two largest oil and gas firms, have eliminated possible competitors in electricity generation. The second concern is whether new entrants into electricity generation who plan to use natural gas, will have it available on the same terms as the two dominant electricity companies. The development of the natural gas market will need to be monitored very carefully to ensure that all entrants into gas-fired generation have equal access to gas supply. The decision of the government to create a single regulator, CNE, to monitor both sectors is a positive development in this regard. The government has also blocked further reductions in competition in this sector by blocking the Endesa-Gas Natural merger of gas distribution assets and it has increased the number of licensed traders in the natural gas sector.

The role for competition in the distribution sector should also be re-examined. There appears to be limited scope for franchise competition between the two large distributors. The use of regulation that induces efficiency has therefore been imperative. The "standard cost" methodology has provided Spanish utilities with opportunities to improve efficiency – however, given the remaining scope for further efficiencies in both generation and distribution (as Endesa estimates it can cut operating costs by half between 1996 and 2006), there is scope for improved regulation in this sector. Perhaps greater use of international competitive benchmarks in comparing costs would help encourage distributors to improve their efficiency and cut the prices they charge. Other means of increasing the number of benchmarks could also be explored.

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Vigilance on the part of the regulator will also be required to see if the legal separation of retailing activity from distribution activity is effective in preventing the retailing businesses of the utilities from taking undue advantage of their incumbent position. They could do this, for example, by passing on retail supply costs to captive customers or by having privileged access to information about customers or about the distributor's tariffs. Transparency in the distribution company's activities and well-defined rules on its relationships with all retail suppliers, such as a code of conduct, would help the regulator in monitoring the situation.

5.2. Regulatory institutions

There is one major issue with respect to electricity sector regulatory institutions: the allocation of responsibilities between the Ministry and the CNSE. The current situation, where the Ministry has most of the significant regulatory powers, leaves the government with considerable flexibility in adjusting tariffs, the rate of liberalisation, or transition cost compensation in a manner consistent with overall government policy.

However, retaining major regulatory responsibilities within the Ministry also responsible for policy-making means that the perception of its role as in impartial regulator could be damaged. For example, last September's agreement with utilities that led to the securitisation of the CTCs was criticised for being conducted in secret and without consulting either the CNSE or other affected parties. Similarly, although the Ministry has the responsibility to review the advice given to it by the CNSE on tariffs, the Ministry does not have to publish a detailed explanation of its own tariff making decisions and how they may have varied from tariffs requested by the utilities or recommended by the CNSE. Investors see regulatory risk as a key risk factor in generation sector investments and see independent regulation as a positive factor. Notwithstanding the substantial outside investor interest in the Spanish sector to date, retaining the regulatory powers within the Ministry may act as a disincentive for new investors, particularly if they were to perceive Ministry decisions are favouring the incumbent utilities.

The CNSE has most of the necessary tools to be seen as independent but has few regulatory powers and has seen its budget cut. Consumer groups, unions, and employer groups have praised its openness, transparency, and activism on behalf of electricity consumers. However, the Ministry and the utilities have less appreciated its activism, particular on the issue of CTC securitisation.

Empowered independent sector regulators are used in many OECD countries including Australia, Finland, Italy, Norway, Sweden, the United Kingdom and the United States. These regulators, unlike the CNSE, have significant regulatory powers such as tariff setting. They also have transparency and accountability requirements.

As the transition to competition proceeds there is less to be gained by leaving primary regulatory responsibilities within the Ministry. In the short run, all market participants would benefit from greater transparency in the Ministry's regulatory activities, such as publishing detailed explanations for their tariff setting decisions. Moving the regulatory activities such as tariff setting from the Ministry to the newly created CNE would boost confidence in the independence of the decisionmaking.

5.3. Energy policy costs

The Spanish electricity consumer is paying a significant proportion of the total bill for various energy policies. These include premiums paid to use domestic coal through the CTC (Ptas 51 billion) the revenues raised by electricity tax (Ptas 100 billion), above-market costs for the support for the special regime (Ptas 88 billion), costs of the nuclear moratorium (Ptas 69 billion), nuclear fuel cycle and other (Ptas 18 billion). This constitutes about 16% of the total Spanish electricity bill before value-added tax is included.

Nearly half of these costs can be attributed to coal. Premiums are paid to utilities to use domestic coal which are then recovered through CTCs. An electricity tax on consumers, while it goes into general revenues, offsets government support for the coal industry. While the coal industry is cutting staff under the current coal mining restructuring plan, many of the Spanish coal mines will remain uncompetitive. The

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restructuring plan also commits the utilities to purchase a certain quantity of coal for each coal-fired generating station out to the year 2005 at prices that are supposed to be freely agreed between the contracting parties in light of the conditions prevailing in the world market. In practise this means utilities pay a price for domestic coal based on the cost of purchasing and delivering imported coal to the same inland power stations. High transportation costs to these inland power stations means that domestic coal prices are well above prices for imported coal delivered to coastal power stations. Thus, the quantity obligations increase electricity costs by restricting the ability of the existing utilities to optimise their fuel mix. Otherwise, utilities would find it cheaper in the short term to burn more imported coal at power stations on the coast where fuel costs are much lower.

While changes in the way coal is subsidised have increased transparency and will reduce the total subsidy received from electricity consumers, domestic coal use in power production needs to be reduced to economically sustainable levels. Furthermore, the agreement with the utilities provides no flexibility in quantities taken from particular mines, removing incentives for individual mines to improve productivity. Such incentive mechanisms in the agreements could be used to encourage the coal companies to lower their costs.

Another apparent difficulty is the use of the electricity tax to pay for restructuring of the coal industry. While industrial adjustment policies for the coal mining regions are needed, it is not clear why taxpayers should pay for the restructuring of the coal industry on the basis of electricity consumption, rather than through a more general tax.

The second major energy policy cost is the subsidy for special regime generation. Here the principal difficulty is the extent to which cogeneration is subsidised under the special regime, which has contributed to the current excess capacity at a relatively high cost. Cogeneration technology is sufficiently developed that it should not require any subsidy to compete in the Spanish electricity market, even in the under 25 MW category. The objective should be to phase out price supports to existing cogenerators, so that they receive market prices for the electricity they deliver to the market. Furthermore, prices for network services used by cogenerators should reflect costs. The only condition to be safeguarded is the access to gas at competitive supply prices.

Subsidies to renewable energy generation also appear to be substantial although not disproportionate to other EU countries. However the current mechanism of a fixed premium is not efficient: there will likely be the continuation of the high growth rate for renewable energy projects, leading to additional burden on the Spanish electricity consumer. Mechanisms for acquisition of renewable energy that would require renewable power producers to compete with one another could increase their cost effectiveness.

With respect to the nuclear-related costs, utilities using nuclear generation do not pay fully the costs related to keeping adequate supplies of nuclear fuel or related to the nuclear fuel cycle. Nuclear fuel inventory costs are expected to be internalised beginning in 2000. Internalising other fuel expenditures would be consistent with assuring a level playing field among competing generators.

5.4. Cost-reflective pricing

There are a number of price distortions in the Spanish electricity system. Cross-subsidies to large consumers under regulated tariffs have benefited industrial competitiveness but come at the expense of the smaller business and residential consumer. This price distortion also meant that despite their liberalisation, large customers were content to remain with their regulated tariffs despite the possibility of lower production costs being available in the market.

In order to boost activity in the market, the Ministry has, in effect, replicated the price distortion in the regulated retail tariffs into the tariffs paid by large liberalised customers. While this measure is expedient and is having the effect of encouraging more market activity, it is not sustainable, as more and more customers become eligible. As more customers opt for the market, captive customers must carry the additional cost burden for the revenues lost by lower capacity and access tariff payments by eligible customers, the higher costs associated with purchasing special regime power generation, and a larger share of nuclear moratorium costs.

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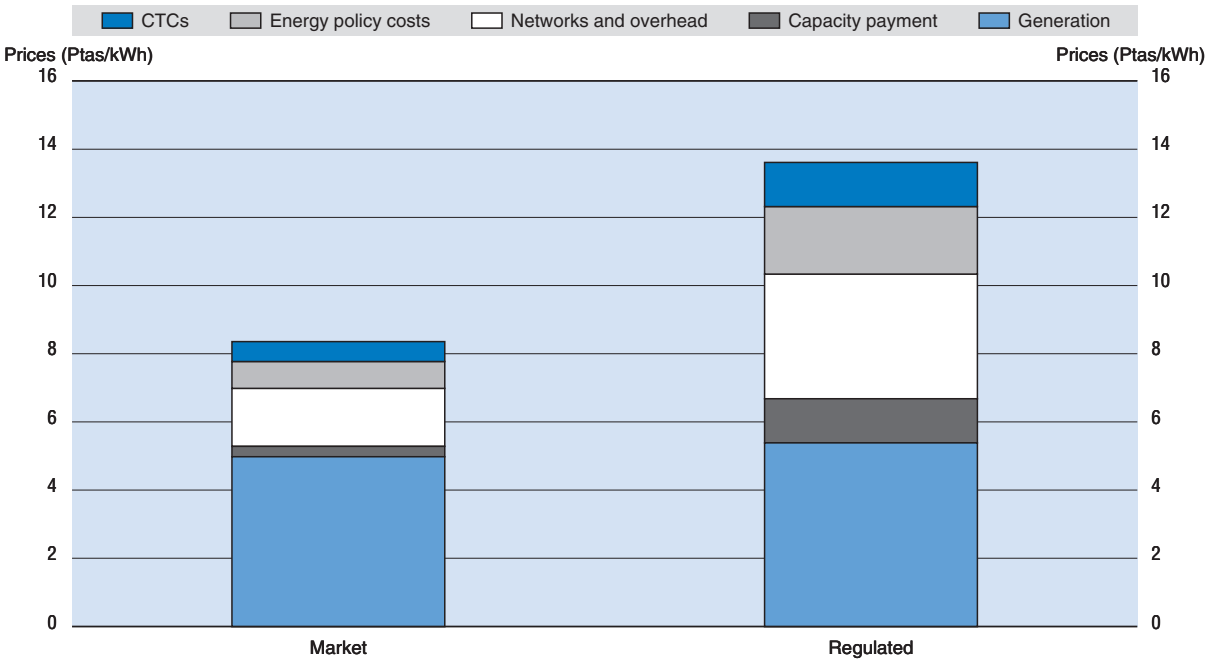
As a result, customers under regulated tariffs are already paying substantially more for electricity than those who are able to go to market. Figure 14 compares the costs by category: generation, network and overheads, energy policy costs and CTCs for the group of customers able to go to the market compared to those who remain on regulated tariff. Generation costs include estimated market prices for generation, capacity payment, and ancillary services and are much higher for the customers under regulated tariff because of difference in demand pattern. Overhead costs include retailing and administration costs, charges for the system operator, market operator, and the CNSE. Energy policy costs includes special regime premiums, energy diversification costs, subsidy for the extrapeninsular systems, demand management, quality of service enhancement, and the energy tax used to support the coal industry.

Altogether, energy policy costs and CTCs add 16% to the bill of the market customer and 24% to the bill of customers under regulated tariff. Capacity payments add a further 4% and 9% respectively. As more customers move to the market, this difference, combined with the lower access fees and capacity payments could lead to an increase in unit costs for the captive customers of several per cent. While the current rate cap guarantees that this shift in costs will not result in rate increases before the end of 2001, the higher underlying costs would mean that rates to captive customers would be higher after 2001 than with a more equal distribution of these costs.

A further distortion exists because prices in the market fully reflect different costs according to time of use but standard retail end-user tariffs do not. Some customers able to access the market may choose not do so because they would pay more in the market versus their time-averaged standard tariff. Changing standard tariffs to reflect time-of-use would remove this distortion and lead to a more economically efficient use of electricity by consumers.

A preferable approach would be to move away from such price distortions and instead move towards tariffs for access that reflect costs, and that share out all subsidies such as for the special regime in a more equitable manner. In this system, the customer would pay the same for transmission and distribution

Figure 14. **Estimate of average prices: market *vs* regulated tariff**



Source: IEA Secretariat based on information provided by CNSE.

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regardless of whether the customer is under a regulated tariff or purchasing from the market. Similarly, subsidies such as the special regime power generation could be shared more equally.

The discounts for interruption of electric power are far too high given the existing surplus capacity and hence the unlikelihood that supplies would actually be cut. This discount should be reduced to reflect the market value of this capability or cancelled altogether when there is clear evidence that the customer cannot be interrupted

Another significant price distortion is the requirement that all consumers including extrapeninsular consumers using the same voltage pay the same tariffs, regardless of cost of service. Similarly, all producers pay the same fee with regard to location. This can have serious distortionary effects on the need for new transmission capacity. For example, a significant proportion of the new generating capacity is proposed for Southwest Spain, close to both a natural gas pipeline and an LNG facility. The construction of many such generating plants, which may be sensible in terms of costs of acquiring gas, may impose excessive costs on the electricity system because the need to construct additional transmission capacity. A system whereby the tariffs for electricity transmission varied by location would eliminate this prospect.

5.5. Costs of the transition to competition

A number of electricity reforms in OECD jurisdictions have included compensation payments to utilities. These payments called in Spain CTCs are commonly referred to as stranded costs. Stranded cost recovery can allow market liberalisation, particularly to allow privately owned utilities, to move forward more quickly. Thus, the decision of the government to permit CTC recovery in the Protocol agreement and the original formulation of the CTCs was set out in the 1997 legislation is consistent with the approach taken in some other jurisdictions. Furthermore, the process by which the original approach was settled was subject to extensive consultation with the utilities, with the CNSE, and with customer groups.

The approach adopted in the 1997 law had a number of advantages. It made the size of these costs transparent, it effectively hedged against the volatility of market prices, and it gave the utilities relatively stable profits and the customers relatively stable prices during the transition period. It also avoided the risk of excessive payments being made to the incumbent utilities which could, in principle, assist them in defending themselves against new entrants. The Ministry as regulator also gains flexibility with this method, and can use the transition period to restructure tariffs in a way that removes cross-subsidies, or provide incentives to the utilities to further restructure to address problems with concentration in the generation sector.

The main drawback of this approach is that it reduces incentives for generators to behave efficiently, as total compensation for their plant is not affected by market prices for generation so long as generation prices are below Ptas 6 per kWh. In practice, the stranded cost arrangements discourage generators from raising prices above Ptas 6 per kWh, as to do so would lead to a reduction in the maximum amount of stranded cost compensation that could be received.[7] As noted above, the amount of CTC is made to vary inversely with the market price, enabling generators to operate under the "umbrella" of the Ptas 6 price which reduces pressure to reduce costs. In addition, in other jurisdictions such as some states in the United States, the value of the generating assets, for which stranded cost recovery was allowed, was actually market tested through sale, rather than relying on negotiation and estimation.

The decision to securitise the CTCs is not unprecedented; a similar approach having been taken in a number of U.S. jurisdictions have used this as a mechanism to convert cash flows into lump sums for the affected utilities. However, the securitisation proposal created a contentious debate on whether the amount securitised was excessive, and whether this gave the utilities an unfair advantage against new entrants into the Spanish market.

Depending on the outcome of the review of the CTC plan by the European Commission, the government may have to make revisions. The government would then have an opportunity to conduct a more open consultation on a plan that meets the needs of consumers and utilities. In particular, the plan should ensure that there are sufficient incentives to minimise overall costs to the consumer. It could also be an opportunity, as has been seen in some U.S. jurisdictions, to negotiate further structural reforms.

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5.6. Air emissions regulation

Emissions of SO_2 and NO_x are regulated in the power sector according to the requirements of the European Large Combustion Plant Directive. Total Spanish emissions of NO_x are limited to 277 000 tonnes as of 1998. Emissions in 1998 were 250 000 tonnes. This limited room for growth in NO_x emissions could require significant new investments in pollution control equipment. These limits could be further restricted under new EU Large Combustion Plant Directives currently under consideration.

There is an opportunity to minimise the additional cost and environmental impact of meeting the NO_x emissions regulation through the use of market-based policies. One example of such a policy would be an emissions cap on all stationary sources of NO_x, with sources issued a fixed amount of tradable emissions permits. Market-based policies could significantly reduce the costs of compliance for the utilities and, if new generators were included, it would also assure a level playing field for controlling emissions in the power sector.

6. CONCLUSIONS AND RECOMMENDATIONS

The Spanish government has substantially liberalised large parts of its electricity sector over the past decade. The major change is to allow the high voltage electricity customers, and to commit to a schedule for all customers, to choose their electricity supplier. The transmission network is largely, and the system operator and market operator are entirely, separated from the vertically integrated utilities. The government has also sold all its shares in the country's largest utility and plans to dispose of its majority shareholding in the national transmission company. The CNSE has provided additional transparency to the reform process and is a strong advocate of greater competition. The government has taken many of the steps needed to develop a competitive electricity market.

In response, there are some positive early signs. Incumbent utilities are implementing plans to increase the efficiency of their operations. Other companies have announced their intentions to build new generating stations in Spain. Regulated end-user tariffs have been falling and increasing numbers of liberalised customers are opting to buy from the wholesale market rather than remain under regulated tariffs.

However, not all of these positive signs can be attributed to increased competition in the electricity sector. Falling interest rates and booming demand driven by a strong economy are causing unit electricity production costs, and hence regulated rates, to fall. A government decision to cut substantially charges to liberalised customers has been the main factor behind increased market participation. There are four main areas where further reforms should be considered by the government to get the maximum benefit from its efforts to date. The most important of these is the structure of generation in the sector. The largest two utilities produce 76% of the power in Spain. There are limited prospects for importing electricity and despite substantial independent entry, the two largest firms are expected to continue to have a dominating share of the market for a number of years. These two firms also have close alliances with large domestic oil and gas firms. Therefore the two largest firms have significant market power and effective competition in generation is likely to develop slowly. Further liberalisation of the gas sector would make entry easier, thus facilitating the development of competition. This implies that while the government will be able to reduce costs through effective regulation during the transition to competition, competition will not be effective at holding prices to consumers down nor promoting economic efficiency once this regulation is removed.

The second conclusion is that regulation of the Spanish electricity sector is not sufficiently independent or transparent. The Ministry, the most important regulator, is not independent from day-to-day political pressures. The independent regulator, although well regarded, has few powers. Greater independence and transparency in final regulatory decisions is desirable in order to build confidence in the development of a truly competitive market. Furthermore, as discussed in the background report to Chapter 3, stronger competition law enforcement in the energy sector would help the attainment of consumer benefits and economic efficiency.

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The third conclusion is that regulated prices do not reflect costs and are distorting the development of competition and shifting additional costs to captive consumers. There are apparently significant price advantages being given to industrial consumers at the expense of residential consumers. The government has set regulated tariffs below market prices for some industrial customer classes. Furthermore, tariffs for use of the network by consumers or power producers do not reflect the different costs for different locations, encouraging inefficient development of the network. With the present pricing formula, the steps to accelerate liberalisation will add some cost burdens to the captive consumers. The effect of these price distortions is to distort choices about energy use as well as decisions about investments in energy efficiency.

Finally, inclusion in the electricity tariff of transition payments (CTCs and the capacity payment) and energy policy costs particularly for the support of the coal industry and for the "special regime", are a substantial burden on the electricity consumer. The size of the payments to utilities for the transition to competition has been controversial. The capacity payment mechanism acts in effect as a further stranded cost payment to the utilities. These costs – for energy policies, costs of transition to competition and so-called capacity payments – constitute about one-third of the total cost of power in Spain. Measures need to be taken to ensure that the benefits of these energy policies exceed their costs, and that there are incentives in place to minimise the overall cost of these burdens on electricity consumers.

Recommendations follow under the following five themes.

– *Develop greater opportunities for competition*

Take steps to improve competition in generation, including divestiture of generating assets, leasing/operating agreements, and caps on capacity expansion by dominant firms.

Eliminate the capacity payment and review electricity market trading arrangements in light of experience with current market prices. Provide retail supply monopolies with incentives to procure least cost supplies.

Carefully monitor developments in the natural gas market and, if necessary, intervene to ensure that all potential competitors including cogenerators have equal access to natural gas supply at cost-reflective prices.

Intensify efforts to strengthen electricity interconnections to neighboring countries.

Aim to introduce full retail competition sooner than currently targeted. In the interim, consider allowing groups of low voltage customers to become eligible for the market through aggregation.

Strengthen the ability of the regulator to monitor the effectiveness of the legal separation of distribution activities from the unregulated activities of generation and retailing. Be ready to use stronger options for separation if monitoring indicates a need.

– *Strengthen the role of the independent energy body*

Shift essential regulatory responsibilities from the Ministry of Industry and Energy to an independent, accountable regulator. In particular examine the potential for making the CNE responsible for regulation of the network, including transmission tariffs, terms and conditions and the calculation of the rebalancing payments between utilities, regulating captive consumers' tariffs and new plant licensing.

For matters remaining under the final responsibility of the Ministry, ensure that the Ministry consults the CNE on all major policy issues and that all published Ministry decisions include explanations of the reasons for the decisions.

Strengthen the independence of CNE. Review procedures for selecting commissioners to ensure that they may act without undue concern of short-term political pressures or allegiances.

Strengthen competition law enforcement in the energy sector, particularly with respect to market access and anticompetitive conduct and the effects of cross ownership on the electricity and natural gas markets.

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– ***Make prices more cost-reflective***

Ensure that network and end-user tariffs are cost reflective and do not discriminate between suppliers or between customers remaining on tariffs or opting to use the market. Standard end-user tariffs should reflect costs by time of use.

Consider the introduction of geographic differentiation of tariffs, according to cost of supply.

Review the existing arrangements and calculations for apportioning costs due to policy actions. Make sure that they do not discriminate between customers remaining on regulated tariffs or choosing to enter the market.

– ***Moderate special support mechanisms***

Reduce the size of subsidies to the coal industry by providing incentive mechanisms for the coal companies to minimise restructuring costs and improve productivity.

Phase out or eliminate price subsidies to all cogeneration regardless of size.

For renewable energy generation, examine more cost-effective approaches of meeting renewable energy objectives such as competitive tendering.

– ***Increase efficiency of environmental regulation***

Evaluate the feasibility of market-based approaches for controlling emissions of NO_x to ensure that control is achieved in the most cost-effective way.

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BACKGROUND REPORT ON REGULATORY REFORM IN THE TELECOMMUNICATIONS INDUSTRY*

* This report was principally prepared by **Patrick Xavier**, consultant to the Directorate on Science, Technology, and Industry, with the participation of **Dimitri Ypsilanti** of the Directorate on Science, Technology, and Industry. It has benefited from comments provided by colleagues throughout the OECD Secretariat, by the Government of Spain, and by Member countries as part of the peer review process. This report was peer reviewed in April 1999 by the OECD's Working Party on Telecommunication and Information Services Policies with the participation of the Competition Law and Policy Committee.

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Executive Summary

Background Report on Regulatory Reform in the Telecommunications Industry

The telecommunications industry has seen significant regulatory reform in OECD countries in recent years. Twenty-three OECD countries now have unrestricted market access to all forms of telecommunications, including voice telephony, infrastructure investment and investment by foreign enterprises, compared to only a handful only a few years ago. The success of the liberalisation process depends on the presence of a transparent and effective regulatory regime that enables the development of full competition, while effectively protecting other public interests. There is a need to promote entry in markets where formerly regulated monopolists remain dominant and to consider elimination of traditionally separate regulatory frameworks applicable to telecommunications infrastructures and services and to broadcasting infrastructures and services.

During 1998 the Spanish government made significant progress in adopting the regulatory principles prescribed by the EU and WTO. In particular, the April 1998 General Telecommunications Law provides a solid foundation for further progress. On 1 December 1998, Spain officially opened to competition its telecommunications market that Telefonica had monopolised for 74 years. Although this occurred 11 months after most of the other EU countries, in important respects the basic regulatory framework now in place in Spain stands up well to a comparison with other OECD countries.

But while the legislated rules are installed, they must be promptly and effectively implemented to ensure a fair, transparent and stable competitive environment for all market players. There are encouraging signs that CMT (the industry regulator) is gaining respect as a well empowered and resourced agency, with some early successes, particularly in regard to significantly lowering Telefonica's interconnection price. However, problems have been identified. On the institutional side, there has been a lack of clarity about the division of responsibility between the Ministry for Development, the traditional telecommunications regulator, and CMT. Moreover, there has also been uncertainty over the division of responsibility ("competency") between CMT and the competition law authorities in regard to control of anti-competitive behaviour. More specifically, in regard to regulatory rules, the demanding conditions attached to licenses run counter to the streamlining intent of the EC's licensing directive; the requirement to base interconnection charges on an ambiguous concept of "real costs" rather than explicitly on LRAIC; the provision in the law that "access deficits" and universal service funding may be offset by a potentially distortive surcharge on interconnection prices (rather than be funded transparently); the lack of resolution concerning the significance of net costs of universal service and need for a universal service fund; the lack of transparency, delays and other concerns relating to the continuing use of direct government authorisation for price changes, delays in installing carrier pre-selection and number portability and problems relating to rights of way, etc.

These problems constitute some of the short-term tasks to be addressed. But regulatory reform is also being further complicated by technological change and "convergence". In common with other OECD countries, Spain must now address the challenge not only of completing the move to an effectively competitive telecommunications market, but also of preparing for the "next generation" regulatory regime which convergence will necessitate.

This report examines the impact of regulatory reform on the performance of telecommunications markets thus far. It concludes that there are early signs that regulatory reform is already beginning to show evidence of beneficial effects. Several new operators with links to formidable international telecommunications companies have entered the fixed line and mobile markets and are deploying infrastructure and services based on state-of-the-art technology. Customer choice and quality of service are improving and long-distance prices have dropped, although monthly subscriber charges and local usage tariffs have risen as part of the price 'rebalancing' that has occurred.

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1. THE TELECOMMUNICATIONS SECTOR IN SPAIN

1.1. The national context for telecommunications policies

The telecommunications sector is an important contributor to Spain's economic growth and net gains in employment. In terms of revenue, the Spanish telecommunications market is projected to grow from about US$16.5 billion in 1996 to about US$25 billion in the year 2000, making the Spanish market of some 40 million people the fifth largest in Europe.

In recent years, the Spanish telecommunications market has witnessed dramatic changes moving from being a closed and restricted virtually monopolised sector to an open market as from 1 December 1998. In principle, any company can now enter to provide any service. However, before December 1998, market entry was restricted to a second fixed line licence to Retevision which began operations in January 1998, and a third to the Lince consortium (led by France Télécom) in May 1998. Lince commenced operations in December 1998. In the mobile market, Telefonica was the sole operator until Airtel received a licence in 1995 for the GSM mode. The third licence was granted to Retevision Movil in July 1998 to operate a DCS 1800 system.

The most important driver of Spain's market and regulatory reform was the requirement to meet European Commission Directives[1] and WTO commitments.[2] The EC remains an important influence and closely monitors the implementation or "transposition" of the telecommunications regulatory package.[3] Notably, Spain (and three other EU member countries[4]) obtained a derogation to delay full liberalisation until after the 1 January 1998 EU deadline, negotiating an extension of 11 months to 1 December 1998.[5] By the end of 1998, Spain was assessed to have largely "substantially transposed",[6] having incorporated into national law the obligations set out in the various EU directives.

Another driver of regulatory reform has been concerns within Spain that the country was lagging in terms of "teledensity" and network modernisation. As Table 1 indicates, the penetration rate in Spain has increased from 24.3 mainlines per 100 inhabitants in 1985 to 32.1 in 1990 and to about 40 in 1997. As Table 1 shows, this was one of the lowest rates of telephone connection in Western Europe and is significantly lower than the OECD average of about 59. When mobile subscribers are included, "teledensity" in Spain was about 51% in 1997 (compared to the OECD average of 64) with some 92% of households connected to the telephone network.

1.2. General features of the regulatory regime

In December 1987, Spain promulgated the Telecommunications (Regulation) Act, which was the first basic statute to provide a legal framework specific to telecommunications and was the starting point of market liberalisation in Spain. The dynamic nature of the telecommunications sector, the market liberalisation process prompted by the World Trade Organisation (WTO) and the European Union (EU), meant that the 1987 Act became outdated and in need of a major overhaul. Major alterations were introduced by the Telecommunications (Liberalisation) Act of 24 April 1997. This was followed in April 1998 by the *General Telecommunications Law* designed to establish a unified legal framework in accord with EC Directives. The objectives of the law are to:

- Promote competition among service operators, with due observance for the principle of equality of opportunity through abolition of exclusive or special rights.
- Determine the public service obligations attaching to the provision of telecommunications services, particularly obligations in respect of universal service, and to guarantee their fulfilment.
- Promote the development and use of new services, networks and technologies, and likewise to promote access thereto so as to foster territorial, economic and social cohesion.
- Ensure the efficient use of limited telecommunications resources such as numbering and the radio spectrum.
- Defend the interests of users, guaranteeing their right of access to telecommunications.

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Table 1. **Access lines per 100 inhabitants in the OECD area during 1985-1997***

	Access lines per 100 inhabitants					Residential access lines per 100 households 1997	Telecom access paths per 100 inhabitants
	1985	1990	1995	1996	1997		
Australia	41.6	46.1	50.8	50.8	51.2	96.47	77.3
Austria	36.1	41.8	46.8	46.6	45.7	#N/A	59.9
Belgium	31.1	39.3	45.7	46.5	48.5	#N/A	58.0
Canada	45.5	55.0	59.7	60.8	61.6	104.89	69.7
Czech Republic	12.9	15.8	23.4	27.5	32.0	46.86	37.1
Denmark	49.7	56.6	61.3	62.1	63.6	#N/A	93.5
Finland	44.7	53.5	55.0	55.4	55.6	87.98	101.2
France	41.7	49.5	56.1	56.9	57.6	107.88	67.4
Germany	32.9	40.3	51.5	54.0	55.0	98.18	64.9
Greece	31.4	38.6	49.4	40.8	51.6	98.06	60.2
Hungary	7.0	9.6	21.3	26.4	31.9	55.43	38.9
Iceland	42.6	51.4	55.3	56.7	56.7	121.50	80.7
Ireland	19.8	28.1	37.0	39.1	42.1		56.5
Italy	30.6	39.2	43.4	44.1	44.9	91.89	65.4
Japan	37.5	44.1	48.9	49.1	47.9	96.75	78.4
Korea	18.5	35.7	48.3	50.3	52.0	115.38	67.1
Luxembourg	42.0	48.2	57.5	62.7	67.1	116.91	83.2
Mexico	4.6	6.2	9.7	9.5	9.8	33.96	11.7
Netherlands	40.2	46.4	51.7	54.1	56.6	#N/A	67.4
New Zealand	38.8	43.9	46.6	49.5	50.5	#N/A	63.6
Norway	42.3	50.3	56.1	58.6	62.6	97.09	101.1
Poland	6.7	8.6	14.9	16.9	19.4	41.55	21.0
Portugal	14.1	24.1	36.5	38.0	39.0	90.50	54.3
Spain	**24.3**	**32.1**	**38.1**	**38.8**	**39.9**	**91.90**	**50.8**
Sweden	62.8	68.3	68.4	68.4	68.0	114.08	103.8
Switzerland	50.1	57.7	61.5	63.3	64.5	96.25	78.8
Turkey	4.5	12.3	23.3	25.6	28.0	79.06	30.6
United Kingdom	37.0	44.1	50.6	52.8	54.0	95.98	68.3
United States	48.9	53.9	61.6	63.3	66.0	108.94	86.3
OECD[1]	32.9	39.2	46.1	47.4	58.9	#N/A	64.3

* Telecommunication access paths include the total of fixed access lines and cellular mobile subscribers.
1. OECD average is a weighted average rather than a simple average.
Source: OECD (1999), *Communications Outlook* 1999, Paris, p. 74.

The basic regime on radio and television is expressly excluded from the scope of the 1998 Telecommunications Law. Broadcasting services are subject to a separate regulatory framework, but the network infrastructure used for radio and TV services are within its scope, especially in relation to interconnection and access.

Box 1 indicates the notable developments in the Spanish regulatory regime since 1987 in chronological order. The laws governing competition also apply to the telecommunications sector. As Box 1 shows, the 1998 General Telecommunications Law was followed by a number of Royal Decrees and Ministerial Orders detailing specific provisions of the General Law in regard to interconnection, licensing, numbering and universal service obligations.

The Law on the Defence of Competition enacted in 1989 is aimed at protecting competition within Spain in all sectors including telecommunications. The law contains three main sets of rules: Article 1 of the law, prohibiting restrictive agreements and practices, closely follows Article 85 of the EC treaty. Article 6 is likewise the equivalent of Article 86 on abuse of a dominant position. Breaches of these rules are punishable by fines of up to 10% of the total turnover of the infringer. The control of concentrations (mergers) is also covered by this law which prescribes a control procedure when one of the two following tests is met:

– The turnover in Spain of all companies participating in the concentration exceeds, in the previous financial year, the amount of 20 billion pesetas.

– A market share equal to or in excess of 25% of the national market or of a substantial part thereof is attained or increased for a certain product or service.

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Finally, acts of unfair competition significantly distorting competition and adversely affecting the public interest are also covered by this law as well as the Law on Unfair Competition.[7]

Box 1. **Developments in the Spanish telecommunications regulatory regime**

Notable developments in the regulatory regime include:

- Telecommunications (Regulation) Act of 18 December 1987.
- Satellite Telecommunications Act of 12 December 1995.
- Cable Telecommunications Act of 22 December 1995.
- Telecommunications (Liberalisation) Act 24 April 1997.
- Numbering Plan which came into force on 4 April 1998.
- General Telecommunication Law of 24 April 1998.
- Royal Decree 1651 of 24 July 1998 on interconnection and numbering.
- Royal Decree 1652/1998 of 24 July on registrations of holders of individual licences and general authorisations and on the single window procedure.
- Royal Decree 1736 of 31 July 1998 on public service obligations.
- Royal Decree 1750 of 31 July 1998 on charges.
- Ministerial Order of 22 September 1998 on authorisation and licensing.
- Numbering regulation 25 September 1998.
- Universal service regulation 26 September 1998.

1.3. Market participants

Box 2 shows the major fixed line operators in Spain and their ownership status. The list is certainly not comprehensive. Indeed, since 1 December 1998, the number of operators with different types of licences (A, B and C) to operate in Spain has continued to increase.

The major operator is the incumbent, *Telefonica de Espana* SA (Telefonica), one of Spain's largest companies and the world's 17th largest telecommunications operator in terms of market capitalisation. Telefonica operated as a monopoly for 74 years and still dominates the telecommunications market.

The second major operator is *Retevision*, a former TV and radio transmission company. Retevision was launched in January 1998 and is establishing itself as the main rival to Telefonica. The company is building its own network and is planning to offer all services, including local telephony, so as to allow the client to migrate from Telefonica. During 1998, Retevision attracted about a million customers or some 10% of the long distance market. There was a particularly rapid penetration of the market in Catalonia, where Retevision has already taken a 14% share of the long distance market.

Lince (also known as Uni2) is the third fixed telephony operator, with France Télécom and ONO/Cableuropa[8] its main shareholders. The licence for this third fixed line operator was granted in May 1998, before market opening on 1 December 1998, as part of the negotiated settlement with the EU. Lince has been providing international and inter-provincial service since 1 December 1998 and within six weeks had some 100 000 subscribers[9] with clients increasing to 400 000 by June 1999. This is well ahead of the company's forecasts and augurs well for its plans to gain a 7.5% share of the domestic telephony business by 2008.

Euskatel, Spain's first regional phone company, started commercial operations in the Basque region in January 1998 and by May 1998 it had signed up over 100 000 customers, or some 11% of the Basque market. Euskatel's financial partners include leading Basque savings banks with 18% of its shares owned by Telecom Italia (its so-called "technological partner").

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Jazztel, which commenced operations in 1998 is investing heavily in deploying a broadband network, as well as the installation of a submarine cable between Bilbao and the United Kingdom. The company hopes to attract 10% of the business market.

BT *Tel*, a subsidiary of BT (UK), has for several years operated Spain's second largest data communications network (Telefonica operates the largest) distributing BT's *Concert* services in the country. In February 1999, BT Tel bought *Arrakis*, Spain's leading Internet service provider, with some 65 000 customers and a 15% share of the Spanish market, for 2.2 billion pesetas (9.5 million UK pounds).

Since full liberalisation of the market on 1 December 1998, there has been a growing number of new entrant operators.

Box 3 indicates the number and ownership of telecommunications operators as at January 1999 in the fast growing Spanish mobile telecommunications market.

Telefonica Moviles has about a 66% market share of the mobile phone business in Spain. At the end of July 1999, Telefonica Moviles had about 6.54 million mobile customers in Spain, of which most subscribe to *MoviStar's* fast growing GSM 900 service while subscribership declined for MoviLine's analogue service.[10] Telefonica disclosed that by November 1998, 37% of the company's profit came from its mobile operations[11] compared with only some 11% towards the end of 1997. Net profits from the mobile business almost quadrupled to 61 billion pesetas. In July 1999, CMT granted a fixed-line telephony licence to Telefonica Moviles permitting it to supply "convergent services" (with a requirement that the company provide separate accounts for fixed-line and mobile services to allay fears of cross-subsidisation practices).[12]

Airtel, using GSM 900 technology, has been competing with Telefonica since 1995 and as at March 1999 had some 32% of the mobile market. Airtel hopes to further consolidate its position with the launch in July 1999 of its fixed line telephone service[13] making it an integrated telephone service supplier.

Box 2. **Main fixed line telephony operators and their ownership status (1998)**

Name of PTO	**PTO ownership status (1998)**
Telefonica:	The incumbent monopoly for 74 years, Telefonica, privatised in 1997, has over 17 million fixed line customers.
Retevision:	*Retevision*, Spain's second fixed-line provider, was formerly government-owned but is now fully privatised. Majority control of Retevision was sold to the Endesa electricity group and Stet-Telecom Italia in July 1997. The final 30% was sold to the consortium in February 1999. As at July 1999, Endesa and Telecom Italia have a 28.7% stake each and Union Fenosa has another 15.5%. Spanish bank BSCH holds 5.5% with the rest belonging to Spanish savings banks. With over 800 000 customers, Retevision has some 10% of the long distance and international market. When its own network is established, it plans to also offer local calls.
Lince (Uni2):	Lince, is the third fixed-line carrier, having been the sole bidder for the license granted in May 1998 ahead of the market opening in December 1998. The Lince consortium partners are France Télécom (69%), Editel (30%) (Banco de Santander 51%; Ferrovial 24.5%, Multitel Cable 24.5%); and Cableuropa (1%). It is notable that Cableuropa and Deutsche Telecom each have an option to acquire an additional 15% stake from France Télécom.
JazzTel:	Using a synchronised digital hierarchy (SDH) network Jazztel plans to specialise in providing specific services for business customers. Its main shareholder is Martin Varsavsky, founder of the US operator Viatel Corp with the backing of Nortel (a Canadian company).
Colt Telecom Espana:	A subsidiary of the Colt Telecom Group (which operates in a range of countries) had been operating in Spain since September 1998 providing a range of high bandwidth value added services. In December 1998 Colt was awarded a licence to provide an expanded range of telecommunications services, including voice telephony.
BT Tel:	A 100% owned subsidiary of BT (UK).

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Retevision Movil, a joint venture between Spain's fixed line operator, Retevision, and Italy's Telecom Italia, was awarded Spain's third mobile phone license[14] in May 1998 through a public tender conducted by the Ministry for Development.[15] Using DCS-1800 technology, Retevision Movil (also known as "Amena") claimed to have more than 200 000 customers by June 1999 and plans to integrate its activities with the fixed line operator Retevision and with cable operators controlled by its shareholders.

The liberalisation guidelines for cable were approved in December 1995. The process of allocating licenses, initiated in 1997, has been finalised, with licences going mainly to two large groups of companies. One group is that formed by Retevision, the electrical companies and Stet. The other group is headed by Cableuropa. Telefonica is licensed to operate cable in all of the 43 demarcations into which the country is divided. Only one license is to be granted to a cable operator to compete with Telefonica in a duopoly situation, in each of the demarcated regions. Cable operators can provide telecommunications services and are permitted to set tariffs freely within their respective territorial demarcation. But Telefonica must wait two years from the time a licence is granted to the second operator before it can offer cable-based telecommunications service in that region.[16] The two-year moratorium has not deterred Telefonica that has plans to invest some US$3 billion over the next 10 years building cable systems in the country.[17]

The cross-ownership of different competing telecommunications operators and the effect of such cross-ownership on competition should be closely monitored. For instance, Endesa and Union Fenosa own shares in Retevision and Retevision Movil as well as competitor Airtel (which now also has a fixed line as well as a mobile licence). To its credit, the regulator (CMT), has required that these companies sell their 8.14% shareholding (each) in Airtel.[18] In May 1999, the shares were purchased by banking group BSCH (Banco Santander Central Hispano) increasing its shareholding in Airtel from 14.09% to 30.1%. In consequence, BSCH had to sell its 5.5% shareholding in Airtel's competitor Retevision. But BSCH continues to have a stake in Uni2 (15.6%), Amena (2.7%), and a 32.4% shareholding in Cableuropa.[19] And there are other examples of cross-ownership. BT (UK) has a substantial 17.81% shareholding in Airtel and is to

Box 3. **Mobile operators and subscribership as at January 1999**

	Commencement date	Number of subscribers (Jan. 1999)	Ownership status
Telefonica Moviline (analogue TACS 900 system)	April 1990	Fell (–18.1%) from 1.08 m in Jan. 1998 to 0.88 m in Jan 1999.	
Telefonica Movistar (GSM 900)	July 1995	Increased by some 100% to 4.4 m between Jan. 1998 and Jan 1999.	100% owned by Telefonica.
Airtel (GSM 900)	October 1995	Increased by 88% to 2.3m between Jan. 1998 and Jan. 1999.	Airtel, the second mobile carrier, which accounts for 30% of domestic cellular business, is backed by Vodafone-AirTouch (21.7%); BT (17.81%); investment companies: Grupo Acciona, Torreal, and Corporacion Financiera Alba; banking group BSCH (30.45%).
Retevision Movil ("Amena" DCS-1800)	Jan. 1999	5 000 subscribers in Jan. 1999.	Jointly controlled by Retevision (40.1%) and Stet, an Italian company, (39.1%), Endesa, Union Fenosa and several savings banks.

Source: OECD and *Global Mobile*, Volume 6, No. 5, 4 March, 1999.

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commence operations in fixed line service. Telecom Italia is an important shareholder in both Retevision as well as cable operator, *Madritel*. Also, the Spanish banks are heavy investors in most of the country's telecommunications operators.[20]

2. REGULATORY STRUCTURES AND THEIR REFORM

2.1. Regulatory institutions

The *Secretaria General de Comunicaciones*, located within the Ministry for Development (the ministry), has been traditionally responsible for regulating the telecommunications sector. The ministry continues to advise the government on telecommunications policy and retains a major role in the new regulatory regime raising concerns about a lack of clarity in the division of regulatory responsibilities. To clarify the division of responsibilities in relation to the independent regulator, the ministry released an unofficial circular on 26 January 1999. Notably, as indicated in Box 4, the ministry is responsible for awarding individual licences where radio spectrum frequency is considered to be limited.[21]

The *Comision del Mercado de las Telecomunicaciones* (CMT) was created by Royal Decree-Law in June 1996 and began operating in 1997 as the independent national regulatory authority provided for in EC Directives. The mission assigned to the authority is to: "safeguard the existence of effective competition in the telecommunications and audiovisual, telematic and interactive services market, for the benefit of the citizens, to ensure proper price formation and to act as arbiter in any conflicts arising in the sector."[22] CMT's broad objective is to facilitate the attainment of the most advanced, least expensive and most accessible telecommunications services. Box 5 details CMT's responsibilities.

The legislation makes commendable effort to establish the prerequisites of an independent regulator. A board consisting of a chairman, a vice-chairman and seven members governs CMT. The authority is not financed by the government but by contributions levied on telecommunications operators.[23] The authority is well resourced in terms of staff. Including the board, there are 91 CMT staff who are not civil

Box 4. **Regulatory powers of the Ministry for Development concerning telecommunications**

- Definition and execution of national policy in the telecommunications sector
- **Development of new administrative regulations,** and drafting of new laws both for telecommunications and broadcasting.
- Co-ordination of the Spanish policy in international telecommunications organisations, and the relations with these organisations.
- Radio spectrum management and monitoring; frequency assignment and spectrum pricing.
- **Control of the quality of telecommunications services and public networks.**
- **Application of penalty procedures.**
- Policies for stimulation and promotion of advanced services.
- Development of technical standards for telecommunications equipment, and type approval.
- Granting of individual licenses for services that use the radio spectrum (with limitation in the number of licenses and licenses for non public services).
- Development of new numbering plans.
- Definition of the different components of the universal service concept and proposals for increasing the number of services included under this concept.
- Control of the content of TV programmes.

Source: Ministry for Development, "The Administration of the Telecommunications Sector in Spain", 26 January 1999.

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servants (staff previously employed by the administration have had to resign their positions). The chairman is appointed by the government, subject to parliamentary approval, with other members appointed by the Minister of Development for five years, with removal before then only for "exceptional and well established reasons". Decisions of the board are made on the basis of simple majority.

The instructions, resolutions, decisions, and requests for information issued by the CMT are binding, and, if ignored, will be considered a serious breach of the telecommunications law.[24] The CMT has authority to ask for any information it requires (restricted to being used only for the purpose specified). Decisions can be appealed to the courts but not to the government. CMT is well endowed with legislative powers and resources and, indeed, has scored some early successes. For instance it is widely regarded to have performed well in achieving a pro-competitive interconnection offer from Telefonica. Another example was the case of RSLCom, a new entrant that saw the potential of offering calling cards allowing the millions of visitors to Spain each year to make international calls at cheaper rates than Telefonica. In August 1998, Telefonica tried to block access to RSLCom's freephone number from payphones in airports and other locations frequented by visitors. RSLCom complained to CMT that found in its favour and obliged Telefonica to let RSLCom customers use the service from any call box. CMT's continued performance in nurturing competition will depend critically on the willingness of the Ministry for Development to hand over real power to make independent decisions to the regulator. It is important for effective regulation that the relationship between CMT and the administration is transparent and that CMT materialises its potential to be an independent national regulatory authority.[25]

As noted earlier, on 26 January 1999 the ministry circulated a brief document outlining the division of responsibilities. It is notable that several areas indicated in Box 4 as the ministry's responsibility, such as control of the quality of services, development of new administrative regulations, and application of penalty procedures, are in many other OECD countries designated as the responsibility of the independent regulator. The policy aspects of these responsibilities (justifiably within the ministry's jurisdiction) should be clearly demarcated from the "operations" aspects (that are the CMT's responsibility). On the other hand CMT is required to assess tariff proposals for services provided by an operator in a dominant position, as does the *Commission for Economic Affairs* (referred to later) which is still the government body that authorises Telefonica's price change applications for those services under price

Box 5. **Responsibilities of the telecommunications regulator, CMT**

Advise the government on telecommunication policy, including:

- Adopting measures necessary to ensure free competition in telecommunications markets.
- Overseeing and granting general authorisations and individual licenses for providing all telecommunication services, except where tendering for a licence is mandatory due to lack of scarce resources, in which case the Ministry for Development is responsible.
- Maintaining public registers of the holders of individual licences and general authorisations.
- Assigning numbering blocks to operators.
- Arbitrating on conflicts between operators in access and interconnection and definition of maximum interconnection prices; approval of the reference interconnection offer.
- Assessing tariff proposals for services.
- Evaluating and reporting on proposals for new regulations.
- Determining the cost of universal service and distributing this cost among operators and administering the universal service fund if one is considered necessary and is established.
- Reporting its views regarding the desirability of mergers and takeovers to the Competition Defence Service.

Source: Ministry for Development, "The Administration of the Telecommunications Sector in Spain", 26 January 1999.

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control. The ministry's involvement in price regulation therefore continues to be significant since it is responsible for briefing it's minister who is a member of the Commission.

CMT can enhance its reputation for independent decisions by moving determinedly towards more open hearings, establishing a formal process for receiving submissions, consulting widely, etc. New entrants have also called for CMT to issue clear and timely guidance to assist them to conform to CMT's filing requirements. These are practices that can be used to good effect in installing a transparent system, as demonstrated by OFTEL and the FCC. Open decisions based on sound reasoning and information makes political over-ride much more difficult and, indeed, is likely to make CMT much less open to allegations of being "captured".

Spain's competition law authorities are the *Tribunal de Defensa de la Competicion* or the Competition Defence Tribunal (henceforth referred to as the Competition Tribunal) and the *Servicio de Defensa de la Competicion* (Competition Defence Service) located within the Ministry of Economy and Finance. Both are responsible for the application of the competition rules contained in the law on the Defence of Competition 1989.

In the context of price regulation, the 1998 Telecommunications Law provides a role for the *Commission for Economic Affairs* (comprising ministers of economics-related portfolios). The Commission may, following a report from the CMT, provisionally set maximum and minimum prices or lay down criteria for the setting and mechanisms for price control in the light of the "actual costs" of providing the service and the degree of competition among operators in the market. Furthermore, in order to determine the said degree of competition, the situation of each separate service shall be analysed in such a way as to guarantee competition, the control of abuse of dominant positions, and access to these services for all citizens at affordable prices. To this end network or service operators shall be obligated to furnish detailed information on their costs subject to whatever criteria and conditions shall be established by regulation. In any event, such information must be relevant to the purpose of price regulation and furthermore must be furnished along with a covering report from an independent firm of auditors accrediting conformance to regulations.[26]

Notably, the Commission for Economic Affairs may establish a provisional surcharge on interconnection prices to cover the access deficit caused by the present tariff imbalance until such time as a balance is re-established, and to help finance universal service pending formation of the National Fund for Universal Service. The said surcharges must be included in the actual interconnection prices.[27]

One question pertaining to these provisions is whether it should be CMT rather than the Commission that should be responsible for price regulation. Another issue is the extent to which the rules pertaining to the accounting separation of costs has in fact been enforced. A third issue is that a surcharge included in the actual interconnection charge will reduce the transparency of the interconnection price and is a distortive and inefficient way of raising funds to offset the access deficit or fund universal service obligations. These issues will be discussed further later.

Another regulatory institution is the *Telecommunications Advisory Board* which is responsible for advising the government "in matters relating to telecommunications." The Board's function is to conduct studies and "make proposals" on matters relating to telecommunications.[28]

2.2. Telecommunications regulation and related policy instruments

As noted earlier, the *European Commission* (EC) has played a major role in driving regulatory reform in Spain and it continues to be responsible for guarding against abuse of a dominant position and anti-competitive behaviour at the general EU level.

An operator (whether a new entrant or an incumbent) which finds that an EU directive has not been properly implemented can initiate action at either (or both) the EU level as well as the national level. At the EU level, the complainant can either file a complaint with the EC or rely on the Commission to take the initiative to open administrative proceedings (negotiations with the relevant member state) or infringement proceedings (litigation before the European Courts). At the national level, the complainant can bring the case before the national authorities and/or courts which, according to the relevant national law, have jurisdiction to apply directly effective EU law.

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There have been several instances of Spanish telecommunications operators taking their complaints to the EC for resolution during 1998 rather than the national authorities.[29] But this may have been in part due to the fact that at that time regulatory rules had not yet been clearly established.

2.2.1. *Regulation of entry and service provision*

With the introduction of full competition on 1 December 1998, there is no limit set on the number of operators, although each must still obtain authorisation or an individual licence to operate.[30] Individual licences are required to:

- Establish or operate public telecommunications networks.
- Provide public telephony services.
- Provide services or establish or operate telecommunications networks which use radio frequency spectrum.

Notably, the government can add to this list by Royal Decree. All other services which do not fall within the scope of the individual licensing regime[31] require a general authorisation.[32]

Both general authorisation and individual licences are granted[33] by CMT. However, the ministry is responsible for awarding licenses for frequency spectrum (when in limited supply).

There seems broad discretion available on what terms to attach to a licence. For general authorisations, attachable conditions are: fulfilment of the essential requirements for the provision of service; a competitive approach to the market; efficient use of numbering capacity; protection of users; routing of emergency calls; access to telecommunications services by disabled people; network interconnection; and protection of national defence and public security.

The Ministerial Order of September 1998 on general authorisation and licensing expressly adds, even for non-dominant operators: the fulfilment of public service obligations; transparency of prices; confidentiality; personal data protection; respect of land and environmental regulations; security in the networks; and detailed invoicing of the service.

The intent of the EC's efforts to develop a licensing directive was to minimise the need for licences and the conditions attached to licences. This was in recognition that licence conditions can be important in impeding/deterring entry and in slowing post-entry developments in competition. However, the need to negotiate an acceptable Licensing Directive led to concessions by the EC which provide more scope to attach licence conditions than are conducive to open competition.[34] Aside from the question about whether Spain is in breach of the EU's licensing Directive, there are questions about whether it is taking advantage of the scope for abuse in the nature and extent of conditions imposed on general authorisation and individual licences.

Before 1 December 1998, applicants for individual licences had to submit detailed technical information including expected quality standards, as well as a business plan and commercial strategy. The business plan must cover at least the first four years of the licence term, and must include information regarding the company's infrastructure investment plan – including commitments and guarantees – and a profitability, solvency and liquidity analysis. Similarly, applicants must include information about their commercial strategy for the first four years, and enclose the model contract that will govern relations between the operator and subscriber, and a description of their customer care policy.[35] A welcome development is that since 1 December 1998, the requirement to submit details of a business plan, as well as some other requirements have been streamlined, at least in principle. However, some conditions remain. Applicants for a B1 national carrier licence must commit to providing 50 interconnection points of presence (one in each demarcated Spanish region) within one year of licence approval. Simple resellers must pay a higher interconnect price to Telefonica and must require their customers to dial a prefix (which resellers consider to be a significant competitive disadvantage). On the other hand, holders of a B1 licence pay a lower interconnect charge than simple resellers, but are required to carry 40% of their traffic over their own infrastructure within two years of commencing operations.

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In this context, it is notable that Spain's offer to licence a third national fixed network in July 1998, ahead of full market opening in 1 December 1998, drew only one bidder, despite the keen interest in entering the market (as demonstrated by the large number of applicants after 1 December 1998). The deterrence to bid in the July offer, it has been suggested, was attributable in part to the terms of the license tender which required that the winning bidder for the license invest at least 100 billion pesetas (about US$653 million) over five years. A spokesman for France Télécom, which headed the winning team, said that this did not deter the Lince consortium because it was intending anyway to spend sums well in excess of what was required by the ministry.

Apart from concerns in regard to onerous licence conditions, the lack of transparency in regard to conditions and procedures, and the length of time required to issue licences in certain cases, have also been the subject of complaints.

Where spectrum is considered to be in limited supply, mobile licences are awarded in Spain through a "beauty contest" on the basis of business plans, network rollout commitments, etc. As indicated earlier, the ministry selects the winner under certain criteria and it is then the responsibility of CMT to administer the licence to ensure compliance with licence conditions.

1 January 2002 is the deadline set by the EC for the commencement of commercial service based on UMTS 3rd Generation technology and 1 January 2000 for the implementation of a licensing system. In November 1999 the government announced that fourUMTS licenses would be granted. In March 2000, Telefonica Moviles, Retevision, Airtel, and Xfera obtained the four licenses. UMTS presents an important regulatory issue, particularly since the broadband capacity it would offer could present the alternative infrastructure for bypassing the access bottleneck which confers market dominance to incumbents such as Telefonica.

A basic issue is whether UMTS licences should be awarded by "beauty contest" or by auctions.[36] The net benefits of each system are difficult to generalise, particularly when dynamic efficiency aspects are included. The French authorities have expressed their preference for awarding UMTS licences by beauty contest[37] rather than by auction. By contrast, the UK will conduct an auction, and Germany has stated in a consultative document published in January 1999 that it also favours the auction model.

Notably, using auctions to determine who obtains access to commercial spectrum would mean that it is licensees, not regulators, who formulate business and marketing plans. Indeed, it would help ensure that spectrum will be allocated efficiently among telecommunications firms and telecommunications services if mechanisms for trading in spectrum are established. If firms can buy and sell spectrum freely they have strong incentives to economise on their spectrum use and to apply the spectrum in its highest value use, just like any other key business input. In the absence of mechanisms for trading spectrum, spectrum can remain in outdated technologies or with inefficient companies longer than is appropriate. New entrants with innovative new services may not be able to bid the spectrum away from old, outdated, existing technologies or uses. As long as spectrum is assigned to firms by government officials using a "beauty contest", there is no guarantee that the spectrum will be allocated to the most efficient user or the most efficient application. Spain should consider moving quickly to establish auctions for allocating spectrum and for establishing tradable property rights in spectrum.

Another issue is whether existing cellular operators should receive licences automatically, or be made to go through the same bidding process as new entrants. Or, indeed, whether in the interests of widening the range of competitors, they should be precluded from obtaining a UMTS licence? Or whether a moratorium of say five years should be applied to give new operators some time to establish themselves but without precluding any operator permanently? Certainly, to promote competition within the mobile market and between mobile and wireline, the case for precluding any existing dominant operator from obtaining a UMTS licence, at least for a specific moratorium period, is a strong one.

Spectrum frequency will become a very important scarce resource in the Information Age. It is essential therefore to increase flexibility in the use of frequencies, allow access to new types of services, and facilitate the optimal use of frequency. Where the efficient use of frequency is considered to require a limit on the number of entrants, the rationale for such restrictions should be made clear and these limits relaxed as soon as practicable. It is essential that the process be based on assuring the longer-term

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requirement for the dynamic efficiency advantages of competition, rather than on criteria stemming from short-term political horizons. In this context, the responsibility for awarding licences for use of spectrum frequency should be shifted from the Ministry for Development to the CMT.

2.2.2. *Regulation of interconnection*

Interconnection charges are a critical factor in the development of effective competition, for one thing because they can account for some 50% of the costs incurred by new operators. The Royal Decree 1651 of 24 July 1998 implements the regulations relating to interconnection set down in the 1998 General Telecommunications Law. Interconnection charges are, in principle, a matter for commercial agreement between operators. But, where necessary, the CMT is empowered to arbitrate and is required to issue, within six months, a binding resolution open to challenge in the courts. A dominant operator is obliged to publish an unbundled Reference Interconnection Offer (RIO) as a standard rate for other service providers. Such an offer can be varied with different prices, terms and interconnection conditions to different categories of operators when justified.

The terms of Spain's derogation negotiated with the EC stipulated that Telefonica had to publish a standard interconnection offer by 1 August 1998. Telefonica's initial RIO was rejected by CMT and after protracted negotiations, a binding resolution was put forward by CMT and the ministry[38] in October 1998. This RIO resulted in Telefonica's interconnection charges being reduced by some 30% to 50%[39] (see Table 2) becoming the second lowest in single transit among EU member countries (with only rates in the UK being lower). However, double transit charges remain too high. The RIO was seen to have been a major test for CMT's effectiveness in promoting competition, a test it is generally regarded to have passed well.

Table 2. **Telefonica's interconnection charge per minute[1] in US$**

	Local	Single transit	Double transit	Interconnection charge in pesetas per minute
March 1998**	1.64*	1.64	4.58	Prices since April 1997 (in pesetas): • Local/metropolitan: Peak = 2.5 per min.; normal = 2.5; reduced = 2.3; • Provincial: Peak = 4.25 per min.; normal = 3.87; off-peak = 2.38 • National: Peak = 7 per min.; normal = 4.97; off-peak = 3.01
Recommended EC "best current (1998) practice"	0.65-1.08	0.98-1.95	1.63-2.82	
1 Dec. 1998	1.15	1.85	3.56	Prices since 1 Dec. 1998 (in pesetas): • Local: Peak = 1.65 per min.; normal = 1.65; off-peak = 1.05 • Single transit: Peak = 2.65 per min.; normal = 2.31; off-peak = 1.62 • Double transit: Peak = 5.11 per min.; normal = 4.44; off-peak = 3.11
Recommended EC "best current (1999) practice"	0.59-1.08	0.94-1.88	1.63-2.70	

1. Based on a three-minute call duration.
* In Spain, the lowest interconnection charge covered interconnection at a local or a tandem exchange. Thus the "local" rate was the same as the "single transit" rate.
** In Spain, this offer was only available to a limited number of authorised operators until full liberalisation on 1 December 1998 (in accordance with the derogation granted under Directive 96/19/EC). Conversion rate to US$ as at March 1998.
Source: Ovum and European Commission.

Telefonica appealed to the national court for a suspension of the order from the ministry approving the RIO[40] but the courts have rejected the appeals. One basis of Telefonica's appeal is that the wrong concept of costs was used to determine the interconnection charge. Telefonica argues that despite the fact that the 1998 Telecommunications Law clearly stipulates that "real costs" must be used (which Telefonica took to mean historical accounting costs), "fictitious costs" have been used to establish interconnection prices. Telefonica points out that the interconnection regulations apply a formula that prevents Telefonica from including a substantial number of network investments in its calculations, many of which were

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mandated according to the government's instructions.[41] In Telefonica's view, this mistaken criterion is what has led the CMT to propose a RIO that deviates widely from real (accounting) costs.

Telefonica argues that CMT's use of the so-called Long Run Average Incremental Cost (LRAIC) approach takes account only of those costs that would be incurred by an operator which uses a plant of optimum size, with the best technology possible. Since in the real world, an operator would have higher costs, the result is that, under these interconnection prices a "real", as opposed to an imaginary, ideal network is made available to third parties interested in using it to conduct business at less than the actual cost involved.[42] Under such circumstances Telefonica argues, third parties cannot be expected to invest in their own networks nor Telefonica in its own. Thus companies would not invest in improving networks. Nor will there be adequate research or innovation for the simple reason that if it is successful, the gains have to be shared, whereas if it fails, the company concerned must bear the costs alone.

The efficient price is clear: to encourage only efficient investment in local service competition, interconnection charges should reflect long-run incremental costs including a reasonable profit margin. The access fees that the access provider charges must be reduced to cost. The best way to accomplish cost-based pricing is through competition itself, but competition in access termination charges is very unlikely as long as access customers face a local monopoly. In the absence of local competition, the regulator should reduce access charges to reflect costs.

Interconnection conditions are still problematic for new entrants.[43] While the RIO was concluded, Telefonica has allegedly been reluctant to provide interconnection on these terms to some operators. In February 1999, the CMT started an action against Telefonica demanding that it provide immediately its RIO to the UK company Colt Telecom.[44] And Airtel and Jazztel have reportedly already complained to the CMT about Telefonica. By July 1999, it appeared that CMT had successfully steered several interconnection agreements with these companies and several other new entrants.

Non-price discrimination[45] is in practice also not easily addressed by interconnection regulations.[46] The scope to act anti-competitively in regard to these non-price terms of access is magnified by the absence of an effective regime to separate monopoly and competitive activities of Telefonica. There is provision for accounting separation in the law but this has not yet been enforced. Accounting separation is admittedly a weak measure since the problems of "information asymmetry" concerning an incumbent's costs, as well as the ingeniousness of "creative accounting" are well known. Nevertheless, data provided on the basis of accounting separation will go some way in restricting Telefonica's cross-subsidisation activities. At minimum, therefore, the CMT should require immediate accounting separation by Telefonica with accounts subject to scrutiny by an independent accounting firm.

Interconnection tariffs are also important for mobile operators. The RIO for basic telecommunication operators can be used as a useful benchmark in negotiations with mobile operators.

2.2.3. *Promotion of local competition: resale and unbundling*

Thus far there has been little development of local competition in Spain. To facilitate market entry and promote local competition, the various pathways to competition should be kept open, including facilities-based competition, resale, and unbundled network elements.

In Spain simple resale is permitted. However, as noted earlier, simple resellers must pay a higher interconnection charge to Telefonica than operators who construct their own infrastructure. Also, customers of resellers must dial an access code before each call. Resellers should not be handicapped since resale can help promote and sustain competition in telecommunications services by: (1) allowing retail-stage competition to emerge more rapidly and on a more geographically widespread basis than facilities-based entry; (2) yielding substantial net benefits to customers by way of price falls and increased customer choice as the retail portion of the industry begins to develop; and (3) facilitating a more rapid rate of facilities-based entry as the number of retail customers increases.

Regulation is required to reduce the market power of incumbents where necessary through restructuring and/or divestiture. As the OECD has warned in its 1997 report on regulatory reform, the ownership of cable television networks by incumbent telecommunication companies, together with their control of

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the public switched telecommunication networks, could give them an extremely powerful bottleneck position in the local loop. Effective competition is likely to develop only when the existing bottleneck power derived from ownership and management of local access networks, is eroded by the emergence of alternative access networks. In this context, reducing the market power of existing dominant operator(s) over alternative infrastructures, such as cable television networks, is crucial. Each source of alternative infrastructure foreclosed by the incumbent makes it less likely that effective competition will develop.

In Spain, a two-year moratorium has been imposed on Telefonica's entry into cable telephony. This is because the government wanted to ensure that new entrant cable companies entering the business to provide integrated television programming, Internet access and telecommunication services to homes and businesses, will have time to establish themselves before Telefonica enters the industry. The initial 16 months moratorium originally applied was considered insufficient because of delays in network construction and other problems encountered by the new entrants and the moratorium period was increased to 24 months. Some companies, including M*adritel* which now has licenses to operate in the Madrid region, are facing significant problems in obtaining local government approval to construct planned networks.

The Spanish government should give serious consideration to requiring divestiture of Telefonica's cable interests so as to remove the distinct danger that the company's cable networks coupled with its dominance over the fixed network would foreclose the potential for cable operators to provide effective competition in the local service market.[47] Alternatively, particularly in view of the delays in installing their networks, the government should at least extend the moratorium period to say five years, (Spain's cable operators association is seeking a five year extension[48]) or to when Telefonica can demonstrate that is no longer "dominant". Two years is far too short a period for new entrants to establish their businesses firmly enough to withstand Telefonica's considerable advantages, particularly in view of problems being experienced in installing planned cable networks. Indeed, the two-year moratorium is already ending in some areas. Telefonica has announced that in early September 1999, it would start to provide cable services in three regions of Spain packaging television, music and high-speed Internet and telephone services with plans to offer free services for an initial period of four to six months. Notably, by the end of 1999, Telefonica would be able to provide cable services throughout Spain.[49]

In extending the moratorium from 16 to 24 months, the Spanish government has acknowledged that difficulties exist that warranted an extension. From all accounts, these difficulties have not been resolved.[50] A further decisive action is required while making it clear that no further amendment will be made since uncertainty in this regard would be damaging to corporate decision-making. Furthermore, the duopoly policy[51] for cable should be rejected in favour of allowing unrestricted market entry.

Spain has no policy in place to allow for access to unbundled network elements that are essential facilities. The pricing of *unbundled network elements* (UNEs) is problematical, as the US debate indicates. In the US, the FCC and some state regulators have decided that the RBOCs' network elements must be made available to new entrants at their incremental *forward-looking* costs – approximately the long-run cost of the best available technology. The decision over UNE pricing is critical since if UNEs are priced either too high or too low, competition in local service will suffer.

If elements are made available at low prices relative to the cost of investing in new facilities, entrants will use the incumbent's facilities even if, on a stand-alone basis, the investment would have been an economic proposition for the entrant. That is, there is a danger that regulatory prescriptions for unbundling at prices that are excessively low may act against the consumer's longer run interests through the reduction of incentives for companies to install their own wired (or wireless) networks. This could generate disincentives to install state-of-the-art technology and services essential to the Information Economy. In general, resale and unbundling should be used as a temporary measure subject to review over time.

One approach that has been proposed is that the price of UNEs be set at the average cost of incremental local access investments during the preceding year.[52] This procedure would avoid looking to hypothetical technologies to assess costs, but would retain the important principle that prices should be set close to incremental costs. Oftel, the UK telecommunications industry regulator, appears to support this approach in its recommendation that an "incurred cost" approach to LRAIC be used.[53]

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The approach adopted in Canada where unbundling of designated elements is mandated for a limited period (five years) is worth considering.[54] Also worth considering is the Netherlands system whereby local loop unbundling will start at cost-based prices and move to commercial pricing over five years. This finite period maintains incentives for firms to seek to deploy their own infrastructure rather than depend indefinitely on another firm to provide it. This approach could be applied in considering a mandated unbundling of Telefonica's xDSL[55] network to allow access by other operators, currently a very topical issue in Spain of close concern to Spain's rapidly growing number of internet users.[56]

2.2.4. *Numbering*

Numbering is another important local competition issue. According to the 1998 Telecommunications Law, all publicly available telecommunications service operators are entitled to have access to adequate numbers in order to achieve an effective provision of their services. The rules on assignment and management of numbering resources have been developed by Royal Decree 1651 of 24 July 1998. Numbering policy is the responsibility of the Ministry for Development while CMT is responsible for managing numbering blocks.

Number portability is also important and refers to the ability of customers to change their location, service provider, or service without being required to change their number. An absence of provisions to allow for number portability acts as an artificial disincentive for customers to switch from the incumbent to a new entrant because such switching imposes transaction costs, such as the burden of informing others of their new number.

The 1998 Telecommunications Law prescribes that fixed network operators must ensure customers' number portability whereby users may retain their number on the fixed public telephone network at a specific location independent from the organisation providing the services. Number portability regulation has been under discussion but as at March 1999 had not been put in place.

Carrier selection through dialling a prefix (*e.g.*, 050 for Retevision) is now available but new entrants argue that carrier *pre*-selection is necessary for effective competition. However, carrier pre-selection is behind schedule in Spain. According to the 1998 Telecommunications Law, pre-selection was to have been available by November 1998 but this requirement was not met. Telefonica claims that the delay in availability is due to technical problems and that switching suppliers, including Ericson, Alcatel and Lucent, do not have the solution at least for some areas. In this context it is notable that carrier pre-selection is firmly in place in several OECD countries such as Australia, Denmark, Mexico, New Zealand, US, the Netherlands, etc. The EC requires member states to ensure by 1 December 2000 that fixed network operators with significant market power enable their subscribers to obtain access to the services of other interconnected service providers, by means of pre-selection with a call-by-call over-ride facility. This requirement should be strictly enforced.

2.2.5. *Rights of way*

In principle, there must not be discrimination between providers of public telecommunication networks with regard to the granting of *rights of way*.

The problem of obtaining rights of way for new entrants can be a formidable one, however. In Spain the ability of powerful local governments to delay the construction of telecommunications networks has received considerable prominence recently in regard to the construction of cable network infrastructure. The case of Madritel, a cable operator facing considerable delay in deploying its network in Madrid is a notable example.

Since concerns relating to the protection of private property and the environment,[57] as well as the scarcity of suitable sites, appear to be growing, the regulatory authority should act to encourage negotiated arrangements and as a last resort impose facility-sharing arrangements. In Spain, CMT has the power to oblige sharing but only for new ducts. The government should consider legislating further powers to enable the mandated sharing – on reasonable terms – of the facilities of all telecommunications operators as well as other public utilities.

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2.2.6. *Regulation of pricing*

As noted earlier, for an unspecified "transitory period", the *Commission for Economic Affairs* is responsible for regulating Telefonica's prices.[58] Telefonica has complained that government-regulated tariffs prevent it from matching Retevision's (unregulated) rates on long-distance and international calls, which, according to Telefonica, undercut its rates by up to 25%.[59] In March 1998, Telefonica appealed to the Spanish Supreme Court against its regulated prices claiming that it is discriminated against since new companies entering the market can freely set tariffs.[60]

In the mobile service sector, Telefonica MoviLine complained that it was kept waiting four years for approval from the Economic Affairs Commission to reduce prices. Moreover, Telefonica Moviles complained that although it had argued for total freedom to set prices, "the administration, however, has judged it necessary to now establish a price fluctuation band, first announced in 1994, which sets the limits within which Moviline's charges are allowed to move."[61] Notably, since June 1999, Telefonica Moviles is only constrained to maximum prices.

According to Telefonica, the decisions on tariffs (Ministerial Orders of 17 March 1998 and 31 July 1998) did not achieve the required tariff re-balancing. Telefonica argues that if tariff rebalancing had been initiated from the time it was first known that telephone services would have to be liberalised (1993-1994), the effects of this measure could have been gradually absorbed. Telefonica points out that such a plan has existed since 1993, when it was drawn up by the Ministry for Development, quantified and published. But evidently, both the Socialist and Conservative Administrations postponed implementation of this plan.[62]

One reason for Telefonica's concern that it has not been permitted to further increase the rental charge (which generates most of the "access deficit") and local call price is that this constrains its ability to reduce the price of long distance calls to levels offered by competitors. With competition already driving long distance prices down and poised to drive them down further (according to Telefonica by about 12% for national long distance and 20% for international calls during 1999), Telefonica is anxious to further increase local charges, particularly the monthly rental charge which is currently about the lowest in the EU[63] to at least about the EU average.

The Ministerial Order of March 1997 foresaw the beginning of tariff re-balancing starting in 1998, with Telefonica permitted to increase the monthly charge from 1 242 to 1 442 pesetas in two steps, 100 pesetas by March 1998 and by another 100 pesetas by August 1998.[64] Telefonica itself considered an increase to 1 900 pesetas per month to be necessary, although no account information is provided to support this claim. In October 1999, Telefonica was allowed to increase the monthly charge by 300 pesetas by August 2001.

Usage charges for local calls were also permitted to increase in terms of a reduction in the number of seconds per tariff unit as indicated in Table 3. In effect, this resulted in an increase of 13.6% in the average call price per minute.

Telefonica claims that in 1993, "the ministry itself officially and publicly acknowledged the existence of an access deficit (of the order of 150 000 million pesetas)".[65] While Telefonica acknowledges that the access deficit is now somewhat lower due to recent rises in rentals, the company is emphatic that, contrary to the government's claim that full re-balancing has now occurred, further price re-balancing is required.

Table 3. **Permitted increase in local charges during 1998**
By way of reductions in the number of seconds per tariff unit

	Level since 1994	1 April 1998	1 August 1998	1 November 1998
Peak-hour	180	138	123	110
Off-peak	180	138	123	110
Reduced tariff	240	172	150	132

Note: Telefonica estimates that the impact of the changes in these charges is equivalent to an accumulated increase of 13% in the average price per minute.
Source: Telefonica at *www.telefonica.es/cgi-bin/telefo*.

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The long delays in government authorisation due to the politically sensitive nature of telecommunications price increases (partly due to its impact on the inflation rate) require that responsibility for price regulation be immediately shifted to CMT whose primary focus is the impact of price changes on competition. Indeed, the Telecommunications Law clearly stipulates that CMT is responsible "to ensure proper price formation". Moreover, price regulation on the basis of a price cap scheme offers the best prospect for a distinct move away from decisions based on political considerations towards "arm's length" price regulation.[66] So long as a price increase does not exceed what is permitted under a "CPI – X" formula, no approval need be obtained. Price regulation should be applied only to those market segments where there is insufficient competition. If the liberalisation experience in Spain follows that of other OECD countries, and there is no reason to believe that it would not, price regulation should not be required for international long distance prices or national long distance prices. Indeed, if applied, such price regulation would diminish the gains from competition.

In designing a price cap scheme, it is important to bear in mind the need to continue to permit substantial price rebalancing towards a better reflection of service costs as a fundamental requirement in addressing the problems stemming from cross-subsidisation. Otherwise, the difficulties of attempting to force competition upon a fundamentally distorted local service market (where prices are kept artificially low) will continue.

The price cap formula should not be designed on the basis of attaining a particular rate of return target as has been the practice in some countries.[67] The price cap formula and the "X" factor it incorporates is meant to promote efficiency incentives while delivering a "productivity-sharing" dividend to customers by way of a targeted fall in real prices. The sustained incentives for efficiency promised by the price cap system arise through the ability of the operator to keep profits earned through superior performance. Relating price caps to profit targets or ceilings would blunt these incentives. Certainly the inefficiencies of profit controls are well known. To focus on *both* price as well as profit control risks applying a system with the worst features of both price regulation approaches.

Price regulation should be seen to be only a temporary measure since price controls can result in distortive inefficiencies, especially when left in place for long periods. As soon as competitive circumstances permit, the price cap regime should be streamlined then withdrawn as effective competition develops. To ensure that price caps are withdrawn promptly when a competitive market develops, a price cap scheme should include a "forbearance provision" (a sunset clause) to oblige withdrawal of price caps in any market that the regulated operator could prove had become competitive.

2.2.7. *Social regulation, including universal service obligations*

The 1998 Telecommunications Law requires that the following services must be guaranteed in whatever terms are determined by regulation:

- All citizens can be connected to the fixed telephone network and have access to the fixed telephone service for local, national and international calls and that such service must permit the transmission of speech, facsimile and data.
- Free directory service.
- Sufficient supply of public payphones throughout the nation.
- Access to fixed telephone service by handicapped people in comparable conditions to those offered to other users.

The law provides that the government may revise and extend the list of services embraced by the universal service concept "to keep pace with technological progress and market demand for services, or for reasons of social or territorial policy". It may also revise the quality of service levels and the criteria for determining prices that guarantee affordability.[68]

Any dominant operator within a given area may be appointed to provide, in that area, any of the services included in the universal service concept. Provision by non-dominant players is possible, provided that minimum standards of quality and price are fulfilled. Telefonica has been designated the dominant operator required to provide universal service until the end of 2005. During 2005, the CMT is required to

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determine whether or not, as from 1 January 2006, Telefonica will continue to be considered the dominant operator and the universal service provider in each geographic area.

There is to be compensation for any "competitive disadvantage" caused by the provision of universal service. The burden which the provision of universal service represents is to be calculated by the operator – according to general criteria specified by CMT – as the net cost of the obligation to the operator concerned. This calculation must be audited and approved by the CMT and the results made available to operators who are obliged to contribute to the USO Financing Fund in proportion to their share of the market.

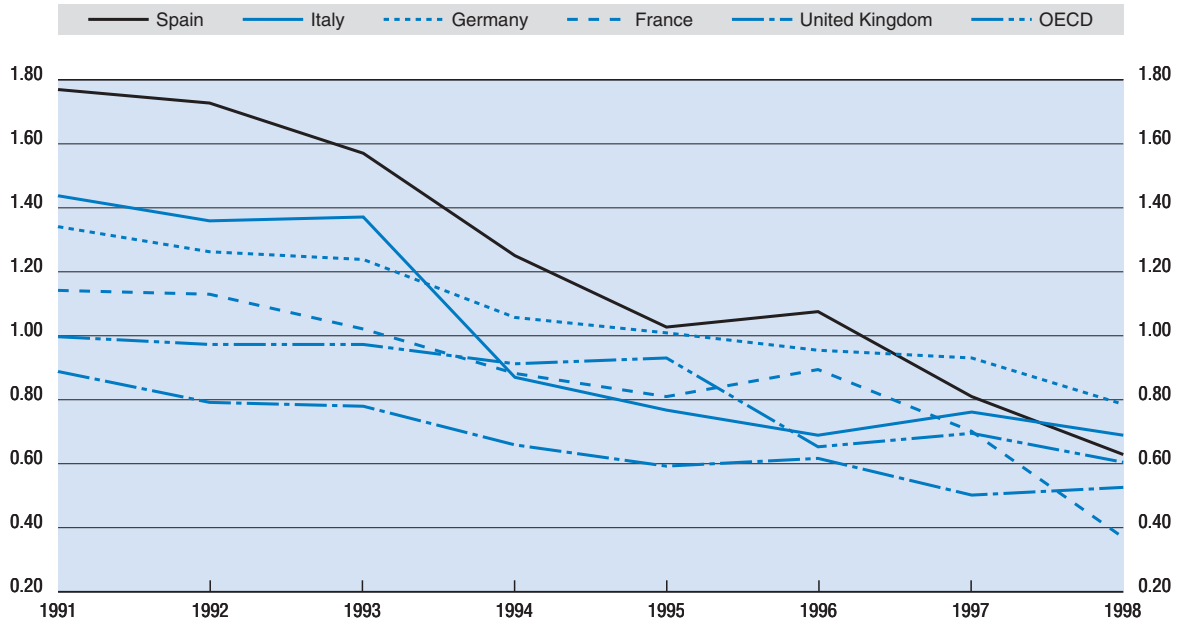
As noted above, CMT is responsible for specifying the costing methodology to be used. But this has not yet been done leaving unresolved the issue of whether the net costs are significant enough to warrant contribution by other operators through the establishment of a universal service fund. This delay is generating considerable uncertainty and concern[69] since new entrants are unsure of whether they will be required to pay any contributions over the next few years, and if so, what their payment obligations are to be.

2.2.8. *International aspects*

Spain's international commitments concerning regulatory reform are related to the regulatory principles in the "Reference Paper" attached to the 1997 WTO agreement of basic telecommunications services. Except for questions about the lack of a transparent universal service funding mechanism, Spain appears to have accorded with WTO regulatory principles..

Several formidable international players have entered the Spanish market, including France Télécom, Telecom Italia and BT. There has also been significant investment from US companies, such as mobile operator Airtouch – which has a 21.7% stake in Airtel. Foreign companies from non-EU states cannot hold more than 25% of the equity in a company granted an individual licence, unless permitted by an international agreement[70] or according to the principle of reciprocity. In exceptional cases, the government can approve a higher level of foreign participation. A Royal Decree of August 1997 stipulates the need to

Figure 1. **Spain's collection charges, 1991-98**
Average of peak one minute to OECD countries, expressed in US$



Source: OECD, Eurodata.

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obtain government authorisation prior to any individual or corporation, whether national or foreign, gaining control of 10% or more of Telefonica's capital.

Telefonica's own offshore activities have been impressive, especially in Spanish-speaking Latin America. While there will no doubt be support for the legitimate commercial activities of a "national champion", the CMT should remain vigilant that Telefonica's customers at home, and its mandated universal service obligations do not suffer as a consequence.

Also notable is that Spain has had relatively high collection charges compared to other OECD countries. As Figure 1 shows, up to 1996, Spain's charges were higher than the other OECD countries in the comparison and higher than the OECD average. However the onset of competition for international telecommunications services has resulted in a rapid decline in these charges and in 1998, Spain's charges were below the OECD average but still higher than countries like France, the UK and Germany. But there is still room for improvement. In particular, Spain still has high charges for non-Europe destinations compared with other EU countries.[71]

2.2.9. *Streamlining regulation*

Regulation can impose costs as well as benefits and there is accordingly need to ensure that benefits of regulation outweigh its costs. Even though Spain has only recently installed a new regulatory system, it has to bear in mind that all regulations should be subject to regular review to ensure that only regulations which confer benefits in excess of costs are retained. The government should require that a systematic regular review of all regulations be conducted to ascertain whether the regulations are still in the public interest and whether such regulation should be abandoned or modified. CMT should implement procedures to review, on a regular basis, regulations which may no longer be necessary. Such regulatory "forbearance" procedures (or "sunset clauses") facilitate the transition to a competitive market regulated through general competition law.

2.2.10. *Application of competition principles*

The 1998 Telecommunications Law stipulates that CMT is required to discharge its functions with due respect for the powers assigned to the competition protection authorities under the Defence of Competition Act 16 legislated in July 1989. Whenever the CMT detects signs of practices liable to restrict competition and which are prohibited under this Act, it is required to bring this to the notice of the Competition Defence Service, also furnishing all factual details at its disposal and, where appropriate, a non-binding opinion as to the judgement that the case merits. Where the Competition Service considers the matter to be serious, it refers the case to the Competition Tribunal for judgement and penalty.

The telecommunications industry as such is not exempted from the competition law, but decisions made by the telecommunications' regulator convey an exemption from the law for conduct that they authorise. Parties following the telecommunications regulator's instructions risk liability if they take it upon themselves to agree on anti-competitive means to do so.

The Competition Law has been applied recently to forbid the incumbent's efforts to exclude competition. Most recently, Telefonica was fined about 14 million pesetas for resisting access by Internet service providers. That was at least the second recent substantial fine for interconnection violations.

The Telecommunications Law of 1997 introduced some ambiguities in the assignment of regulatory competency, between the competition authorities and CMT, as the CMT's powers seemed to extend to resolving questions about restrictive practices and concentrations that are also subject to the Competition Law. These problems were addressed by the 1998 Telecommunications Law: the CMT is to advise the government of its views about mergers, without prejudice to the Tribunal's own separate recommendation, and the CMT is to communicate to the Competition Service evidence and non-binding recommendations about restrictive practices.

The 1998 General Telecommunications Law is considered by some to be unclear on the division of competency (responsibility) between the Competition authorities and CMT since both are responsible for protecting competition. The current division of competency between the CMT and the Competition

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Tribunal in regard to the regulation of anti-competitive behaviour should be clarified, since it is causing considerable uncertainty[72] not only to operators but also to the regulatory agencies involved.[73]

The government evidently feels this allocation is unclear because the proposal for new competition law legislation is intended to ensure that competition policy is truly "horizontal" and to clear up the assignment of jurisdiction between the competition and telecommunications regulatory agencies.

The usual merger procedures apply to transactions in telecommunications. But merger reporting is voluntary, and although there are procedures and deadlines for investigation and recommendation by the Competition Tribunal, in the end decisions to accept, reject, or impose conditions on a merger are made by the government, case by case. They are thus treated as matters of economic policy, rather than application of competition law. An example of a merger decision in telecommunications is the government's approval of the 1998 acquisition by Retevision of Redes TB and Servicom, two internet service and access suppliers, so that Retevision could compete more effectively with Telefonica in downstream telecommunications markets.[74] The CMT may notify the Competition Defence Service of any merger within its purview if it believes the merger falls under the merger control provisions of competition law.[75] CMT may submit during the second-stage investigation when the matter is at the Competition Tribunal, a non-binding report to the competition authorities prior to the government's decision on whether to clear the merger.

The role of the Spanish competition law authorities in telecommunications is expected to increase. But those institutions, particularly the Tribunal, are inadequately resourced, and lack telecommunications-specific expertise. Perhaps as a result, competition decisions are said to take far too long (between one and two years). Adequate resources must be devoted to bring greater clarity to the competition rules and muscle to allow them to be enforced quickly and effectively. One way of improving the system, in addition to increasing the agencies' resources, could be to give independent agencies such as CMT the power to submit evidence and claims directly to the Competition Tribunal.

2.2.11. *The impact of convergence on regulation*

The onset of technological, infrastructure and service convergence between the telecommunications, broadcasting, information technology and content sectors is now exerting pressure for regulators to look beyond current concerns that effective competition develops in telecommunication markets to consider how to facilitate the process of convergence or at least to ensure that regulation does not present barriers to convergence. A major concern here is that regulatory barriers do not constrict materialisation of the potential economic and social benefits of convergence and the new services it will deliver, including, notably, electronic commerce.

Spain should increase attention given to the impact of convergence now even though it is just establishing specific policies to liberalise its telecommunication markets. Prompt action will help ensure that short-run regulatory decisions are consistent with broader longer-term policy objectives, so that regulatory change does not occur in an *ad hoc* manner.

3. PERFORMANCE OF THE TELECOMMUNICATIONS INDUSTRY

3.1. Regulation and market performance

The rationale for regulatory reform is the desired effects it is expected to deliver. Thus in assessing the impact of regulatory reform, the primary criterion is how well it has delivered these desired effects. The main elements of market performance examined below are:

- Lower prices.
- Network development and modernisation.
- Improved quality of service.
- Services based on leading edge technology and infrastructure.
- Increased product range.
- Increased customer choice.

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These effects are among those promised by effective competition.

This section focuses on available indicators relating to these main elements of performance. The concern relating to network development and modernisation is important since it is critical in the delivery of the benefits of the Information Economy. This makes it important to also identify how reform is impacting on operator revenue and profitability since these factors influence the capacity for network expansion and modernisation.

3.2. Price trends

As depicted in Table 4, long distance prices have been falling in Spain since December 1995. Since 1997 the falls continued in anticipation of the introduction of competition.

Table 4. **Falls in Telefonica's long distance tariffs**

December 1995	International calls	–13.1%
July 1996	International	–13.15%
March 1997	International	–7.73%
April 1997-July 1997	Interprovincial	–8.7%
July 1998[1]	Provincial	–5%
	Interprovincial	–15%
	International	–12%
April 1999	Provincial	–10%
	Interprovincial	–20%
	International	–12%

1. Includes reduction in price due to conversion from a system of charging per minute to charging per second.
Source: Ministry for Development and Telefonica at *www.telefonica.es/cgi-bin/telefo*.

In 1998, Telefonica lowered its inter-provincial long distance charges by some 15%, while it cut international tariffs by 12%. In 1999, provincial calls (calls up to 50km) were lowered by 10%, while interprovincial (calls beyond 50km) and international calls will fall by 20% and 12% respectively. Telefonica expected international call prices to fall by 27.56% over 1999.

Telefonica has also changed its tariff system to bill its users per second, as opposed to the previous system of billing per three minutes for national calls and per one minute for international calls.

On 1 September 1998, Retevision, a new entrant, cut its long-distance rates by an average of 16% and international rates by 8%. The Barcelona-based operator (which now has over 600 000 clients and one million lines in service) lowered its prices in accord with its declared strategy of always keeping its rates lower than Telefonica's. In June 1999, Jazztel announced prices that were estimated to be around 20% less than Telefonica's prices. BT which entered the fixed line market in June 1999 also announced its intention to compete vigorously especially in terms of connection fees, rentals and prices of international calls.[76]

The standard "list" prices of long distance calls do not tell the full story. Competition has resulted in a range of price discount schemes being introduced, with varying discounts and eligibility conditions, including up-front fees for some schemes but not others. In 1999, Telefonica introduced schemes offering corporate customers up to 40% reductions in prices. Telefonica and Retevision have several discount schemes on offer[77] to residential customers and Telefonica also offers a set of discounted Internet rates.

On 18 September 1998, Telefonica MoviLine, (Telefonica's analogue mobile service subsidiary) cut 65% off its connection charge, lowered its monthly subscription charges by between 10% and 12%, and dropped its usage charge by some 12% to 53%.

Because the generally reduced prices for newly competitive long distance services have been offset by increased prices for less competitive basic carriage local services, the extent of gains to customers cannot be generalised. Clearly customers who make significant long distance and international calls are more likely to be better off.

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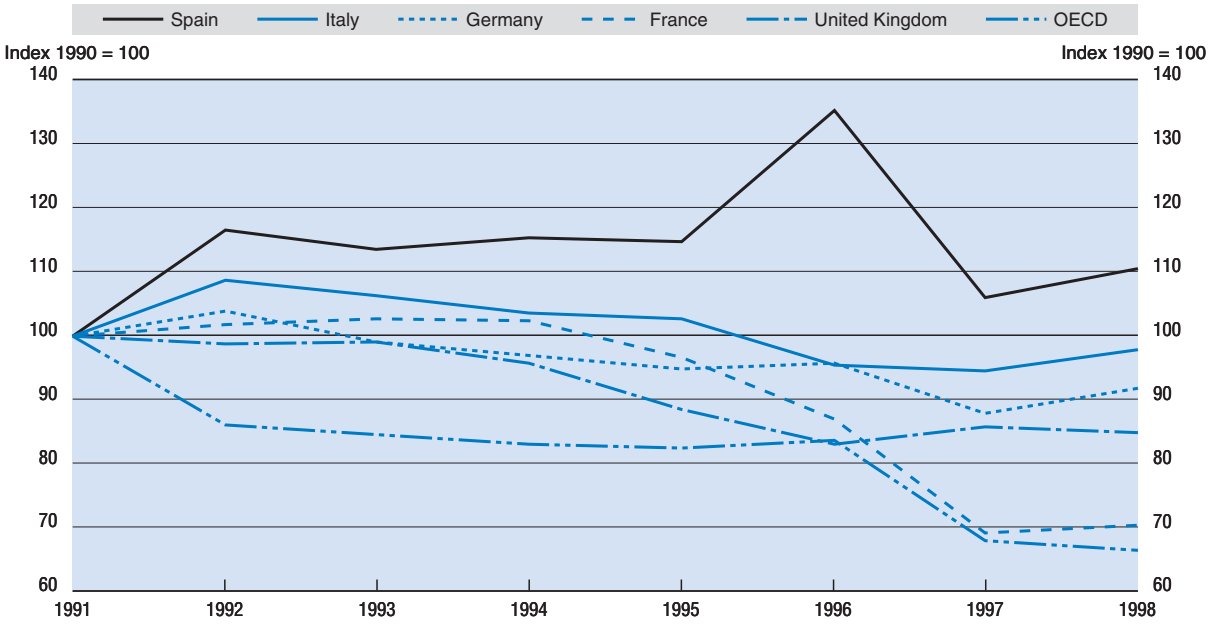
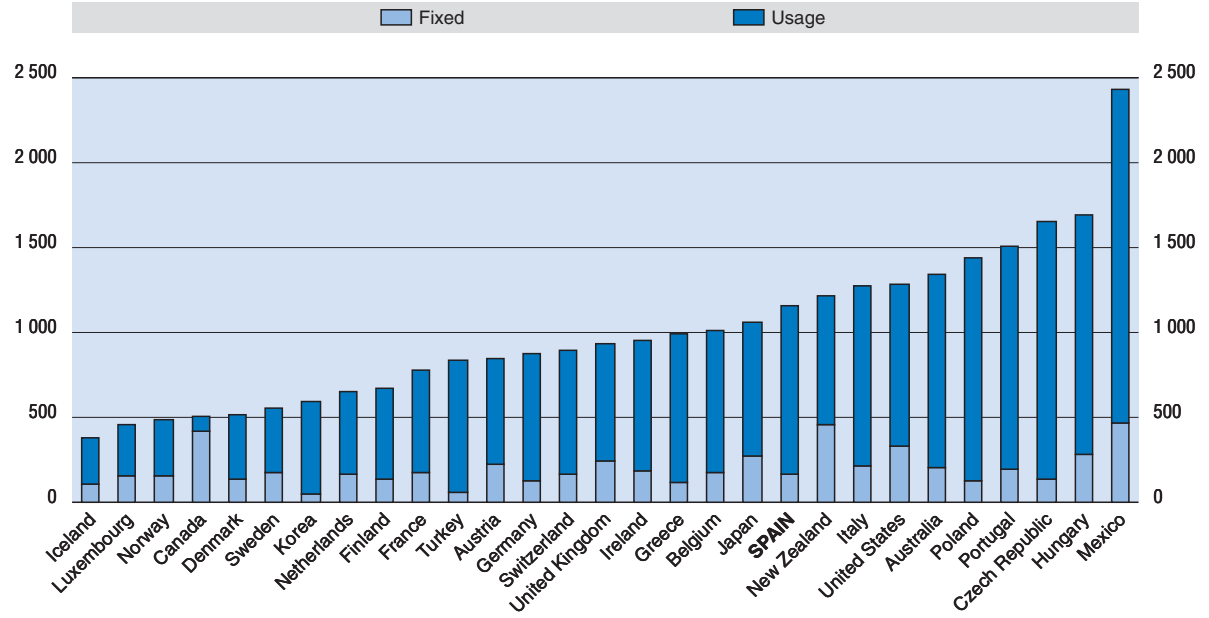
Figure 2. **OECD national business tariff basket, 1991-98**



Source: OECD, Eurodata.

Figure 3. **OECD national business basket as at November 1999**
In US$ PPPs



Source: OECD, Eurodata.

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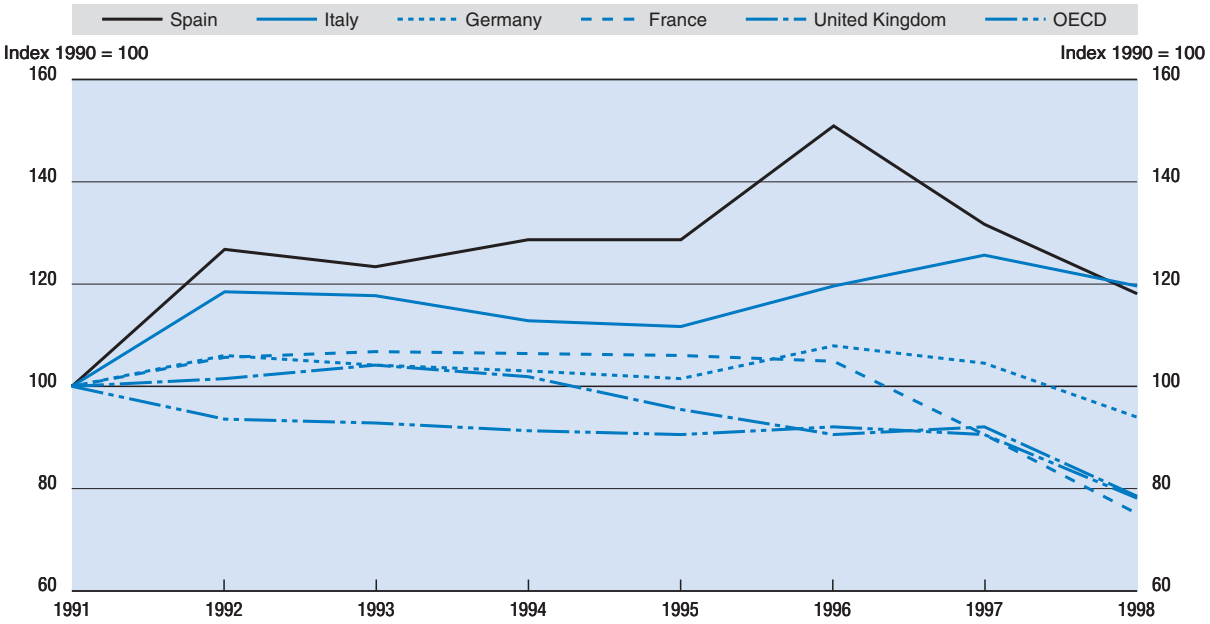
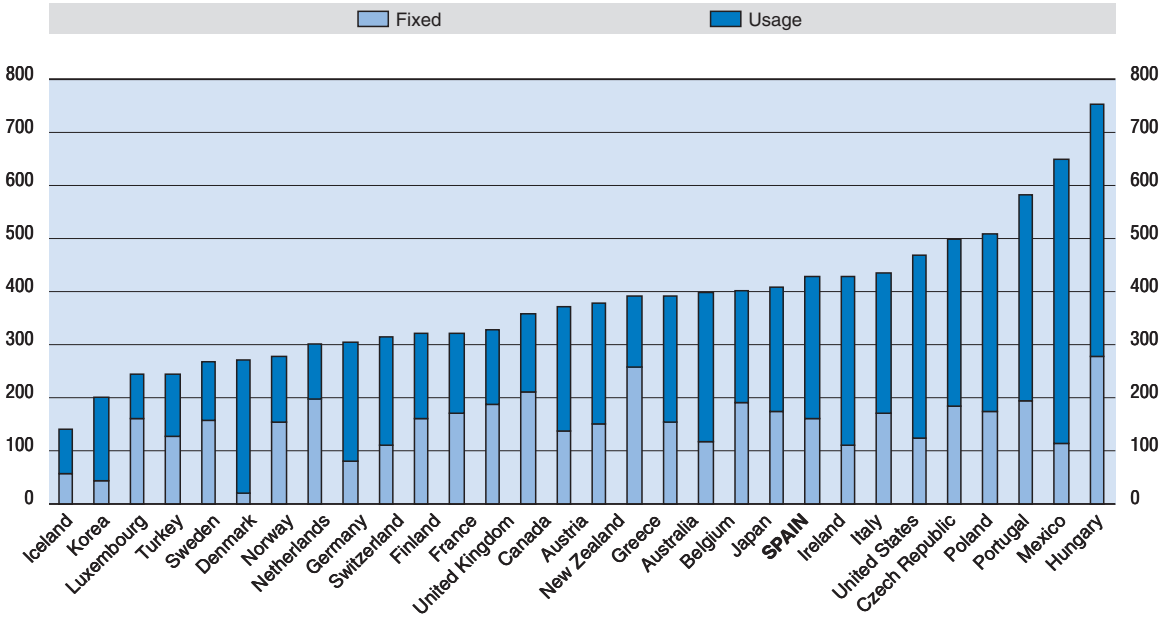
Figure 4. **OECD national residential tariff basket, 1991-98**



Source: OECD, Eurodata.

Figure 5. **OECD national residential basket as at November 1999**
In US$ PPPs



Source: OECD, Eurodata.

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Price comparisons undertaken by the OECD indicate that Spain's long distance prices have been and still are amongst the highest prevailing in OECD countries.[78] While, as noted above, the onset of competition has led to recent price falls, as Figures 2 and 4 show, the fall in the price of the OECD national business and residential baskets other countries shown have been relatively greater than Spain's. Figures 3 and 5 indicate that prices in Spain as at November 1998 were at the higher end of an OECD comparison for both business as well as residential customers. According to OECD data, Spain's prices for leased lines were also relatively high.[79] The relatively high prices Telefonica charges for leased lines was confirmed a European Commission report released in November 1999.[80] But since Spain's market was only fully opened to competition in December 1998, 11 months later than most other EU countries, Spain's relatively poor performance is not surprising. The experience of other OECD countries that have liberalised their telecommunications markets sooner indicates that there is potential for considerable further price falls in Spain.

3.3. Impact on revenue and profitability

A source of concern about market liberalisation was that this would lead to an erosion of the incumbent's revenue and profits reducing its capacity to expand and modernise the network. This has not happened in Telefonica's case. Telefonica discloses that as at May 1999, it has lost 14% of market share for intercity calls, 11% for international calls, and 4% for provincial calls.[81] But revenue and profits have continued to rise.

As shown in Table 5, from a total sales revenue of about US$9 billion in 1992, Telefonica's revenue rose to about US$14 billion in 1995, US$15.3 billion in 1996 and US$15.6 billion in 1997. In 1998, total traffic billed to customers grew by 12.1%.

Table 5. **Telefonica – some financial data for 1992-1997**

	1992	1993	1994	1995	1996	1997
Sales (US$ million)	8 924	12 203	13 162	14 297	15 288	15 601
Net income (US$ million)	793	1 079	856	1 094	1 222	1 255
Earnings per share ($)	2.52	3.45	2.68	3.42	3.82	3.58
Dividends per share ($)	1.19	1.19	5.13	1.17	1.32	1.11
Stock price FY close ($)	25.85	36.75	34.42	41.04	67.87	89.24

Source: Telefonica, and data published by Reuters News Services.

Although Telefonica lost some 6% to 7% of the long distance market during 1998, the company's net profit is reported to have risen by 14.5% (to 217.9 billion pesetas) in 1998 and it expects profits in 1999 to again rise by at least as much.[82] Earnings per share has risen from US$2.25 in 1992 to US$3.58 in 1997. Reflecting confidence in the company, Telefonica's stock market price has risen sharply in recent years. In 1998, the value of the company's shares increased by 52%, sustaining a trend which has seen them increase by 104% since the conclusion of the privatisation process in 1997.[83]

Cellular service

The number of subscribers to mobile service in Spain grew by about 68% between January 1998 and January 1999 to some 7.5 million and to 17 million by March 2000, and is forecast to keep increasing strongly over the next few years. 88% of mobile subscribers are now connected to digital GSM networks.

As Table 6 indicates, revenue from Telefonica's cellular telephony service operated by its subsidiary, Telefonica Moviles, which has a market share of about 70%, increased by about 40% between 1996 and 1997. Indeed, Telefonica Moviles is assuming the role of profit engine and in 1998 is expected to earn around 37% of the group's total profit.

Airtel too is improving its financial performance posting a net profit of 2.78 billion pesetas in 1998, after three years of losses since commencing operations in 1995.[84]

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Table 6. **Telefonica Moviles financial data**

	1996	1997	Increase between 1996 to 1997 (%)	1998	Increase between 1997 to 1998 (%)
Operating revenue (million ptas)	258 882	362 938	40.2	468 203	29.0
Capital expenditure (million ptas)	140 997	100 203	–28.9	92 269	–7.9
Total assets	352 744	400 459	13.5	459 449	14.7
Carried calls	1 684	2 954	75.4		
Cellular customers	2 345 645	3 187 696	35.9	4 894 264	53.5
Mensatel customers (paging)	56 125	344 689	514.1	391 574	13.6
RadioRed customers (trunking)	8 906	17 612	97.8	24 469	38.9
Basic telephony with cellular access	222 260	238 626	7.4	252 028	5.6
Employees	1 831	2 377	29.8		

Source: Telefonica, Annual Reports.

3.4. Network development and modernisation

The growth in telecommunications access lines provided in Spain by Telefonica fell from a compound annual growth rate (CAGR) of 6.2% 1987-92 to 2.8% during 1992-97.[85] The later CAGR figure for Spain compares unfavourably against an average rate for OECD countries of 3.9% during 1992-1997.

Table 7 indicates that in Spain, public telecommunications investment (*i.e.*, Telefonica's investment) as a percentage of revenue has fallen significantly over the past ten years. From a peak of 65% in 1989-91, the percentage of revenue devoted to investment fell to 26%.

Table 7. **Public telecommunication investment as a percentage of revenue**

	1986-88	1989-91	1992-94	1995	1996	1997
Spain	46	65	36	33	33	26
OECD average	26	27	25	23	25	24

Source: OECD (1999), *Communications Outlook* 1999, Paris, Table 4.10, p. 81.

As Table 8 shows, at about US$230 in 1997, Telefonica's investment per access line was less than the OECD average of US$283. Table 9 indicates that Telefonica's network digitalisation has grown between 1991 to 1998 to cover 86% of the network which is a digital coverage behind that of many other OECD countries that have already achieved a 100% coverage.

Table 8. **Public telecommunication investment per access line in US$**

	1988-90	1991-93	1994-96	1997	1997 (PPP)
Spain	383	312	265	230	272
OECD average	226	245	259	273	259

Source: OECD (1999), *Communications Outlook* 1999, Table 4.12, Paris, p. 83.

Table 9. **Telefonica's network digitalisation, 1991-1998**

1991	1992	1993	1994	1995	1996	1997	1998*
33.6	36.4	41.4	47.8	56.5	67.4	80.7	86.2

*1998 figure provided by Telefonica to OECD, 17 January 1999.
Source: Telefonica, *Annual Report* 1997.

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3.5. The impact of new entrants on network development

Retevision plans to spend 360 billion pesetas in a ten year investment program. Retevision plans to install over one million lines, including 9 600km of fibre optic as well as microwave links. The company will cover all cities populated by more than 300 000 by the end of the year 2000, providing coverage to 95% of the population.

Airtel, has announced that it is constructing a 6 000 km fibre optic network throughout Spain in conjunction with railway company Renfe. Airtel also plans to invest between 60 billion and 70 billion pesetas during 1999 on improving its fixed telephone (which would commence operations in May 1999), Internet and mobile phone business.

Lince (France Télécom) plans to invest 207 billion pesetas (US$1.4 billion) over a ten year period in order to gain 7.5% of the domestic market by 2008. The company announced that it would build a local telephony network in 72 towns and cities by 2001, with fibre rings in some business districts, wireless local loop in 60 towns, and data network services including asynchronous transfer mode, frame relay, VSAT (very small aperture terminal) and X.25.

BT *Tel* disclosed it had already invested "several hundred million pounds" in Spain as part of a European infrastructure investment program estimated to have cost UK pounds 1.5 billion ($2.467 billion) to UK pounds two billion so far. BT started operations in Spain in 1994 and provides corporate voice and data over a leased network to an estimated 1 000 corporate users. BT, which already operates a data transmission company in Spain and is a main backer of Airtel, the second mobile carrier, added basic telephony services to its Spanish operations in 1999.

Jazztel Telecommunications, a new entrant based in Barcelona, is building an entirely new state-of-the-art network infrastructure for Spain, based on a fibre optic cable over which it plans to offer broadband services. The so-called E1-4U network has been designed as a multi-service network with a capacity of 20Gbps upgradable to 320 Gpbs to provide the most advanced multimedia services: voice telephony and data on Internet, and intelligent network as well as customised services. Jazztel plans to combine long-distance and local broadband infrastructure targeted at business users in major cities.[86]

Euskatel, another new entrant, plans to extend the backbone network and build its local networks. By the year 2007, Euskatel intends to have 300 000 lines installed, representing over 25% of the market. Euskatel has formed a strategic alliance with Retevision to use its fixed and mobile network for long distance and international calls and offers its customers local calls by direct access to its own fibre optic network in the Basque Country. This access allows subscribers not only to make phone calls but also to use the Internet and receive 18 cable TV channels.

Retevision, led by Telecom Italia, is a fixed network operator that will invest 597 billion pesetas by 2008 with service coverage rising to 95% by 2000.

Retevision Movil has been awarded Spain's third mobile licence and plans to spend 600 billion pesetas in the Spanish mobile telecommunications market by 2008. *Retevision Movil* is the first operator to use DCS-1800 technology and plans to invest about 280 billion pesetas (US$1.98 billion) to establish its own network. Due to a series of interconnection agreements with Telefonica and Airtel, it is able offer national cover from the start, although initially it will only be present with its own network in eight of Spain's most important towns.

Code Division Multiple Access (CDMA)-based platform networks[87] are being developed by the San Diego based Qualcomm to deliver mobile and fixed wireless systems.[88] CDMA technology enables the provision of value-added services such as data transmission, voice mail and other digital products, allowing a cellular telephone company to offer local service through mobile frequencies.

Iridium has obtained a B-2 licence to operate in Spain.[89] In October 1997, Iridium signed roaming agreements with Airtel Moviles and Telefonica Moviles.

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3.6. Increased range of products and services

The entry of new operators with new technology, products and services is expanding the range of customer choice. R*etevision* has announced the launch of a telephone translation service to facilitate commercial dealings for Spanish companies calling abroad. By dialling 902, the desired language is selected and the interpreter participates in a three-way conference.[90]

Telefonica is responding vigorously to the challenge of new competitors with its own new services, including price discounts and prepaid cards (such as prepaid cards which enables customers to place calls from any telephone using a password). Caller ID, three way calling, call forwarding and call waiting are now increasingly available. Telefonica is reported to have attracted three million subscribers to its P*lanes Claros* (Transparent Plans) discount scheme, or 24% of the company's 12.5 million residential customers. The company estimates that 60% of its customers who make use of long distance and international service use one of the Planes Claros schemes.

As elsewhere, the Internet is a growing presence in Spain increasing the demand for telecommunications networks that can provide packet-switching and other functions that are necessary to facilitate further Internet growth. In relation to Internet usage, it is noteworthy that RSLCom, a new entrant, is planning to sell Internet calling cards to Spain's immigrant communities. By routing calls over the internet – RSLCom owns the Delta Three Internet telephony network – the otherwise prohibitive cost of calling countries such as Columbia or the Dominican Republic would be reduced dramatically, although there is a noticeable drop in quality. OLA Telecom, a new Internet telephony operator, has announced plans to offer a high quality Voice over Internet Protocol (VoIP) phone-to-phone service with toll voice quality circuits. BT has also announced plans to supply IP telephony and Telefonica has focused increasingly on developing its Internet services (*e.g.* linking with Cisco to deliver voice and video data over the Internet).[91]

The development of state of the art telecommunications infrastructure being accelerated by competitive entry will facilitate the rapid convergence between communications services and materialisation of its promised benefits.

3.7. Quality of service

There is no doubt that improvement in telecommunications technology has significantly improved quality of service. Table 10 shows that in terms of the usual indicators, Telefonica has performed well.

Table 10. **Telefonica's quality of service indicators, 1990-1997**

	1990	1991	1992	1993	1994	1995	1996	1997
Faults per 100 lines*				2.0	1.7	1.3	1.5	1.6
% repaired in 24 hours							94.4	97.2
Answer seizure ratios	45.7	48.1	51.4	52.7	57.1	60.1	60.0	59.4
Waiting time for new connections (days)				8	5	3	4	5
Itemised billing** (%)				17	54	65	92	100
Digitalisation of fixed network*** (%)				41		56		81

* Figure is for faults in urban areas. In rural areas: 9.7 per 100 lines in 1996 and 8.2 per 100 in 1997. In 1997, 81% of faults in rural areas were repaired within 2 working days.
** Itemised billing provided free of charge.
*** In 1997, about 75% of mobile service subscribers were connected to digital networks.
Source: OECD (1999), *Communications Outlook* 1999, Table 8.5, p. 199, Paris.

Telefonica's quality of service has improved markedly between 1990 and 1997. When polled, however, customers frequently identify billing accuracy as their paramount concern in regard to quality of service. In this respect Telefonica's performance is more contentious.[92]

In an effort to improve services and customer relations in response to growing competition, Telefonica has reduced provisioning times for international leased lines to an average of 44.7 days. Fault reports per 100 lines dropped to 8.48 per month from 9.87 per month and the average duration of outages was reduced from 150 to 120 minutes between February 1998 and June 1998.[93]

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3.8. Productivity

Competition also promises to exert sustained pressure for productivity improvement (thereby enhancing the potential for price falls).

Total factor productivity estimates for Telefonica are not available. While only a rough indicator of productivity, according to the widely used "lines per employee" measure Telefonica showed an improvement of about 57% between 1990 and 1997. As Table 11 indicates, this improvement was comparable to the average improvement of 58% in OECD countries. However, the OECD average "lines per employee" was at 206 somewhat lower than Spain's 217. Also, since 1995, while the number of lines and revenue have grown, as noted earlier, Telefonica's operating costs have remained relatively constant, suggesting that cost control measures put in place have performed well.

Table 11. **Spain (Telefonica) – access lines per employee, 1985-1997**

	1985	1990	1995	1996	1997	Change 1990-97 (%)	Employment change 90-97 (%)
Spain	130	160	217	205	217	57	–7
OECD average	117	147	194	199	206	58	0.04

Source: OECD (1999), *Communications Outlook* 1999, Paris, p. 210.

3.9. Benefits to community and employment

Accelerated network development is creating employment in the telecommunications industry with multiplier effects in other industries. Importantly market liberalisation is helping Spain to accelerate deployment of the infrastructure requirements of the Information Economy. This will help position Spain to benefit from the opportunities that will emerge and will also help enhance her international competitiveness.

In discussing technological developments, it is informative to consider the impact on employment levels. Despite considerable "downsizing" by telecommunications carriers in many countries, as Table 12 indicates, Telefonica's employees in Spain rose from about 72 000 in 1985 to some 78 500 in 1990 but by 1997 had fallen back to 1985 levels. During 1998, Telefonica shed about 4 000 employees amounting to some 7% of its workforce.[94]

The data does not allow jobs recently created by new entrants to be monitored. There have been reports that new entrants such as Retevision and Jazztel have increased staff numbers, including some attracted from Telefonica.[95]

While Telefonica's employees are at about the same level as 1985, the entry of new operators promises that the telecommunications industry as a whole is poised to grow. The business plans announced by the new concession holders estimate that a substantial number of new jobs will be created over the next few years. For instance, Retevision Moviles plans are expected to create 3 957 direct jobs and 34 000 indirect positions over a ten year period.

3.10. Some costs of regulatory reform impacting on customers

In countries where competition has been introduced, some customers have been victims of unscrupulous operators[96] and have:

- Found that their long distance carriers have been switched without proper consent (a practice known as "slamming" in the US).
- Received bills for services they never ordered (a practice referred to in the US as "cramming").
- Been levied line item charges that are sometimes too high and are often inadequately explained.

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Such infringements are likely to occur in Spain as competition intensifies unless action is taken to contain them. A remedy for dealing with slamming and other billing issues is the provision of clear and timely information to subscribers. Three important principles can be identified. First, telephone bills should be clearly organised and should highlight any new charges or changes to services provided. Second, telephone bills should provide clear descriptions of all charges and of the service provider responsible for each charge. Third, telephone bills should contain clear and conspicuous disclosure of information necessary to make inquiries about charges.

The government should consider requiring the establishment of an industry *Code of Conduct* backed up by a *Customer Service Guarantee* scheme to help maintain standards by prescribing financial compensation for customers when operators fail to meet minimum service levels, including billing accuracy. The government has recently approved a ministerial order containing regulations about quality conditions, a step in this direction.

CMT should determine – after broad consultation with customers – information to be made publicly available that will enable customers to make comparisons (such as of quality of service) delivered by operators. Customers – residential and business – too need adequate information in order to make efficient choices among the increasing range of products and operators in a competitive telecommunications market. After all, a major benefit promised by competition is that customers will be empowered with more choice. Regulators can help enhance the efficiency of this choice by ensuring that information made available to customers is meaningful, relevant, accurate, timely, and unbiased.

CMT should define performance indicators that enable evaluation of the effectiveness of competition and should ensure such data is available on a timely and regular basis. It is important that information to enable the performance of regulatory reform to be monitored and assessed is available. This section makes a start on this task. But additional information generated in time should allow a more thorough assessment to be made. Improved information is also crucial for assessing the nature and scope of any problems associated with efficient development of, and equitable access to, the developing Information Economy and for designing well-targeted and cost-effective strategies for overcoming them.

4. CONCLUSIONS AND RECOMMENDATIONS

4.1. General assessment of current strengths and weaknesses

The regulatory regime in Spain displays some distinct strengths, including those listed below.

Box 6. **Strengths**

- Pro-competitive telecommunications legislation consistent with EU and WTO regulatory principles.
- Market entry has been liberalised for both fixed wireline and mobile service with several new licenses already awarded.
- Entry of several carriers with links to formidable international European and US telecommunications.
- Operators, facilitating plans to develop technologically-advanced network facilities.
- No line-of-business restrictions between fixed-mobile, CATV and telephony.
- Strong pro-competitive Reference Interconnection Order (RIO) concluded in October 1998.
- Potential for development of infrastructure competition through cable networks.
- Recognition by the government of the need for effective pro-competitive regulation.
- CMT, the industry regulator, has adequate legislative power and resources.

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The 1998 Telecommunications Law is strongly pro-competitive in principle. But although the legislation was a crucial step, effective competition will develop only if the legislated rules are implemented vigorously and effectively and this will require a sustained commitment to pro-competition reform.

Market entry has been liberalised for both fixed wireline and mobile service with several new licences already awarded, largely to operators with links to formidable international European and US telecommunications operators. Several new entrants have plans to develop technologically-advanced network facilities and this will enhance the prospects for infrastructure competition. There appears to be clear recognition by the government of the need for effective pro-competitive sector specific regulation with an increasing role for competition law as the number of operators increases and competition intensifies. CMT has adequate powers and resources, and has scored an early success in achieving a strongly pro-competitive initial Reference Interconnection Offer from Telefonica.

Weaknesses

Significant weaknesses are also, however, evident as listed below.

Box 7. **Weaknesses**

- Conditions attached to licences have been too onerous and not in accord with the "streamlining" intent of the EU Licensing Directive.
- Although some price re-balancing towards costs has occurred, further re-balancing is required since price-distorted markets impede competition.
- Delays in implementation of essential competitive safeguards including numbering policy, carrier pre-selection and frameworks to assure rights of way for new entrants.
- The legislation's reference to the ambiguous concept of "real costs" and its provision that surcharges may be made to the interconnection price to offset "access deficits" and universal service costs has been problematical.
- Unclear allocation of responsibilities with respect to price regulation with price changes still subject to government authorisation (with long delays experienced) rather than on an "arm's length" price cap scheme administered by CMT.
- Although provided for in the legislation, the question of whether a transparent, competitively and technologically neutral universal service costing and funding mechanism should be established has not been resolved.
- Undeveloped local service competition.

Licences have been awarded on the basis of a transparent published procedure but there has been concern over the range of demanding conditions attached not only to licences, but also to so-called authorisations, even for non-dominant operators. Moreover, an individual licence has been required for some leased lines, which in many other countries requires only an authorisation.

Onerous conditions attached to licenses can act as a deterrent to entry and can present post-entry disadvantages for a new entrant and it's preferred competitive strategies. Conditions attached to licences also precipitate the problem of harmonising conditions between old and new licenses. The approach to licensing Spain has taken was not the intent of the 1997 EU Licensing Directive which was emphatically to streamline licensing principles and procedures and minimise conditions attached to licenses.

Licensing for use of (limited) radio frequency spectrum is still the responsibility of the Ministry for Development.

Although some price re-balancing towards costs has occurred, more might be required. When Telefonica issues its cost information, price distortions should be eliminated to favour competition. Price modifications

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are still subject to government authorisation. This may partially account for the perception in some quarters that in practice the source of real regulatory control has not really moved out of the Ministry for Development.

Under the 1998 law, a dominant operator is required to provide CMT with separate accounts, for example, for telephone services and for interconnection service, but this has not been rigorously enforced and has not yet occurred. While the effectiveness of accounting separation is weakened by the problems of "information asymmetry" about an incumbent's costs as well as by the ingeniousness of "creative accounting" the information provided may go some way towards detecting cross-subsidisation activities.

An explicit, portable, competitively and technologically neutral universal service fund required for the cost-effective pursuit of network development and universal service objectives has not yet been established. And this is causing uncertainty on the part of both incumbent and new entrants (who remain uncertain about what their payment obligations will be). Moreover, there seems to have been inadequate action to address the impact on regulation of quickly converging technology and markets.

So while a good start to regulatory reform has been made in Spain, much more needs to be done. It is notable in this context that a study (conducted for BT) published in January 1999 found Spain to be the "worst offender", of ten European Union countries it compared, for hindering new entrants. The study[97] ranked the regulatory systems in terms of issues such as licensing conditions, non-discrimination against new competitors, transparency of accounting procedures used by the traditional operator and the independence of the national operator. While a reassessment some six months later[98] found that regulatory conditions in Spain had improved noticeably, it concluded that further improvements were required.

It is true that since the Spanish market has been open to full competition only from 1 December 1998, 11 months later than most other EU countries, there has been less time for reforms to be implemented and to take effect. Nevertheless, the study does sound a warning that the administration in Spain should not adopt a complacent view that it is "ahead of other EU countries" in terms of regulatory reform legislation. Such a reputation will be earned (and maintained) by how effectively the rules are implemented and by the benefits delivered.

4.2. Potential benefits and costs of further regulatory reform

While the impacts of reform – some of which are long term – need to be judged over many years, Section 3 of this document pointed to some early evidence that some benefits are already identifiable by way of:

- Lower national and international long distance prices for both fixed line and mobile service, although offset to some extent by increased monthly subscriber and local usage charges.
- Accelerated network development and modernisation.
- Wider range of services, including advanced services.
- Increasing choice for customers.
- Improved quality.

A sustained commitment to regulatory reform is required to ensure that the regulatory principles enacted recently are effectively implemented and weaknesses addressed. Moreover, there are additional complexities emerging as a result of technological and market "convergence" that require attention.

In the short term, the task is to ensure that local markets become competitive and that regulatory constrictions on competitive incentives in those markets (such as restrictions to price rebalancing) diminish. From a longer term perspective, the most important impact of pro-competitive regulatory reform is its contribution to facilitating dynamic growth, innovation and employment. The introduction of competition has already accelerated and will continue to accelerate the development and adoption of new technologies and services, including the growth of electronic commerce and other information-intensive sectors, and the development of the Information Economy. The new products and services that customers might demand are difficult, if not impossible to predict. But the possibilities and potential benefits are substantial.

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4.3. Policy recommendations

The following recommendations are based on the assessment presented above, and the policy recommendations for regulatory reform set out in the OECD *Report on Regulatory Reform* (OECD, June 1997).

Ensure that regulations and regulatory processes are transparent, non-discriminatory and applied effectively.

- ***Reduce barriers to entry by minimising the requirement to obtain a license and the range of conditions attached to a licence.***

There has been broad discretion available to the Ministry for Development and CMT in the decision to grant a licence, and on what terms to attach to a licence. Licensing procedures need to be simplified. This could best occur through implementing a general class licensing framework rather than require individual licences for entry.

- ***Amend the legislation providing for the use of "real costs" as a basis for setting the price of interconnection so that it explicitly refers to long-run average incremental cost* (LRAIC) *as the appropriate cost basis for pricing.***

The concept of "real" or historical costs is not meaningful as Telefonica is in the process of price adjustments by eliminating cross-subsidies and operating inefficiencies developed as a result of its former monopoly position. Efficient pricing needs to be based on forward-looking LRAIC costs, including a reasonable profit margin.

- ***Refrain from collecting funds to offset any "access deficit" or fund universal service as a surcharge on the interconnection price as provided for in the legislation. Any access deficit should be addressed through appropriate price rebalancing.***

Assuring interconnection to the incumbent's public switched telephone network is a key competitive safeguard. Such safeguards are particularly important where, as in Spain, the incumbent carrier is vertically integrated into local, long distance and other services and therefore with strong incentives to hinder equal access. Progress in establishing an effective interconnection regime is important to assuring that the benefits generated from competitive market structures are fully realised.

Recent steps have reduced the economic distortions generated by Spain's interconnection regime. To help ensure effective competition, the price of interconnection to the incumbent's public switched network should be based on long-run average incremental costs. Interconnection rates based on "real costs", interpreted as historical accounting costs, will maintain high rates and restrict new entrants from offering lower rates to customers. Further, any access deficit contributions should be addressed through price rebalancing, and transparently separated from interconnection charges.

- ***Require Telefonica to provide unbundled access to its network by other operators on reasonable terms, including any* ADSL *enhanced segments, for a limited period of five years.***

Forward-looking LRAIC-based pricing is also the appropriate cost basis for pricing unbundled network elements. To maintain incentives on new entrants to deploy their own infrastructure rather than depend indefinitely on the incumbent's, the requirement on Telefonica to provide unbundled elements of its network should be restricted to a specific specified period.

- ***Take steps to assure new entrants appropriate access to rights-of-way.***

An arbitration procedure to be used when carriers and local governments cannot reach agreement on the use of public land should be established. In addition, improved arrangements should be made for facility sharing between operators insofar as this would not impose an unreasonable economic burden or technical difficulties on the incumbents and facility-based carriers.

- ***Ensure that numbering allocation and number portability policies for both mobile and wireline carriers are competitively neutral. Policies should allow for call over-ride to enable carrier selection on a call-by-call basis.***

An absence of provisions to allow for number portability acts as a strong disincentive for customers to switch from the incumbent to a new entrant because such switching imposes transaction costs, such as

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the burden of informing others of their new number. Moving forward toward full implementation of a permanent form of number portability would be an important step in ensuring that subscribers do not face artificial disincentives in deciding whether to switch between carriers in response to price competition. It is also important that Telefonica comply with carrier pre-selection obligations by January 2000.

- ***Introduce policies to promote infrastructure competition in the local loop. In this context, Telefonica's cable television business should be divested.***

Future local competition will depend importantly on the ability of alternative infrastructure to offer both voice telephony services and newly developing information services. As discussed earlier, due to its dominance in the local market, permitting Telefonica to engage in cable operations generates a high risk that it can foreclose an opportunity for cable to provide an alternative local loop for telephony. Divesting Telefonica's cable operations would help stimulate local competition as well as competition in the CATV market. At minimum, there should be a moratorium on Telefonica's entry into cable telephony for five years or until Telefonica is no longer considered dominant in the local service market.

To promote competition in the local market, various entry options should be maintained, including facilities-based competition. The regulator needs to ensure that access to unbundled elements of Telefonica's network is made available at reasonable prices.

- ***Abandon the duopoly policy in the CATV market in each of 43 demarcated regions to permit other entrants.***

CATV infrastructure provides one of the most rapid and efficient means to stimulate entry into the local loop. Maintaining a duopoly only retards the build-up of competition in this area.

- ***Move price regulation from government authorisation to become the responsibility of CMT.***

The regulation of prices through government authorisation – a practice with a history of long delays being experienced before approval is granted – was one which may have been appropriate during the era of government owned monopoly provision of telecommunications. It is unsuitable for current competitive circumstances particularly since it depends on a process which lacks transparency and is driven more by political considerations rather than the pro-competitive need for price flexibility in the dynamic, converging, telecommunications industry. If price regulation is considered necessary, it should be on the basis of an "arm's length" price cap regulation scheme designed and monitored by CMT.

- ***Base price regulation on a simple transparent price cap approach. Incorporate an appropriate "sunset clause" to ensure that streamlining/abandonment of price regulation occurs as soon as effective competition permits.***

The price cap formula should be designed to allow continued price rebalancing of prices to reflect costs. Price rebalancing should be conducted as rapidly as possible since price-distorted markets impede competition. But Telefonica should be required to substantiate its claim of the substantial "access deficits" it incurs by making available for public examination the data upon which it bases its calculations. The benefits ownership of the local loop confers should not be overlooked.

In order to enable the pricing flexibility that "convergent" technologies, markets and services require, price cap regulation should be clearly installed as a temporary measure to be streamlined and withdrawn as soon as (competitive) conditions permit. To help ensure price caps are withdrawn promptly from competitive markets, a price cap scheme should incorporate a "forbearance provision" to oblige withdrawal of price caps in any market that the regulated operator could prove had become competitive.

- ***Proceed without further delay to estimate the net cost of Telefonica's universal service obligation and, if considered necessary, promptly establish an explicit, portable, competitively and technologically neutral universal service fund.***

There should be no further delay in deciding whether the significance of the net costs of Telefonica's universal service obligations constitutes a competitive disadvantage thereby warranting the establishment of a separate Universal Service Financing Fund to which all operators would contribute. Such a fund would make the delivery of universal service more transparent. In an era of rapid technological change, it is important that it be designed to be technologically neutral.

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A preliminary step in the process is the definition of the nature, extent and speed with which universal service objectives are to be addressed. Since (as noted earlier) the Ministry for Development is responsible for specifying universal service coverage, it should complete this task as soon as possible to enable CMT to proceed with the determination of the net costs of the universal service obligations identified.

Reform regulations to stimulate competition and eliminate them except where clear evidence demonstrates that they are the best way to serve the broad public interest.

- ***Review regulations in all areas of telecommunications regularly and systematically with a view to streamlining and where appropriate abandoning them***.

The government should require that a systematic regular review of all regulations be conducted (say every three years) to ascertain whether the regulations are still in the public interest and whether such regulation should be abandoned or modified. "Forbearance" procedures (or "sunset clauses") should be incorporated to ensure that regulations no longer necessary are eliminated.

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NOTES

1. The EC Directives include: Terminal Equipment Directive (88/301/EEC of 16th May, 1988); Services Directive (90/388/EEC of 28th June 1990); ONP Framework Directive (90/387/EEC of 28th June, 1990); ONP Leased Lines Directive (92/44/EEC of 5th June 1992); Satellite Directive (94/46/EC of 13th October 1994); Cable Directive (95/51/EC of 18th October, 1995); Mobile Directive (96/2/EC of 16 January 1996); Full Competition Directive (96/19/EC of March, 1996); Licensing Directive (97/13/EC of 10th April, 1997); ONP Interconnection Directive (97/33/EC of 30 June 197); ONP Amending Directive (97/51/EC of 6th October, 1997); Telecoms Data Protection Directive (97/66/EC of 15th December, 1997); ONP Voice Telephony Directive (98/10/EC of 26th February, 1998).
2. Spain made international commitments for regulatory reform through its acceptance of the regulatory principles in the "Reference Paper" attached to the February 1997 WTO agreement on basic telecommunications services.
3. The most recent of which is, "*Fourth Report on the Implementation of the Telecommunications Regulatory Package*", Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, November 1998. *http//www.ispo.cec.be/infosoc/telecompolicy*; *http//www/europa.eu.int/comm/dg4/lawliber/libera.htm*
4. Extensions were to 1 July 1998 in the case of Luxembourg, 1 January 2000 in the case of Ireland and Portugal, and 31 December 2000 in the case of Greece. The Irish government subsequently announced its intention to liberalise the Irish market by the end of 1998, one year ahead of its extended deadline.
5. The negotiations established a schedule for implementing EU Directives, including: on 1 January 1998, notifying the European Commission of Spain's procedures for the award of licences to provide basic telephony services and the supply of public telecommunications networks; granting a third basic telephony licence by 30 April 1998 (this was done on 27 May 1998); publish and provide for the entry into force of the procedures to grant basic telephony licences by 1 August 1998; totally liberalise the market by 1 December 1998.
6. "Substantially transposed" means that it is considered that the major provisions and principles of the EC directive concerned have been transposed.
7. The Law on Unfair Competition generally deems unfair any behaviour that is contrary to good faith. In particular, the following are expressly stated to constitute unfair behaviour: acts of confusion, misleading statements, the offering or delivery of gifts, advantages or supplementary conditions in certain circumstances, denigration of competitors or their products, comparisons (when relating to criteria which are not analogous, relevant or verifiable), acts of imitation, exploitation of a third party's reputation, violation of secrecy, inducement to breach of contract, violation of norms (when significant competitive advantage has been attained through the breach of rules, or the simple breach of rules designed to regulate a competitive activity), discrimination and predatory pricing.
8. The ONO Group is the largest broadband telecommunications and cable television multiple systems operator in Spain. The group controls and manages contiguous telecommunications and cable television franchises serving 3.8 million homes and 265 000 businesses situated in some of Spain's fastest growing areas.
9. El Pais, "Uni2 has 100 000 subscribers", 19 January 1999.
10. Analogue service is to be phased out by the year 2007.
11. David White, "Telefonica boosted by mobile growth", *Financial Times*, 17/11/1998, p. 32.
12. "CMT Awards Fixed-line Licence to Telefonica Moviles", *Cinco Dias*, 12 July 1999.
13. "Airtel Launches Fixed Phone Services", *Gaceta de los Negocios*, 16 July 1999.
14. The government, reportedly, had hoped that Retevision would align with Airtel, to form a full service wireline and wireless telephone company, thus leaving France Télécom as the sole bidder for the third license. But in July 1998, Airtel's shareholders blocked any link up with Retevision.
15. Retevision Movil beat a consortium led by France Télécom that in December 1998 said it would go to court to challenge the decision (according to Reuters News Service).
16. Jeffrey Lewis, "Telefonica Must Wait Two Years Before Selling Cable Services", *Bloomberg News* as reported in *Total Telecom*, 4 December 1998.
17. "Major Groups Battle It Out in the Cable Sector", *El Pais*, 6 June 1999.
18. "Endesa Sells 7.9% of Cepsa, Market Shrugs News". *Reuters News Service*, 23 March 1999.
19. Government Will Force BSCH to Choose Between Telecom Holdings", *El Pais*, 8 July 1999.
20. The Spanish government announced in June 1999 that it would restrict financial institutions from holding significant stakes in mote than one public company in each sector. The government reportedly informed BSCH it would be allowed to hold more than 3% of only one company in key sectors such as telecommunications. *Reuters*

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News Service, "Spain's BSCH in Talks on Sale of Retevision Stake", 16 July 1999 and "Spain's BSCH Seeking Control of Airtel Paper", 26 July 1999.

21. Under the terms of the 1998 General Telecommunications Act, the Ministry for Development shall exercise such powers in respect of general authorisations or individual licences as are not assigned to the CMT under the Telecommunications (Liberalisation) Act of 24 April 1997.
22. Jose Maria Vazquez Quintana, Chairman of CMT, "CMT *and the Spanish telecom market*," Comision del Mercado de las Telecommunicaciones, Madrid, October 1998.
23. Any holder of a general authorisation or individual licence for the provision of services to third parties is obligated to pay a charge of 1.5 per 1 000 or 0.15% of revenue on an annual basis.
24. Almudena Arpon de Mendivil, "Creating Competition in Spain's Telecoms Market", *Global Competition Review*, August/September 1998, p. 28.
25. Public Network, "Spain: Now the Siesta is Over…", October 1998, p. 28.
26. 1998 General Telecommunications Law.
27. 1998 General Telecommunications Law.
28. The composition and rules of functioning of the Telecommunications Advisory Board is established by the government by Royal Decree. Its members represent the state administration, the regional administrations, the local administration through its most representative associations or federations, users, operators managing telecommunications services or public telecommunications networks, the telecommunications equipment manufacturing industry and the most representative trade unions in the sector.
29. Airtel took its complaint over being made to bid an excessive amount during the auction of the mobile licence it won. The EC found in Airtel's favour and the Spanish government made a substantial refund to Airtel. This experience appears to have soured the authorities attitude towards the use of auctions for awarding spectrum licences. Telefonica has also submitted complaints to the EC, including one over not being permitted by the government to rebalance its prices.
30. The EU Licensing Directive (97/13/EC of 10th April, 1997) specifies that the circumstances in which individual licenses can be required are limited: for certain specified purposes (namely to allow access to scarce resources, give rights of way, or impose limited obligations on the licensee) or for the provision of public voice telephony services, public telecoms networks or other networks using radio frequencies. The number of licenses can be limited only to the extent that it is necessary to ensure the efficient use of radio frequencies or for so long as limitations are necessary to ensure the availability of sufficient telephone numbers. Conditions for authorisations (whether general or individual) must be objective, non-discriminatory proportionate, transparent and limited to those listed in the directive. Fees for licences are to reflect the administrative costs of the relevant national regulatory authority.
31. There are several categories of licences. **Type A Licence:** Provision of publicly available fixed telephone service, by means of the use of a set of switching and transmission media. This does not include "mere re-sellers of the telephone service."

    Type B Licence: Publicly available telephone service by means of the establishment or operation, by its holder, of a telecommunications network.
    B 1 – Provision of the publicly available fixed telephony service by means of the establishment or operation, by the licence holder, of a public fixed telephone network. The operation of the network includes the right to provide leased lines. **B 2** – Provision of the publicly available mobile telephony service by means of the establishment or operation, by the licence holder of a mobile telephone network. This network may be:
    a) A terrestrial network.
    b) A medium or low-orbit satellite-based network.

    Type C Licence – Establishment or operation of public networks, without the holder being entitled to provide a publicly available telephone service.
    C 1 – Establishment or operation of public networks that do not involve the use of public radio spectrum.
    C 2 – Establishment or operation of public networks that involve the use of public radio spectrum. These networks may be:
    a) Terrestrial networks.
    b) Satellite-based networks.
32. Known as a "class licence" in some countries.
33. Licences are for 20 years, and can be renewed for another ten at the holder's request, but are not to last more than 50 years.
34. For a detailed discussion, see P. Xavier (1997), "The Licensing of Telecommunications Operators: Beyond the EU's Directive" *Telecommunications Policy*, September.
35. Ministerial Order Establishing the Regulations Governing Individual Licences, 26 September 1998.
36. It has been contended that the initial spectrum availability constrains the number of licenses that can be awarded for national coverage to four (Government of France, *The Introduction of* UMTS *in France*, December 1998).
37. Basing judgement on criteria such as the bidder's coverage plans', views on roaming onto rival second or third-generation networks; the subsidisation of networks in areas of low-population density (government of France, *The Introduction of* UMTS *in France*, December 1998).
38. "Spanish Regulator Passes First Test", *Eurocom*, 13 November 1998, p. 3
39. Telefonica claimed that revenue would fall by 20 billion pesetas (US$13.8 million) a year. "Spain's Telefonica Says Lower Fees Will Cut Revenue", Andrew Davis at Bloomberg News, *Total Telecom*, 23 November 1998.
40. "Spain: Court Turns Down Telefonica Over Interconnection Tariffs", *Cinco Dias*, 7/12/98.

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41. "Memorandum about Regulation in Spain: Telefonica's Views" Submitted by Telefonica, January 1999, p.3.
42. "Memorandum about Regulation in Spain: Telefonica's Views" Submitted by Telefonica, January 1999, p. 8.
43. David Molony, "Spain's Regulatory Delay Deters New Entrants", *Communications Week International*, No. 201, 980316, p.13.
44. "CMT Starts Action Against Telefonica Over Colt Telecom", *Gaceta de los Negocios* 13/02/1999 (Reuters News Report).
45. The access provider can discriminate in providing access in various and subtle ways that are difficult for regulators to detect and monitor: by providing poor interconnections, slowly and/or ineffectively repairing and maintaining leased network facilities, and delaying or denying the use of local network innovations to their competitors. The access provider who is also a down stream competitor, has strong incentives to behave in this way, leading customers to reject alternative providers thereby preserving their position.
46. In March 1999, Airtel asked CMT to act as mediator in efforts to persuade Telefonica to "unblock negotiations on interconnection charges". (*El Pais*, 26/03/1999, p.67). Notably, CMT has shown some determination to address such problems. On 18 March 1999, it made a provisional ruling under which Telefonica must make its network more accessible to RSLCom. The ruling was made in response to RSLCom's complaint that Telefonica has made the technical requirements for interconnection more complicated in order to deliberately delay a new competitor's entry into the market. ("RSLCom complains about access to Telefonica's networks", *El Pais*, 25/03/1999 p. 63).
47. Technically, the cable telecommunications service would not be provided directly by Telefonica but by one of its subsidiaries called Telefonica Cable.
48. Spain's cable operators association has made submissions to the ministry and CMT asking for an extension of the moratorium by five years (in addition to the 24 months already in force). See "Los operadores de cable piden que Telefonica no de servicio en 5 anos". El Pais, 11 March 1999.
49. "Telefonica to Start Cable Services in Three Areas Saturday" *Reuters News Service*, 27 August 1999.
50. See "Los operadores de cable piden que Telefonica no de servicio en 5 anos." El Pais, 11 March 1999.
51. The sense in which there is a duopoly policy needs to be explained. The qualifying titles to provide cable telecommunications service comprehend two main classes of services: (a) the so-called telecommunications services, including telephony network, access to Internet, data transmission, etc; and (b) broadcasting services, mainly radio and television. There has been complete liberalisation in respect of the first mentioned category. The second class of services, radio broadcasting and cable television has not been liberalised. Thus cable telecommunications services are provided in full competition and only the cable broadcasting services are still provided under a duopoly restriction.
52. Litan R and R. Noll (1998), "Unleashing Telecommunications: The Case for True Competition", *Brookings Institution*, Policy Brief #39 – November, p. 5.
53. Oftel (1998), "Access to Bandwidth: Bringing Higher Bandwidth Services to the Consumer", a consultation document issued by the Director General of Telecommunications, December. At *http://www.oftel.gov.uk/competition/llu1298.htm*.
54. The approach to pricing unbundled elements introduced in the Netherlands in March 1999 is also worth considering. Prices are to be initially related to LRAIC rising over five years to commercial negotiated levels. This approach is considered to maintain incentives for new entrants to develop their own infrastructure rather than continue to depend on the incumbent's unbundled network.
55. xDSL is a generic abbreviation for a range of Digital Subscriber Line (DSL) systems providing high speed access for customers over existing copper telephone cables in the local loop.
56. On 26 March 1999, the Ministry for Development announced that it had approved a flat monthly charge of 5 000 pesetas (about US$33) for internet users (after an initial fee of 15 000 pesetas), applicable by Telefonica upon introduction of ADSL (asynchronous digital subscriber line) technology. (The new technology avoids lines being saturated and allows the communication of data at a higher speed.) The monthly charge for higher transmission speeds would be set at between 9 180 and 18 800 pesetas. ("Spain Approves Flat 5 000 Peseta Internet fee". Reuters News Service, 26/03/1999). Retevision has urged mandatory unbundling (with provision for co-location) of Telefonica's ADSL enhanced network.
57. A cost of market liberalisation perceived by the community has been in regard to environmental degradation as companies dig up streets to deploy cable networks in ground, or above ground through installation of antennas or overhead cable. Spain's 1998 Telecommunications Act contains specific penalties for operators who act in a manner that degrades the environment.
58. Price discount schemes also require approval by the Commission for Economic Affairs to ensure that there is no discrimination in the provision of discounts. Sharp price reductions through discounts are not necessarily evidence of anti-competitive predatory pricing (with prices reduced below costs). Indeed, price discounts are generally to be welcomed as an aspect of the lower prices competition promises to deliver. Regulatory intervention in regard to setting a "price floor" should be based on the principle that only predatory price falls below long run incremental costs be prohibited.
59. Telefonica is reported to have complained that in Spain: "We lack clear and precise rules that are equal for all, and an independent referee capable of settling conflicts.", David White, "Madrid Attacked on Phone Tariffs", *Financial Times*, 980130, p. 02.
60. "Telefonica Appeals to Supreme Court Against Regulated Prices", *Cinco Dias*, 13/03/98.
61. "Moviline Lowers Its Prices and Launches New Products." *Telefonica Moviles*, 15/12/1998.
62. "Memorandum About Regulation in Spain: Telefonica's Views". Submitted to the OECD study team, January 1999, p. 3.

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63. OECD (1999), *Communications Outlook* 1999, Paris 1999.
64. In fact, in June 1998, Telefonica increased the monthly charge by 200 pesetas in one step.
65. "Memorandum About Regulation in Spain: Telefonica's Views" Submitted to the OECD study team, January 1999, p. 12.
66. OECD (1995), "*Price Cap Regulation – Policies and Experiences*", Paris. Also OECD (1999), *Communications Outlook* 1999, Paris.
67. Mexico and to some extent the UK and Australia.
68. The General Telecommunications Act 24 April 1998, (English Translation, p. 20).
69. Gartner group, "Liberalisation Milestones: One year on." Issue 2, January 1999. At *http://www.bt.com/liberalisation*.
70. Spain has ratified the Fourth Protocol on Basic Telecommunications, attached to the WTO's General Agreement on Trade in Services and the 25% limit does not apply where the foreign company is from a country which is party to that agreement.
71. OECD, *Communications Outlook* 1999, Paris, 1999.
72. According to a Spanish legal authority on the matter: "One of the most significant issues to be taken into consideration when assessing the defence of a telecommunications operator in competition matters is deciding which rules to apply and before which authorities they should be invoked." Almudena Arpon de Mendivil, "Creating Competition in Spain's Telecoms Market", *Global Competition Review*, August/September 1998, p. 28.
73. In May 1999, cable operators disappointed with CMT's ruling authorising Telefonica to continue marketing a combined package, that includes basic telephony services, satellite television with the Via Digital brand and access to the Internet through Teleline, announced they would appeal the CMT decision to the Competition Tribunal. The cable operators also have another complaint before both the CMT and the Competition Tribunal alleging that Telefonica has abused its dominant position to engage in unfair competition. *El Pais* (1999), "Regulatory Body Rules in Favour of Telefonica", 22 May.
74. Questionnaire response, 12 February 1999 (Item 11).
75. Section 17, 1998 General Telecommunications Law.
76. "Jazztel Enters Market with Aggressive Pricing Strategy", *Reuters Business Briefing*, 26 July 1999.
77. It has been estimated that about 1.7 million subscribers are using Telefonica's discount schemes that are providing discounts of some 10% to 60% off standard list prices. Telefonica's so-called *Clear Provincial Discount Plan* gives subscribers discounts of 10% on calls within the same province during the day and 15% from 8 pm to 8 am when calling 20 pre-selected telephone numbers. Telefonica's new rates on off-peak calls will fall to 13.91 pesetas per minute for calls within the same province. Rates will fall to 12.1 pesetas per minute from 5 pm to 8 pm and to 11.42 pesetas from 9 pm to 10 pm. Telefonica has a Low User Scheme called "Abono Social" ("Social Scheme") for elderly people with low incomes. This scheme offers a discount of 95% of monthly charges and a 70% discount on usage charges. Telefonica also has a discount scheme for Internet use.
78. OECD (1999), *Communications Outlook* 1999, Paris.
79. OECD (1999), *Communications Outlook* 1999, Paris.
80. European Commission (1999), *Towards a New Framework for Electronic Communications infrastructure and associated services – The 1999 Communications Review*, Brussels, November.
81. *El Pais*, 19 May 1999.
82. Telefonica Press Release 25 February 1999.
83. Telefonica, *Annual Report* 1998, p. 9.
84. "Spain's Airtel Made a 1998 Profit of 2.78 Billion Pesetas" *Reuters News Service*, 10 February 1999.
85. OECD (1999), *Communications Outlook* 1999, Paris, Table 4.1, p. 97
86. Jazztel will use DWDM (Dense Wavelength Division Multiplexing) technology which will allow carriage of one hundred times more information over a fiber optic cable than with PDH (Plesiochronous Digital Hierarchy) technology, which most Spanish networks have used previously. As well as being fast, it is highly reliable due to its SDH (Synchronous Digital Hierarchy) ring structure. At *http://www.jazztel.es*.
87. CDMA uses unique digital codes, instead of separate FR frequencies and channels, to differentiate subscribers' phone conversations. This advanced digital technology is said to provide eight to ten times more capacity and enhances voice and call quality and in-building coverage compared with traditional analogue systems. In addition to clarity and capacity benefits, CDMA allows the operator to minimise the total number of cell sites that must be installed to cover a geographic area.
88. For instance, some analysts consider that fixed wireless, which uses digital microwave technology to provide basic local telephone service, more economical than wireline networks in providing service to remote and unserved areas. With the use of fixed wireless service, the installation cost per line is estimated to decrease significantly and there is also a significant reduction in installation time, which accelerates cost recovery of the initial investment. But the system requires radio spectrum.
89. "Spain: Iridium Obtains B-2 Licence from CMT", *Reuters News Service*, 2 February 1999.
90. Spain Retevision Starts Translation Service", *Reuters News Service*, 9 February 1999.
91. "Telefonica Enlists Cisco for Internet Push", *Reuters News Service*, 15 July 1999.
92. Telefonica itself has argued that it is important to shift from a preoccupation with the operator's internal indicators of performance to those of concern to customers.
93. Data Communications, *Spain's PTT Shapes Up*, Vol. 27, No. 11, 980800, p. 36

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94. Telefonica's Annual Report 1998, p. 101.
95. Retevision Hires Telefonica Managers", *El Pais*, 13 July 1999.
96. "Consumers First", Remarks of US Federal Communications Commissioner, Susan Ness, before the Consumer Federation of America Utility Conference, Washington, DC. 1 October 1998.
97. Gartner Group, "Liberalisation Milestones: One Year On", Issue 2 January 1999. This report is available at: *http://www.bt.com/liberalisation*.
98. The Gartner Group, "Liberalisation Milestones", 3 June 1999. The report is available at: *http://www.bt.com/liberalisation*.

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