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## TWO DECADES IN THE EUROPEAN UNION - ECONOMIC SUCCESS OF SPANISH REGIONS

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### **Introduction**

The southward enlargement of the European Union, with the full accession of Spain in 1986, has opened up new opportunities for this country. Twenty years since the integration can be viewed as a success story. Spain has achieved high level of economic development and now is an important part of European Union - from both economical and political point of view. The accession has started a multifaceted process of adjustments. Entry to the European Union has also brought many economic advantages, especially those resulting from the influx of the EU structural funds, which have been used to improve the physical infrastructure and human resources. Other aspects of integration are also important, such as expansion of Spanish trade with the Community and inflow of foreign direct investment into Iberian Peninsula.

The most important consequence of this process is a great reduction of economic and social disparities between Spain and the rest of European countries.

The objective of the research is to present economic aspects of Spanish Autonomous Communities' development. Autonomous Communities - the Spanish regions -- were established after the death of Francisco Franco and the restoration of democracy. This administrative system was created on the strength of democratic Constitution in 1978, as a result of general public demand. After four decades of dictatorship, the process of democratization had to be combined with the process of central government power devolution, driven by the fact that Spanish regions and their communities are varied in many aspects including history, culture and language. These dissimilarities have had a great influence on differences in economic and social conditions between regions.

This paper focuses on territorial units, regarded in the European nomenclature (for statistical purposes) as NUTS 2 level. Research is based on the analysis

of reports by the European Commission, as well as national studies. Also EUROSTAT and national statistical data were used in the article.

The chronological range covers the period from 1986 - the year of Spanish integration with the European Union structures - till the end of the last programming period ending in 2006.

### **Spain today - twenty years after accession**

Spain covers just about 4/5 of the Iberian Peninsula area. The population resident in January 2005 was higher than 43 million inhabitants [OECD 2007]. Spain is divided into 17 regions called Autonomous Communities (Comunidades Autonomas) - Aragon, Balearic Islands, the Basque Country, Cantabria, Catalonia, La Rioja, Madrid, Navarra, Andalusia, Asturias, Canary Islands, Castile-La Mancha, Castile and Leon, Extremadura, Galicia, Murcia, Valencia and two autonomous cities located in Africa - Melilla and Ceuta.

Over the last twenty years, Spain's economy has managed significant achievements in terms of growth and employment. Expansionary monetary policy, fiscal carefulness, beneficial structural reforms and the positive effects of the European structural funds combined to contribute to this performance. Real GDP growth has reached average value of approximately 3.4% a year since 1986 and has been appreciably above the euro-area results. Spain also experienced stronger private consumption and investment growth compared with the euro area as a whole, 4.0% and 6.1% respectively [European Commission, 2006].

Employment rates have increased considerably since integration with the European Union from 46.5 to 64.3% of all persons of working age. Gross national income per capita has also grown from 9 594 to 27 028 US dollars in last twenty years.

Table 1

## Spanish economy main indicators (1986 - 2005)

	1986	1988	1990	1992	1994	1996	1998	2000	2002	2004	2005
Total population (1000)	38 537	38717	38 851	39 069	39 296	39 479	39 722	40 264	41 314	42 692	43 398
Population growth rates	0.31	0.22	0.15	0.33	0.27	0.23	0.35	0.84	1.46	1.64	1.65
Employment rates <sup>11</sup>	46.5	49.6	51.8	50.5	47.4	49.3	52.4	57.4	59.5	62.0	64.3
Unemployment rates	17.5	15.8	13.0	14.7	19.5	17.8	15.0	11.1	11.1	10.6	9.2
Gross domestic expenditure on R&D <sup>2)</sup>	0.58	0.68	0.80	0.86	0.79	0.81	0.87	0.91	0.99	1.07	-
Inflows of foreign direct investment <sup>3)</sup>	-	-	-	13 351	9 276	6 821	11 798	39 582	39 249	24 775	22 973
GDP deflator <sup>4)</sup>	10.9	5.9	7.3	6.7	3.9	3.5	2.5	3.5	4.3	4.0	4.1
Government deficit <sup>5)</sup>	-	-	-3.9	-3.7	-6.5	-4.7	-3.0	-0.9	-0.3	-0.2	1.1
Gross national income per capita <sup>6)</sup>	9 594	11 243	13 178	14371	15012	16 536	18 338	20 909	23 403	25 672	27 028
Real GDP growth (%)	3.3	5.1	3.8	0.9	2.4	2.4	4.5	5.1	2.7	3.2	3.5
GDP per hour worked <sup>7)</sup>	-	-	-0.1	2.8	2.9	1.0	-0.2	0.1	0.6	0.7	0.9

Source: OECD (2007), Factbook 2007: Economic, Environmental and Social Statistics, OECD Publications, Paris.

<sup>11</sup>Share of persons of working age (15 to 64 years) in employment

<sup>2)</sup> As a percentage of GDP

<sup>3)</sup> Millions of US dollars

<sup>4)</sup> Annual growth in percentage

<sup>5)</sup> As a percentage of GDP

<sup>6)</sup> US dollars, current prices and PPPs

<sup>7)</sup> Annual growth in percentage

These positive changes, however, are limited by weaknesses in certain areas: inflation rate is still high and it reached 4.1% in 2005, unemployment is more than 9% of labour force and labour productivity is lower than average level of this indicator in euro area.

### Economic evolution of Spanish regions

Spanish integration with the European Union was a giant step on the road to highly developed economy. Spain, formerly a country which was economically lagging behind, and had a high level of unemployment, turned into a modern and competitive state. Integration with the European Union structures forced this country to restructure and liberalize its economy.

This success is noticeable not only on the state but also on the regional level. However to understand the foundations of today's Spanish regions' success, it is necessary to look back to two aspects:

- creating the administrative system on the strength of democratic Constitution in 1978 and
- beginnings of Spain's integration process with the European Union.

The first component of Spanish regions success is the decentralization process, which speeded up the acquisition of governing skills and helped to improve methods of spending European structural funds. This is of vital importance, as European funding obtained by Spain within the framework of structural funds and the Cohesion Fund have played the role of the most significant instrument to determine economic development of Spain and its particular

regions. The European aid resulted in a higher economic development rate, increased investment in infrastructure and caused considerable reduction of unemployment. [Piecuch, 2006],

Process of public devolution in Spain started with the creation of a democratic Constitution, ratified in 1978, which predicted Autonomous Communities' rights to self government. In accordance with the Constitution, State of Autonomies was founded. Seventeen regions - Autonomous Communities - make up the State of Autonomies.

During the last three decades, Spanish regions have taken over responsibilities for providing local communities with public goods and services within their respective territories. Depending on the way a given region became an Autonomous Community, we can point out two different groups of regions. The first are the regions with a *low level of responsibilities*, which assumed their competencies (including organization of their institutions of self-government, town and country planning and housing, public works, regional transportation and infrastructure, agriculture, management of environmental protection, culture, tourism and sport promotion, etc.) not immediately, but in five years. Those regions are Aragon, Asturias, Balearic Islands, Cantabria, Castile-La Mancha, Castile and Leon, Extremadura, La Rioja, Madrid, Murcia. [Castells, 2000].

For historical reasons, only a small group of regions immediately received the full range of competencies mentioned above. Those regions, with a *high level of responsibilities* were also granted powers in education, health area, justice and public order.

Nowadays, after a quarter of a century, some differences between low and high level of responsibilities regions still exist, but Spanish Autonomous Communities have much the same competencies [Molero, 2001].

Transfer of responsibilities was only the first step in the process of power decentralization. Along with the competencies, Autonomous Communities had to receive also the resources to finance all expenditures. Spanish Constitution laid out two

systems for financing regional expenditures. There is an ordinary or common system which is applied in the majority of Spanish regions (Aragon, Balearic Islands, Cantabria, Catalonia, La Rioja, Madrid, Andalusia, Asturias, Canary Islands, Castile-La Mancha, Castile and Leon, Extremadura, Galicia, Murcia, Valencia) and a special or charter system, which is based on historical rights of the Basque Country and Navarra (figure 1).



**Figure 1.** Spain and its regions - territorial grid

For years, in Autonomous Communities under ordinary system, one could observe considerable expenditure responsibilities, but with very restricted revenue autonomy. Their role in setting tax rates was very limited. The financial system was based exclusively on ceded taxes and the Sufficiency Fund - resource treated as a participation in state revenues. Finally negotiations within the Autonomous Communities Fiscal and Financial Policy Council in 1996 led to an increase of regional fiscal autonomy [Molero, 2001].

The second system of fiscal decentralization - the charter system - covers the Basque Country and Navarra, and is characterized by the complete decentralization of revenues' responsibilities, or in other words, extensive fiscal autonomy. The most important taxes, including income, wealth, corporation or inheritance tax, are administrated in full by regional governments. Indirect taxes, such as value added tax or excise duties are administered on the regional level, but regional authorities have no rights to define bases or to change tax rates [Garcia-Mila, 2002].

Table 2

## Evolution of GDP per capita rate in Spanish regions (1986-2004)

Regions	Years					
	1986	1990	1994	1997	2000	2004
Spain	69.8	74.1	76.1	79.3	83.9	89.0
Andalusia	52.8	57.0	56.7	58.8	61.8	68.6
Aragon	75.9	83.0	84.8	85.8	87.7	94.9
Asturias	70.4	70.0	71.7	67.9	70.1	76.9
Balearic Islands	90.4	97.0	97.5	97.5	103.4	101.0
Basque Country	89.5	90.0	90.9	95.3	102.8	110.8
Canary Islands	69.3	76.0	75.3	75.5	79.6	82.0
Cantabria	67.0	74.0	74.6	73.3	78.4	86.7
Castile and Leon	65.0	67.0	70.8	74.3	76.0	83.8
Castile-La Mancha	54.5	63.0	64.1	64.7	65.9	69.9
Catalonia	82.3	92.0	93.1	96.8	102.2	106.4
Extremadura	44.2	49.0	53.6	50.7	53.4	59.3
Galicia	55.0	58.0	59.3	64.5	65.2	71.6
La Rioja	83.3	83.0	87.2	91.0	95.5	96.6
Madrid	85.9	96.0	95.2	104.2	114.0	116.7
Murcia	67.3	74.0	67.6	65.8	70.4	74.6
Navarra	84.8	98.0	91.2	100.6	106.8	111.9
Valencia	70.9	74.0	73.5	76.3	81.0	83.0

EU15 = 100

Source: European Commission (1998), *Sixth periodic Report on the Social and Economic Situation and Development Regions in the European Union*, Brussels/Luxembourg.

It should also be noted that the power over autonomously regulated taxes is limited by the rules of tax harmonization on state level, which means that the effective overall tax burden must not be lower than the burden existing in the rest of the State. Furthermore, international tax treaties must be kept, and free movement of capital and persons within the Spanish territory must be respected and guaranteed. At the end of each fiscal year, regional governments of the Basque country and Navarra transfer the previously agreed quota to compensate central government's nationwide expenditures of general nature, such as armed forces or diplomatic representation [Gordo, 2000].

The second reason for the success of Spanish regions was connected with the existence of certain well developed industrial areas, which, in fact, had been highly developed even before the integration with the EU. Moreover, Spain shares a border with a founder member of EU and a highly developed economy - France - and those better developed areas, namely the Basque Country, Navarra, Catalonia, and Aragon, were located close to that border. It is highly possible that these well-developed Spanish

Autonomous Communities were the main source of structural changes, and of speeding up the process of economic development [Piecuch, 2004].

In addition to positive performance, these regions were also able to absorb surplus of labor force from other Autonomous Communities. Thus the regions became the center of economic performance, even though the major part of European funds went to less developed areas. Despite that fact, the accessible data illustrates how well developed they are - this concerns especially the aforementioned Autonomous Communities: the Basque Country, Navarra and Catalonia, as well as Madrid and Balearic Islands - regions focused on services and tourism (table 2). Since Spain's integration with the EU, those regions have achieved high level of economic development in terms of GDP per capita. It is the reason why differences between well developed regions and the remaining Autonomous Communities have been significant, and what is even worse, they have been increasing systematically. This situation causes considerable concern, because the most important aim in this area of the European Union is to narrow

regional economic and social differences between well and less developed regions under Objective 1 of Cohesion Policy [European Commission, 2001]<sup>1</sup>.

### Evolution of Autonomous Communities' labour market

Transformation of Spanish economy is closely connected with the situation in the labor market, which leads to large disparities in unemployment rates between Spanish regions (table 3). For example,

the aforementioned well developed regions, located close to the French border, have nowadays only minor problems with unemployment but until mid-1990s, high speed of economic growth in the Autonomous Communities wasn't linked with positive adjustments on their labor markets. Quite the opposite, with obligation of reforms, and adjustment to European common market conditions, unemployment rate in Spain rose dramatically in the middle of 1990s [Piecuch 2006b],

Table 3

Evolution of labor market indicators in Spanish regions (1997-2005)

Regions	Unemployment rate		Unemployment rate Young (15-24)		Long term Unemployment		Employment Rate	
	1997	2005	1997	2005	1997	2005	1997	2005
Spain	21.1	9.2	39.8	19.7	51.5	24.5	48.3	63.3
Andalusia	32.0	13.8	50.8	24.5	47.3	25.3	39.5	55.4
Aragon	14.4	5.8	30.0	12.8	44.5	16.9	54.0	68.2
Asturias	21.2	10.2	50.3	24.4	65.6	39.8	43.2	55.8
Balearic Islands	12.2	7.2	26.5	17.7	39.4	13.2	58.5	67.9
Basque Country	18.8	7.3	39.4	19.1	61.2	24.8	49.7	65.5
Canary Islands	20.9	11.7	39.0	24.3	48.9	26.1	47.6	59.7
Cantabria	21.1	8.5	45.1	18.0	64.3	28.3	45.9	62.0
Castile and Leon	19.9	8.7	43.8	19.4	52.5	24.9	47.7	62.7
Castile-La Mancha	19.1	9.2	37.8	18.4	40.9	25.4	47.8	61.4
Catalonia	17.4	7.0	33.3	15.9	57.7	21.4	55.3	69.3
Extremadura	29.5	15.8	43.9	28.3	41.9	28.0	41.8	54.4
Galicia	19.2	9.8	37.1	21.0	58.7	32.0	49.9	61.1
La Rioja	11.8	6.2	26.5	14.2	52.0	22.6	54.0	69.1
Madrid	18.4	6.8	36.8	16.5	57.5	21.8	49.4	68.5
Murcia	18.3	8.0	28.6	15.6	46.2	25.3	48.6	62.8
Navarra	10.0	6.2	29.9	14.8	42.0	17.7	56.1	69.1
Valencia	21.4	8.8	40.4	19.4	44.1	22.4	49.4	64.5

Source: EUROSTAT, European Commission (2007a), *Fourth report on economic and social cohesion. Growing Regions, growing Europe*, Luxembourg.

The improved competition level of the Spanish economy brought considerable decrease of the index at the end of the last century but still in many Spanish regions the lack of jobs is the main economic problem, and unemployment rate remains very high. Moreover, long term unemployment concerns 1/3 of total number of the unemployed persons. On the other hand, with the economic expansion in the Basque Country, Catalonia, Madrid, Balearic Islands and Navarra, the number of jobs is on the boost up. High-speed

level of economic growth and positive changes in the labour market can be especially noticed in Navarra, La Rioja and Aragon (table 3). Unemployment rates decreased in the group of well developed Autonomous Communities by 1/3 in 2005 in comparison with the moment of accession to EU,

Objective 1 regions also experienced decrease in unemployment rate, but their present situation is much less favorable. Despite that fact, a remarkable improvement in the situation of the labor market in

<sup>1</sup> Till the end of the last programming period 2000 - 2006 Objective 1 was the main priority of the European Union's cohesion policy. In accordance with the treaty, EU tried to speed up economic development of the regions which were lagging behind, and which have a number of economic problems - namely low level of investment, a higher than average unemployment rate, lack of services for businesses and individuals or poor basic infrastructure.

In the current programming period 2007 - 2013 Objective 1 is called Convergence Objective but the aims are much the same: improving conditions and factors leading to real convergence for the least-developed Member States and regions. In European Union with 27 Member States, this objective concerns 17 countries and 84 regions with GDP per capita below 75% of the Community average. Moreover there are another 16 "phasing-out" regions receiving aid under Convergence objective with a total of 16.4 million inhabitants and a GDP only slightly above the threshold, due to the statistical effect of the larger EU. The amount available under the Convergence objective is EUR 282.8 billion, representing 81.5 % of the total [European Commission, 2007b]

Spain as a whole should be noted. Since 1986, the year of integration with the EU, unemployment rate in Spain was one of the highest among European Union countries. On the day of accession, it amounted to more than 21% of all labour force. By 1994, it reached the figure of 24%, three times exceeding European Union average. And yet, during the following years, the value of this index was systematically reduced, and in 2005 it was down to 9.2% of all labour force

[European Commission 2006].

Differences in unemployment rate between Autonomous Communities since the year of integration with the European Union have remained considerable. In northern regions-namely Navarra, La Rioja, Madrid Catalonia and Aragon - unemployment rate doesn't exceed 7% of all labour force, while in southern Spain - in Extremadura - it reaches as much as 16%.

Table 4

#### Employment by sector in Spanish regions between year 1995 and 2004 (% of total)

Regions	Agriculture		Industry		Construction		Services	
	1995	2004	1995	2004	1995	2004	1995	2004
Spain	8.1	5.4	18.9	17.4	9.1	12.1	64	65.1
Andalusia	10.6	9.3	12.0	11.3	9.3	13.2	68.1	66.2
Aragon	11.4	7.8	21.3	21.8	7.5	11.0	59.8	59.4
Asturias	12.3	4.2	20.6	18.3	8.7	13.0	58.4	64.4
Balearic Islands	8.2	2.2	7.4	8.1	9.6	15.9	74.8	73.8
Basque Country	2.6	2.5	28.2	27.3	7.8	9.7	61.4	60.5
Canary Islands	8.2	2.6	7.4	6.6	9.6	15.4	74.8	75.4
Cantabria	9.6	6.6	19.0	17.5	10.3	14.3	61.1	61.6
Castile and Leon	13.1	10.9	17.0	17.6	10.3	12.8	59.6	58.7
Castile-La Mancha	13.0	15.0	19.0	18.9	11.2	12.7	56.8	53.4
Catalonia	3.5	2.5	26.2	23.6	8.1	10.6	62.2	63.3
Extremadura	15.4	15.4	8.8	9.2	13.5	14.0	62.3	61.5
Galicia	23.2	8.3	15.1	18.8	9.6	12.5	52.1	60.3
La Rioja	11.6	11.4	29.8	27.0	6.0	12.0	52.7	49.5
Madrid	0.9	0.5	15.6	11.9	8.6	10.7	74.8	77.0
Murcia	11.5	9.9	18.2	17.8	8.4	12.0	61.9	60.3
Navarra	6.7	5.4	30.1	27.6	7.7	11.9	55.5	55.1
Valencia	6.7	3.5	24.3	21.9	9.4	13.3	59.7	61.2

Source: EUROSTAT, European Commission (2004), *Third report on economic and social cohesion: A new partnership for cohesion. Convergence, competitiveness, cooperation*, Luxembourg.

Significant level of unemployment rate in two Autonomous Communities, Andalusia and Extremadura, is connected with the necessity of regional economy restructuring, especially in the agriculture sector. In mid-1980s, the primary sector was responsible for more than 20% of total employment. By the year 2004 the level of employment in agriculture has decreased to 5.4%. Difficulties in the labor market had negative impact in all those regions with less developed economies and lack of possibility for non-agricultural job creation. In mid-1990s, unemployment rates reached the highest level - as much as 32% in Andalusia and 29.5% of all labour force in Extremadura.

Employment structure is one of the most important aspects of any region's performance. Conversion in this area allows to see direction of changes in the

analyzed regions. In early 1980s, just before Spanish accession to the European Union, a tendency to adjust the level of employment in each sector to economic efficient structure has been observed. This trend has been escalated in the following years as a response to the necessity of member countries increasing their competitiveness. The most significant changes can be observed in the primary sector of agriculture. In many Autonomous Communities, which depended on agricultural production in the years before accession, this adaptation had violent character. In Galicia, since 1995, employment in agriculture has decreased from 23.2% (of total employment in all sectors) to 8.3% in 2004. Simultaneously, employment increased in other sectors, mainly in services. Similar changes have been observed in other regions formerly belonging to Objective 1 and now receiving structural aid under

Convergence objective - namely Castile-La Mancha, Extremadura and Andalusia (table 4).

The highest level of employment in services is noted in regions closely connected with tourism - namely Canary Islands, Balearic Islands and the capital region of Madrid. In 2004, the level of employment in this sector was running at about 75% of total employment.

### Conclusions

Spanish integration with the European Union structures was a constructive step on the road to modern, well-developed economy. Spain, previously economically backward, with giant problems on the labour market, turned into a modern and competitive country. Integration with EU forced Spain to reorganize and liberalize its economy and to reduce unemployment rate.

Positive results of the integration process are so important because for years majority of Spanish regions have been lagging behind economically. They had been disadvantaged due to peripherality, topographic restrictions and lack of reforms under Franco's dictatorship. After accession in 1986, these factors caused integration problems with the European common market. Till the end of 1980s most of Spanish regions were considered to be areas, in which traditional economy was not adapted to market conditions. Nowadays analyzing Spanish situation, we can undoubtedly say that integration with the European Union was the right step on the road to modern economy.

New Member States can learn much from the Spanish case because their situation today is comparable to the Spanish situation twenty years ago. Similarly to Spain back then, Central and East European Countries, integrated with the European Union in years 2004 and 2007, have a huge amount of unsolved economic and social problems. But since the first moments after accession, similar to Spain, majority of New Member States and their regions have participated in a significant portion of community structural aid. As we can see in Spain, the European structural funds result in increased economic development rate and cause considerable employment rise.

The years to follow will show if structural evolution in the New Member States follows a path similar to that undertaken in Spain, which allowed Autonomous Communities to be successful in economic growth and unemployment reduction.

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## **Two Decades in European Union - Economic Success of Spanish Regions**

### Summary

Since accession to EU Spain has achieved high level of economic development. Integration has started a multifaceted process of adjustments. Entry to the European Union has also brought many economic advantages especially thanks to EU structural funds, which have been used to improve the physical infrastructure, labour forces and capital stock. The most important consequence of accession is a great reduction of economic and social disproportions between Spain and the rest of European countries.

Spain's economy has managed significant achievements in terms of growth and employment in the last twenty years. A combination of expansionary monetary

policy, fiscal carefulness, beneficial structural reforms and the positive effects of the European structural funds has contributed to this performance.

This success is noticeable not only on state but also on regional level. In the mid 80's most of Spanish regions were considered as areas with traditional economy which was not adapted to market conditions. Nowadays analyzing Spanish regions' situation we can say that integration with the European Union was an accurate step on the road to modern economy.

**Key words:** Spain, European Union, economic growth, unemployment rate, regions