Spain and Portugal in the Euro Area: Lessons for Cyprus
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Abstract
This paper compares the economic performances of Spain and Portugal in the European Monetary Union (EMU) and draws some lessons for economic policy in Cyprus. Although high growth recorded in Spain could be partially attributable to euro entry conditions and a strong population shock, appropriate policy choices have played a paramount role. In particular, on the back of sustained fiscal consolidation, the Spanish public sector partially offset the pervasive effects on the current account of the credit impulse associated with the fall in the risk premium. In contrast, pro-cyclical fiscal policies exacerbated the effects of the credit impulse and led to a boom/bust adjustment process in Portugal, while increasing female participation and strong immigration underpinned wage moderation. Now that Cyprus has adopted the euro, the experiences of Spain and Portugal in EMU pinpoint the importance of an adequate fiscal governance system to ensure fiscal prudence, especially in good times. Across-the-board expenditure rules would ensure wage restraint in the public sector and promote economy-wide wage moderation. In parallel, reforming the education, training and apprenticeship systems, while ensuring an adequate degree of market competition, will support productivity growth in Cyprus.

Keywords: Adjustment in the Euro Area, Fiscal Policy, Structural Reform, Fiscal Governance.