1987/1988

OECD ECONOMIC SURVEYS

PORTUGAL

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ECONOMIC SURVEYS

PORTUGAL

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to article 1 of the Convention signed in Paris on 14th December, 1960, and which came into force on 30th September, 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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The Socialist Federal Republic of Yugoslavia takes part in some of the work of the OECD (agreement of 28th October, 1961).

Publié également en français.

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Annex I

BASIC STATISTICS OF PORTUGAL

THE LAND

Area (thousands sq. km)	92.1	Major cities, resident population in thousands (1986):	
		Lisbon	830
		Porto	347

THE PEOPLE

Population (1986, thousands)	9 716	Civilian employment (1986, thousands)	4 084
Number of inhabitants per sq. km	105	as a percentage of total:	
Civilian labour force (1986, thousands)	4 546	Agriculture	21.8
		Industry	33.9
		Services	44.3

PRODUCTION

Gross domestic product in 1986 (million of US dollars)	28 990	Gross domestic product at factor cost by origin in 1986 (%):	
Gross domestic product per head in 1986 (US dollars)	2 984	Agriculture	9.0
Gross fixed asset formation in 1986 : % of GDP	21.6	Industry	39.3
per head (US dollars)	644	Services	51.7

THE GOVERNMENT

Public consumption in 1986 (% of GDP)	14.0	General Government current revenue in 1986 (% of GDP)	37.0
Public investment in 1986			
% of GDP	4.9		
% of total investment	22.7		

FOREIGN TRADE

Exports of goods and services as a % of GDP (1986)	33.6	Imports of goods and services as a % of GDP (1986)	36.2
Main exports as a % of commodities exports 1986, SITC:		Main imports as a % of commodities imports 1986, SITC:	
Food, beverages and tobacco (0, 1)	8.2	Food, beverages and tobacco	11.0
Basic and semi-finished materials (2, 3, 4)	12.2	Basic and semi-finished materials	25.0
Manufactured goods (5, 6, 7, 8)	78.4	Manufactured goods	63.4
of which: Chemicals (5)	6.1	*of which:* Chemicals	11.3
Machinery and transport equipment (7)	15.7	Machinery and transport equipment	29.3

THE CURRENCY

Monetary unit: Escudo		Currency units per US $, average of daily figures:	
		Year 1987	140.794
		February 1988	138.818

Note: An international comparison of certain basic statistics is given in an annex table.

This Survey is based on the Secretariat's study prepared for the annual review of Portugal by the Economic and Development Review Committee on 27th January 1988.

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After revisions in the light of discussions during the review, final approval of the Survey for publication was given by the Committee on 18th February 1988.

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The previous survey of Portugal was issued in May 1986.

Introduction

A current external deficit of 13½ per cent of GDP in 1982 led to the adoption, the following year, of an adjustment programme aimed at drastically reducing domestic absorption. Monetary policy, supported by an appreciable devaluation, played a large part in the adjustment. Over the period 1982 to 1984, the public sector borrowing requirement was reduced by the equivalent of 3 percentage points of GDP; real wages fell by more than 13 per cent, and investment by about one-quarter. Overall, final domestic demand declined by about 8 per cent. By 1984, the external deficit was down to 3 per cent of GDP.

The severity of the squeeze, and the fact that it was concentrated on the private sector, led to strong "catch-up" pressures from 1985 once the restoration of external equilibrium removed the immediate constraint on policy. Strong terms of trade stimulus to domestic demand was actually reinforced by expansionary policies. Real wages recovered part of the ground they had earlier lost. By 1987, final domestic demand was over 15 per cent above its 1985 level (thereby more than reversing the earlier decline), with imports up by more than 40 per cent in volume. These trends are reviewed in Part I. Economic policies and the short-term outlook are assessed in Part II.

Falling oil prices and the decline in the dollar eased the external constraint during the last two years, thus permitting booming domestic demand. But maintaining external equilibrium remains a key medium-term condition for pursuing the growth needed to further Portugal's development. Entry into the EC is increasing the country's openness, thus making this external constraint all the more keenly felt. A root cause of the fragility of the external balance is the persistent, large public sector deficit. Moreover the size of the public sector – extending widely into areas best left to the market – increases rigidities. The economy's ability to adapt to the challenges of greater international exposure will depend to a large extent on reform in this area. The authorities intend to deal with these problems by reducing State intervention in the economy and by cutting government borrowing, so channelling domestic saving into productive investment. This general orientation is embraced by an ambitious medium-term programme. This programme, and the key issues it raises, are examined in Part III. Policy conclusions are presented in Part IV.

I. Recent trends

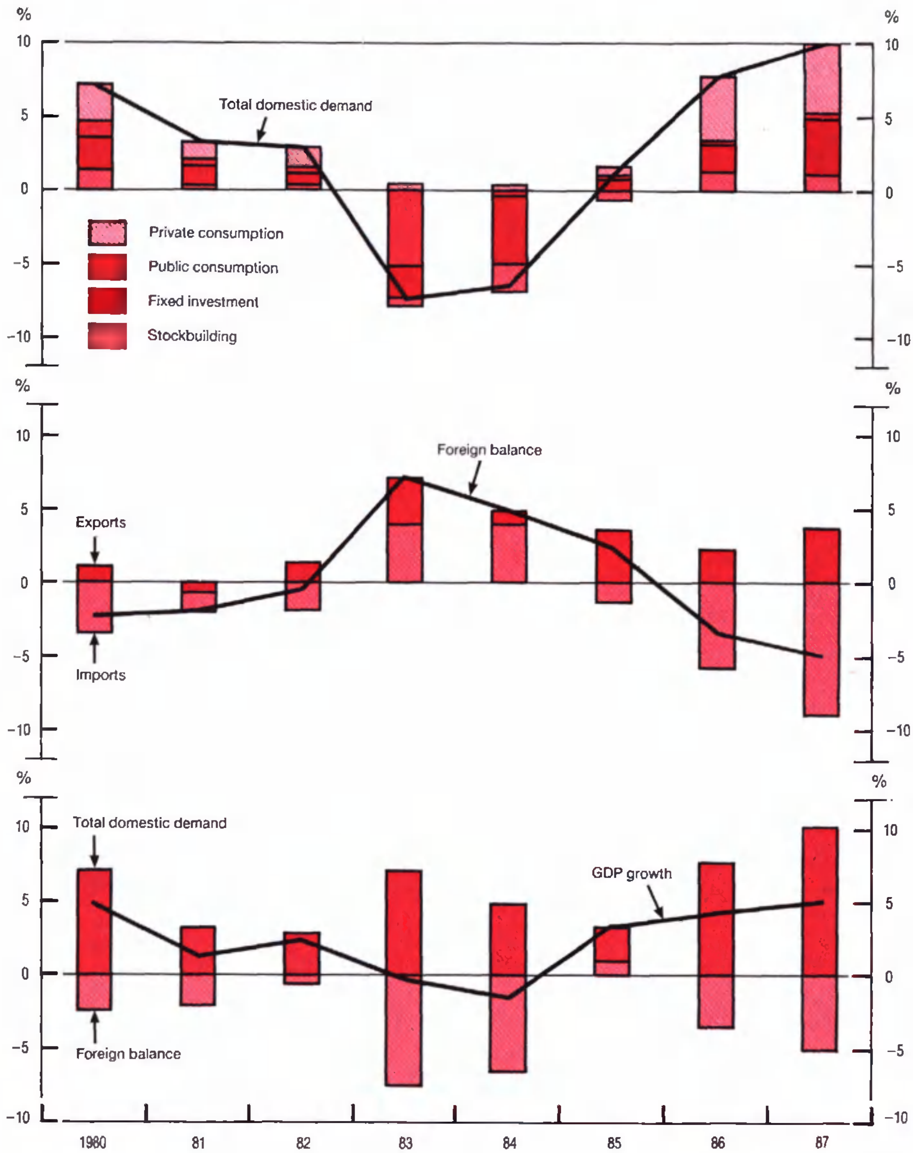
Domestic developments

Demand and output

Restoration of external equilibrium by 1985 enabled the authorities to ease economic policy appreciably. Interest rates were cut and the growth of monetary aggregates accelerated, particularly in real terms. Fiscal policy also stimulated domestic demand selectively in 1985, and more generally in 1986 (see "Fiscal policy" in Part II). Wage increases, notably in public enterprises, boosted purchasing power from 1985 onwards; the tax burden on earned income was eased and social transfers (pensions and unemployment benefits) rose considerably. Favourable external factors gave additional stimulus. The fall in raw material prices and the depreciation of the dollar improved corporate finances; Portugal's entry into the EEC brought large transfers to enterprises. During the period 1986-87, total domestic demand grew at an annual rate of about 9 per cent, making up for the decline in 1983 and 1984. To a larger extent than during the previous upturn, demand was led by private consumption, which was 10 per cent higher in 1987 than in 1982. But investment, which had fallen more steeply and had picked up later, remained below its 1982 level. Buoyant domestic demand led to a sharp deterioration in the real foreign balance (see Diagram 1). The volume of imports rose by over 40 per cent from 1985 to 1987. Notwithstanding rapid export growth, the external balance's contribution to growth became strongly negative in 1986 and 1987. All in all, GDP grew at an annual rate of nearly 4 per cent over three years.

After falling by 5 per cent over the period 1983-1984, households' real disposable income rose by around 12 per cent during the ensuing three years. This was primarily due to a 10 per cent rise in per capita real wages. Employment changes had a more limited impact since the number of persons in dependent employment began to rise again only from mid-1986. Social benefits received by households rose by 30 per cent in 1986 and by 20 per cent in 1987 – far more rapidly than social

Diagram 1. **CONTRIBUTION TO GDP GROWTH**
As a percentage of GDP in the previous year



Source: OECD, *National Accounts* and OECD Secretariat estimates.

Table 1. **Demand and output**

Percentage changes (at constant 1977 prices)

	1982 Current values Esc. billion	1983	1984	1985	1986	1987
Private consumption	1 287.1	–1.0	–3.0	1.0	7.0	7.3
Public consumption	276.2	2.7	2.5	1.7	1.6	2.0
Gross fixes investment	574.8	–7.5	–18.0	–3.0	9.5	19.0
Final domestic demand	2 138.0	–2.2	–5.9	0.3	6.6	8.9
Stockbuilding[1-2]	56.4	–5.2	–0.4	0.8	1.3	1.2
Total domestic demand	**2 194.4**	**–6.6**	**–6.1**	**1.0**	**7.9**	**9.9**
Exports	488.5	16.7	14.2	11.0	6.7	10.8
Imports	832.5	–8.7	–2.7	3.9	17.5	24.0
Foreign balance[1]	–344.0	7.1	4.9	2.3	–3.4	–5.1
GDP	**1 850.4**	**–0.3**	**–1.6**	**3.3**	**4.3**	**5.0**
Gross fixed investment						
By sector						
General government	62.9	–9.1	–13.2	0.0	25.0[4]	43.1[4]
Public enterprises	118.0	4.9	–24.5	–8.2	17.7[4]	18.8[4]
Private sector[3]	394.0	–11.0	–16.5	–1.8		
By product						
Machinery and equipment	280.1	–12.2	–26.8	–0.4	16.2	26.0
Construction	294.7	–3.0	–10.0	–5.0	4.3	12.5
Total value added in:						
Agriculture, forestry and fishing	160.8	–5.0	2.8	5.5	3.8	4.9
Manufacturing	554.9	1.0	–0.8	4.5	5.0	4.3
Services	932.1	–0.1	–1.2	2.9	4.0	5.1

1. Contribution to GDP growth.
2. Including statistical discrepancy.
3. Including banking and insurance.
4. Including changes in stocks.

Sources: Ministry of Finance; Banco de Portugal, *Annual Report;* OECD Secretariat.

insurance contributions – and the burden of direct taxation was eased in 1986, primarily by adjusting tax schedules for inflation. In addition, the savings ratio fell in 1986 and 1987, no longer playing a countercyclical role as it had in the past. The positive correlation between households' saving and real disposable income is apparent whether migrants' remittances – which correspond to incomes of non-residents and are mostly saved[1] – are excluded or not (see Diagram 2). Lower saving over the past two years can be explained by several factors: a "catch-up" effect involving particularly purchases of durable goods; the country's accession to the

Table 2. **Households' disposable income**

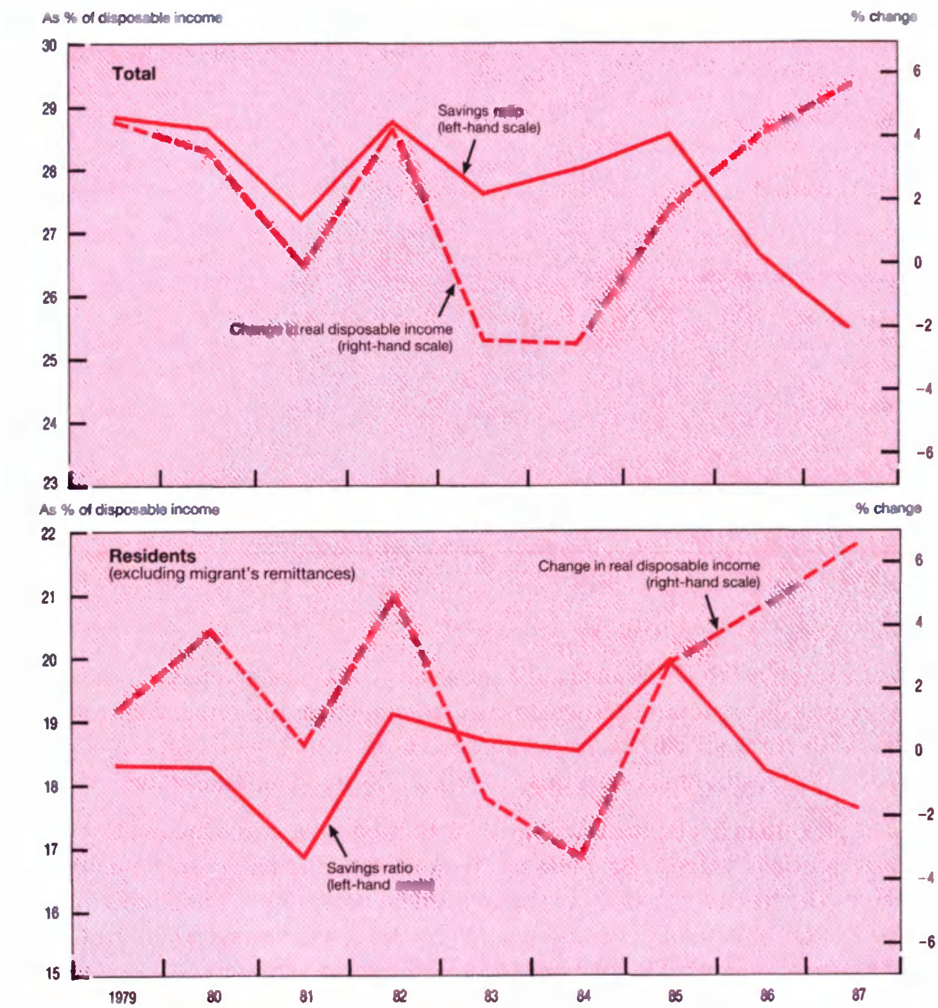
Percentage changes

	1982 Current values Esc. billion	1983	1984	1985	1986	1987
Compensation of employees	967.3	19.6	16.1	22.3	18.7	14.9
Income from property and entrepeneurship	687.1	32.8	32.4	23.6	9.9	11.2
Domestics transfers	250.0	25.7	23.0	21.4	29.6	20.0
Transferts from abroad	215.0	12.6	32.4	11.9	9.7	19.7
Gross income	2 119.4	23.9	24.1	21.7	15.7	14.6
Direct taxes	108.5	43.0	3.4	30.8	0.2	1.7
Social insurance contributions	205.5	28.5	32.2	22.5	21.2	7.1
Disposable income	**1 805.4**	**22.2**	**24.6**	**21.0**	**16.6**	**15.4**
Consumption	1 286.7	24.2	23.9	20.1	19.8	17.4
Savings ratio[1]	–	27.7	28.0	28.5	26.6	25.3
Real disposable income		–2.6	–2.4	1.8	4.1	5.5
Memorandum item:						
Consumer prices	–	25.4	27.7	18.9	12.0	9.5

1. As percentage of disposable income.
Sources: Ministry of Finance; OECD Secretariat.

EEC, as a result of which customs duties on some goods were lowered, certain import quotas removed and administrative procedures simplified; the actual composition of income, with rising social benefits, characterised by a high propensity to consume; and lastly the wealth effect resulting from the fall in the inflation rate[2].

The pick-up in fixed investment in 1986 allowed most of the ground lost during the three previous years to be made up. Both private and public sector enterprises were hit by the credit controls under the adjustment programme. Public enterprises in particular were affected by the restrictions on foreign borrowing, which had been a major source of funding. The lowering of interest rates in 1985 certainly helped to get investment moving (see "Monetary policy" in Part II) and the proportion of authorised credit unused, which had risen in 1985, fell. Fixed investment was also stimulated from 1986 by the authorities' deliberate policy of implementing a major infrastructure and construction programme, and by the first inflow of EEC financial aid, which initially had a not inconsiderable influence on investment decisions. Furthermore, a tax incentive scheme was introduced in mid-1986. Rebuilding of inventories took place on a very large scale in 1986, reflecting oil purchases prompted by the fall in world prices. The positive contribution of restocking to GDP growth – nearly 1½ per cent – was thus entirely cancelled out by a rise in imports. Similarly, Diagram 2. **DISPOSABLE INCOME AND THE SAVINGS RATIO**



Sources: OECD, *National Accounts;* Banco de Portugal, *Annual report.*

in 1983 the very rapid fall in inventory investment was accompanied by a marked decline in imports.

The improvement in Portugal's competitive position in 1983 resulted in a very rapid increase in the volume of exports: these contributed 3½ percentage points to

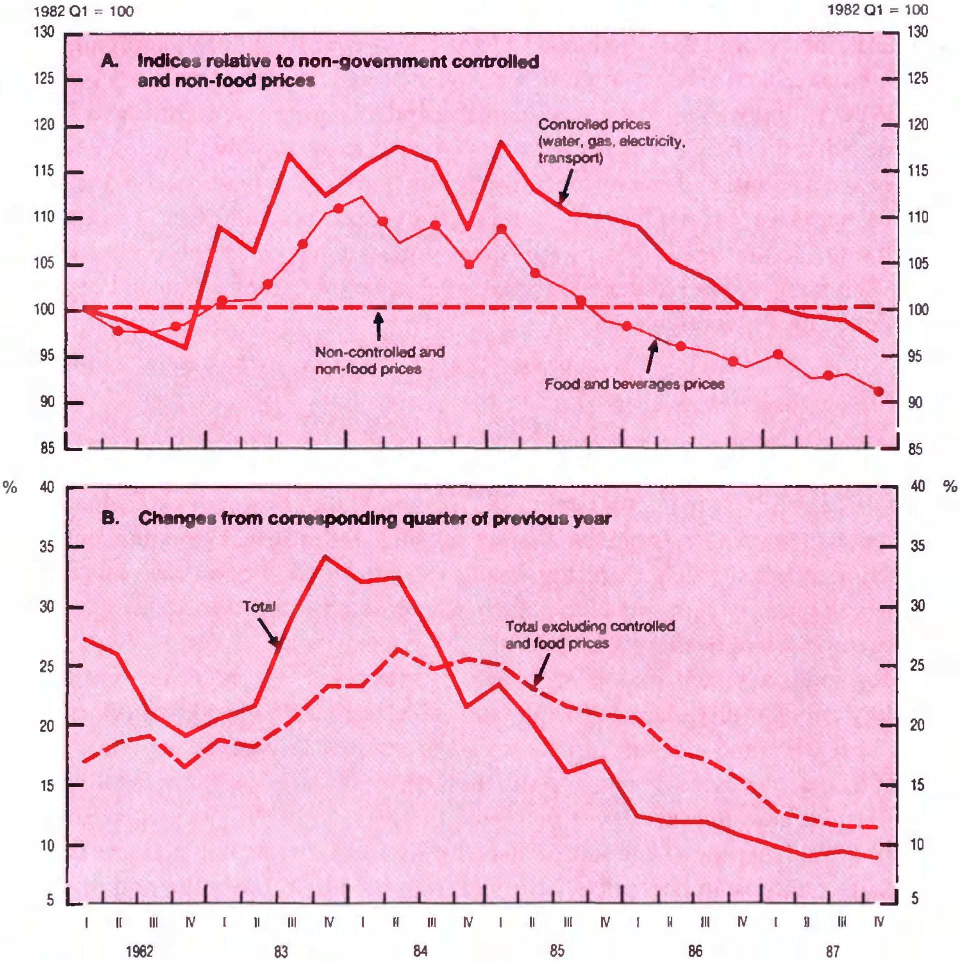
GDP growth in each year from 1983 to 1987. With imports much more volatile, the size of the external balance's contribution to growth was dominated by changes in the volume of imports. In 1983-1984, real imports fell by over 10 per cent, implying a real foreign balance contribution to growth of 6 percentage points annually. In contrast, since 1986, with the boom in domestic demand and to a large extent the liberalisation of trade with the EEC, imports have grown extremely rapidly. The real foreign balance's contribution became negative again. Portugal's external balance thus remains sensitive to the country's relative cyclical position (see Diagram 4), underlining the precariousness of the improvement achieved in the previous three years. This point will be examined in greater detail below in the section on Portugal's dependence on the foreign sector.

Prices, wages and costs

Inflation, as measured by the increase in consumer prices, fell from over 25 per cent in 1983 and 1984 to 9.5 per cent in 1987. Nonetheless, Portugal's inflation rate is still 5 percentage points above the average for OECD-Europe. The improvement in underlying inflation has been rather less (see Diagram 3). Price rises in 1983 and 1984 were necessary elements of the macroeconomic stabilization programme. First, controlled prices were sharply increased. The largest increases (30 to 40 per cent) were for food, a sector that is still heavily subsidised, for housing expenditure including public utility charges (water, gas and electricity), and for transport[3]. The prices of textiles and clothing, a sector that is exposed to competition and thus to market forces, rose more slowly. Second, the large devaluation of the escudo required to correct the external imbalance increased the price level. In 1985, this exchange rate policy was suspended and several moderating factors came into play. As in other European countries, import prices benefited from the fall in the dollar and in oil and other primary commodity prices. The dollar exchange rate has a very strong influence on prices in Portugal, which is highly dependent on agro-food imports as well as on energy imports. A high proportion of agro-food imports (37 per cent in 1985) are from the United States, in particular grains and oilseeds. Also, after EEC entry, customs duties on some products were lifted, thereby helping to increase supply. Lastly, the increases in controlled prices were more moderate. Food prices and public utility charges have risen at a slower rate than prices of other goods and services, so that the rate of consumer price increases has slowed to less than 10 per cent since December 1986 (see Diagram 3, Panel B).

However, higher indirect taxation limited the slowdown in price rises. The introduction of VAT is estimated to have added about 2 points to the rise in consumer

Diagram 3. **OBSERVED INFLATION[1] AND UNDERLYING INFLATION**



1. Consumer price index (excluding rent) and components; end of quarter.
Source: INE, *Boletim mensal d'estatistica.*

prices in 1986. Moreover, the State took a large share of the real income gain from the terms-of-trade improvement, by cutting subsidies on various imported products and especially by raising the tax on petroleum products – which reduced the general government deficit (see below). The increase in the tax on petroleum products practically offset the fall of about 50 per cent in the price of crude oil imports.

Domestic prices remained virtually unchanged. Enterprises benefited in 1986 from a slight reduction in fuel oil prices (down 4.8 per cent), in sharp contrast with the rise in 1985 (up 22 per cent). The potential reduction in the rate of price increases that would have occurred had the fall in the price of oil and agricultural imports been fully passed on to consumers is put at 4 points.

Substantial wage increases were awarded in 1985 and 1986 as part of a deliberate policy by the authorities to compensate for the fall in real wages that had taken place during the previous three years (see Table 3, Panel A). In 1985 wages were raised by over 20 per cent in the public sector, this sector traditionally serving as a benchmark for all other wage negotiations. Contractual wage increases in the public sector were lower the following year but, taking account of wage drift, they averaged close on 20 per cent (8 per cent in real terms). The wage increases in public enterprises were again higher than in the private sector. The national minimum wage was also raised. However, the growth in unit labour costs was more moderate for the following reasons: first, productivity gains resulting from the cyclical upswing were high (over 4 per cent in 1985 and 1986); second, the adjustment for inflation of tax brackets and the lowering of employers' and employees' social insurance contributions in 1986 narrowed the "tax wedge" i.e. the difference between the cost of labour to the employer and the wage received by the employee, which had been widening

Table 3. **Wages and prices**
Percentage changes

	1983	1984	1985	1986	1987
A. Average wages implicit in collective wage agreements					
Real	-5.1	-7.9	2.0	4.7	[1]
Nominal	19.1	19.1	21.7	16.9	12.1[1]
of which:					
General government	19.2	19.1	22.3	16.5	11.5[1]
Public enterprises	18.7	19.8	23.2	18.1	11.0[1]
Private sector	19.1	17.1	21.2	16.9	12.3[1]
Nominal minimum non-agricultural wage	21.5	20.0	23.1	17.2	12.0[1]
B. Private deflators					
Private consumption prices	25.4	27.7	18.9	12.0	9.5
Import prices	33.7	26.2	11.0	-7.2	6.5
GDP at market prices	24.9	23.7	21.7	17.8	11.7
GDP at factor cost	24.6	25.2	18.7	13.1	12.1

1. Data for January-September.
Sources: Banco de Portugal, *Sintese Mensal de Conjuntura;* Ministry of Labour and Social Security; OECD Secretariat.

steadily for some ten years. The third and most important element was the improvement in the terms of trade in 1985 and especially in 1986. For the first time since 1980 consumer prices (which for wage-earners are the appropriate yardstick of inflation) rose at a slower rate than producer prices (GDP deflator) (see Table 3, Panel B). Lastly, cost of servicing external debt diminished, narrowing the gap between national output and national income. The upshot was that substantial gains in wage-earners' purchasing power accompanied an improvement in corporate profitability in 1985 and 1986.

Price deceleration continued in 1987, but at a slower rate. Foreign prices ceased to play a decisive role and it was rather the slowdown in wage costs that allowed the trend to be consolidated. A new framework for labour/management consultation, a cornerstone of the Government's incomes policy, was introduced at the beginning of the year. Wage negotiations are from now on based on an official inflation target. Accordingly, the reference inflation rate for wage negotiations in 1987 was set at 9 and 8 per cent respectively for the first two quarters and at 7 and 6 per cent for the third and fourth quarters. Nominal wages were to rise in line with these rates, plus expected productivity growth in the company or sector involved, giving due weight to its financial situation and competitive position. As an interim measure, a catch-up clause will operate for the third and fourth quarters of 1988 if inflation turns out to be higher than expected. In line with this new policy, public sector wages exerted a more moderate influence in 1987 than in the previous two years. The increases in the national minimum wage were also more moderate in 1987 than in the previous two years. But coverage has been extended, and it now applies in full from the age of 18 instead of 20. All told, these adjustments, notwithstanding their social function, risk discouraging employers from taking on the unskilled, the young, women and the long-term unemployed. Average wage increases awarded up to October ranged between 12½ per cent and 10 per cent, decreasing as the year went on. The average increase for the year is estimated at 12 per cent, which, bearing in mind the expected productivity gain of 3 per cent economy-wide, is roughly in line with the settings of incomes policy. However, it is possible that in the sectors and enterprises where productivity gains were lowest wage increases were not sufficiently differentiated.

Labour market

The labour market situation improved at the beginning of 1985, when the pick-up in activity took hold. During the recession phase, the deterioration in the labour market had been alleviated by a number of factors specific to Portugal – a fall in the female participation rate and a temporary decline in the labour force; a revival of employment in agriculture; virtually no redundancies; the non-payment of wages in some ailing enterprises; real wage flexibility – all features that were analysed in the previous *Economic Survey*[4]. These factors meant that the decline in activity was reflected in a fall in the labour force and in slack capacity rather than in higher unemployment. The unemployment rate in the strict sense did not exceed 9 per cent between 1983 and 1985, compared with 7½ per cent during the 1980-82 expansionary phase[5]. Given slack capacity, the productivity cycle and the foreseeable reversal in the trend of participation rates, there were grounds for fearing that the recovery would have only a small and delayed impact on employment and unemployment. According to a survey of households carried out by the National Statistics Institute, the total number of employed rose by 0.8 per cent during the second half of 1986 (over the same period of the previous year) and by 2.6 per cent during the first three

Table 4. **Employment and the labour market**

Percentage changes

	Thousands persons 1984	1985 / 1984	1986 / 1985	1987[4] / 1986
Labour force	4 476	–0.3	0.1	1.0
Total employment	4 095	–0.5	0.2	2.6
of which:				
Agriculture and fishing	969	0.0	–8.1	4.0
Industry	1 009	0.9	0.4	4.7
Construction	350	–5.3	0.3	5.7
Services	1 737	–0.5	4.5	0.4
of which:				
General government[1]	541	–1.1	6.4	1.0

	1984	1985	1986	1986[4]	1987[4]
Participation rate[2]	46.7	46.2	46.0	46.1	46.4
Unemployment rate[3]	8.5	8.6	8.6	8.7	7.3
Male	5.9	6.4	6.5	6.5	5.5
Female	12.1	11.7	11.4	11.7	9.6
Fixed-term employment					
As % of total employment	13.4	13.2	15.8	15.4	17.2
As % of new contracts	68.3	67.2	67.1	68.2	70.7[5]

1. Including employees in private education and health.
2. As a percentage of the total population.
3. As a percentage of the labour force. Data based on the narrowest definition of unemployment, which includes only persons who have been actively seeking a job during the four weeks prior to the survey.
4. Average of three quarters.
5. Average of first half-year.

Sources: National Statistics Institute, Employment Survey; Ministry of Labour and Social Security, Quarterly Employment Survey.

quarters of 1987[6]. Agricultural employment – which still accounts for 22 per cent of total employment, compared with an EEC average of 9 per cent – fell particularly steeply (down 8 per cent in 1986). However, this figure included a catch-up element after two years' overmanning in the sector because of the difficult employment situation elsewhere in the economy. The 1987 figures do, however, show employment to be rising once again in the farm sector.

Most new jobs again were subject to fixed-term contracts, which accounted for 70 per cent of new contracts in early 1987[7]. This trend in a period of buoyant activity, characterised by a general climate of confidence, demonstrates the importance that employers attach to having a certain amount of flexibility in managing their workforce, given that the legislation in this area is fairly rigid. An Act of February 1986 exempted employers from social insurance contributions if they offered a permanent contract to certain categories of the unemployed. The weak response from employers indicates a reluctance to take on workers whom they would subsequently find difficult to lay off. In the past, another way in which businessmen in difficulty got round the virtual impossibility of reducing the permanent workforce was to suspend the payment of wages or social insurance contributions. On some estimates, wages were owed to 92 000 people at the beginning of 1984 (mainly in the textile, metallurgy, shipbuilding and transport sectors), compared with less than 40 000 in the third quarter of 1986.

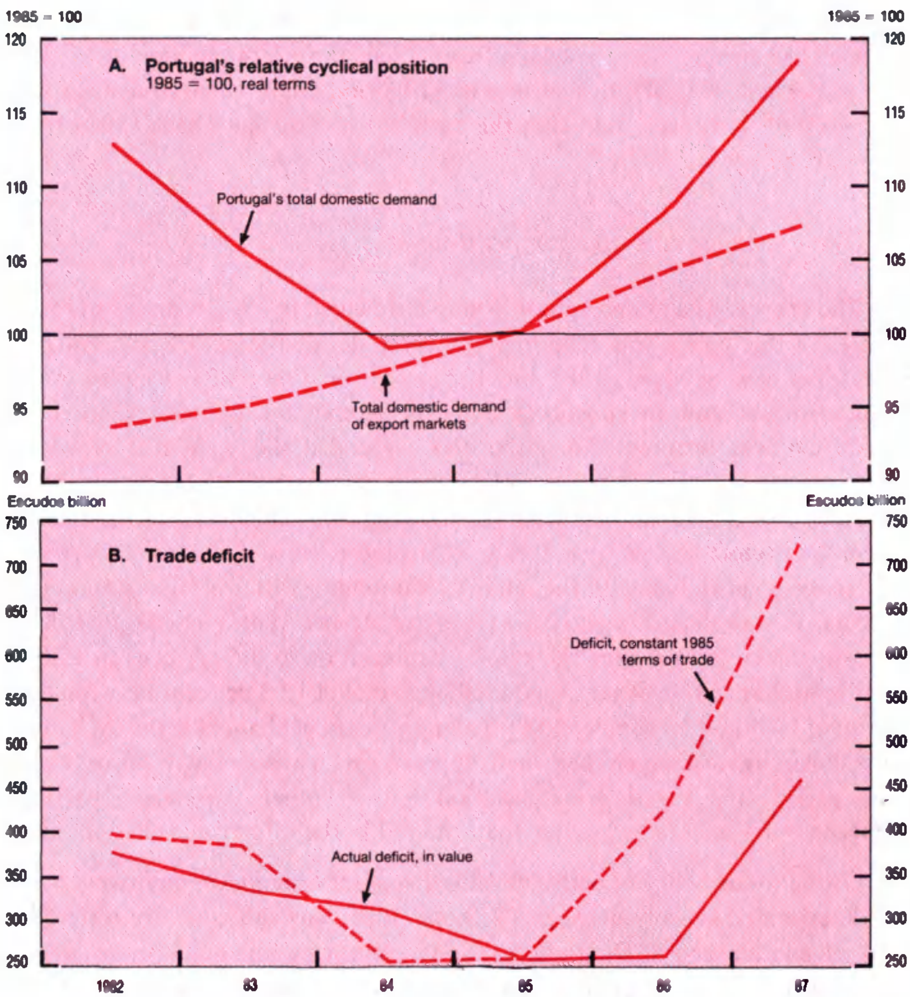
The fall in the unemployment rate since the end of 1986 was due partly to the application of ad hoc measures under the employment policy implemented with the financial aid of the EEC (the European Social Fund). 26 000 young people and long-term unemployed were employed on specially-designed programmes in 1986, and another similar number during the first half of 1987. Approximately 150 000 people took part in training schemes in 1986, compared with less than half that figure a year earlier. In contrast, the funds allocated to preserving jobs in enterprises, and the number of people concerned, fell steeply. In spite of a certain cyclical improvement in the labour market, there are a number of constraints on its future development, which will be examined in Part III.

External relations

Portugal's current account balance has been affected in recent years by three main factors:

- The transition from the period 1983-1985 in which the decline in domestic demand and the policy of maintaining a very competitive exchange rate allowed resources to be switched to the external sector to the period 1986-1987 which was characterised by a strong pick-up in domestic demand and a more neutral exchange rate policy, led to a worsening in the real trade balance;

Diagram 4. **PORTUGAL'S CYCLICAL POSITION AND TRADE BALANCE**



Sources: OECD, *National Accounts* and OECD Secretariat estimates.

- The terms-of-trade improvement in 1985 and especially in 1986 as a result of the fall in oil and commodity prices largely offset the adverse effects of the worsening in the real trade balance;
- Portugal's entry into the EEC boosted trade, especially imports, and increased the inflow of capital transfers.

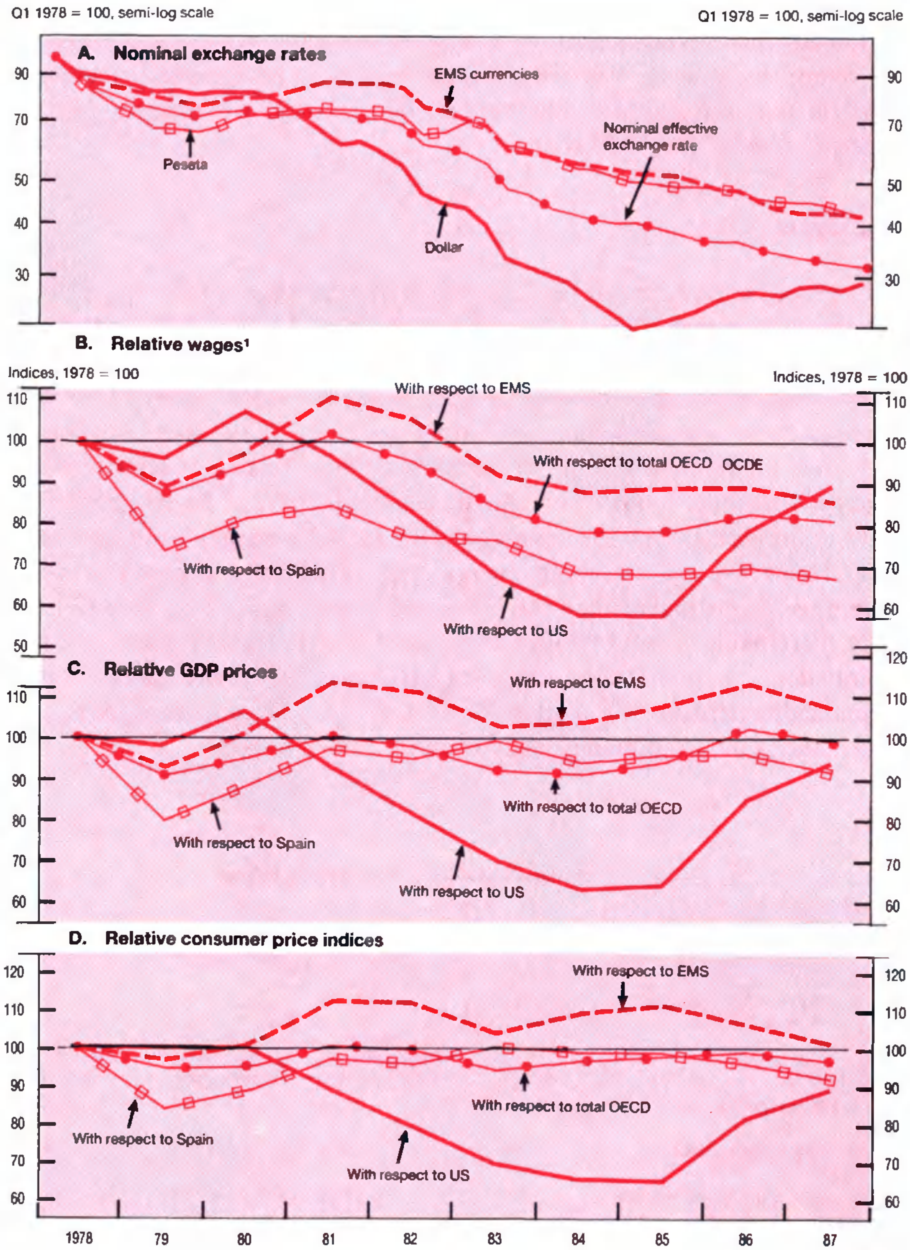
As Diagram 4 shows, the reduction in the trade deficit went hand-in-hand with a narrowing in the demand growth differential between Portugal and its main trading partners between 1982 and 1985. From 1986, the re-emergence of stronger growth of domestic demand in Portugal than that in its export markets again caused the trade deficit to widen and revealed the underlying fragility of the country's current external position. The current account swung from a deficit of $3 245 million in 1982 (more than 13 per cent of GDP) to a surplus of $1 159 million in 1986, equivalent to 4 per cent of GDP. It is estimated that the surplus for 1987 may have fallen to about $650 milllion.

The exchange rate and competitiveness

The crawling-peg depreciation policy introduced in 1977 remains in force[8]. In 1982-1983 this policy was reinforced by three devaluations (9.6 per cent in June 1982, 2 per cent in March 1983 and 12 per cent in June 1983) designed to restore competitiveness and to substitute domestic supply for imports. Once external equilibrium was restored, the authorities suspended the system of crawling-peg devaluation (which was at the rate of 1 per cent a month) between November 1985 and April 1986, with the main aim of curbing inflationary expectations. But the system was reintroduced with a rate of depreciation of 0.9 per cent per month, progressively cut in line with the inflation differential with Portugal's main trading partners. It was thus down to an average of 0.5 per cent a month in 1987. The authorities' aim is to reduce the rate of depreciation to 3.5 per cent in 1988. The effective exchange rate of the escudo fell by a total of 12.3 per cent between the first quarter of 1986 and November 1987. Taking account of changes in the exchange rate of the dollar, against which the escudo appreciated on average by 7 per cent over the same period, the escudo's depreciation against other currencies, particularly European currencies, was greater than the fall in the effective exchange rate[9].

Owing to the policy of active devaluation of the escudo, competitiveness, which had deteriorated sharply between 1979 and 1981, was subsequently restored until 1984, as can be seen in Diagram 5. The improvement was much more marked in respect of the trend of relative wages than of GDP deflators, on account of the major wage adjustment (in 1983 and 1984, hourly earnings in manufacturing fell by 8 and

Diagram 5. **EXCHANGE RATE OF THE ESCUDO AND INDICATORS OF COMPETITIVENESS**



1. Hourly wages in manufacturing.
Source: OECD Secretariat.

6.7 per cent respectively in real terms). Some of the indicators suggest that between 1984 and 1986 competitiveness worsened slightly; it should be noted, however, that wages in common currency terms remained virtually stable relative to those in the EMS countries. Between 1986 and 1987, Portugal's competitiveness as measured by real wages improved by nearly 2 per cent *vis-à-vis* its trading partners and by nearly 6 per cent *vis-à-vis* the EMS countries.

Current balance

In 1986, the trade deficit totalled around $1.6 billion, the same as in 1985 but about one-third of the deficits in 1981 and 1982. The reduction in the trade deficit in 1985 reflected an improvement both in volume and in the terms of trade. But the virtually unchanged trade balance in 1986 was attributable solely to the terms-of-trade gains, as volume deteriorated sharply (see Table 5). Between 1983 (when the stabilization programme was in full force) and 1986, the rate of growth of export volumes fell steadily, probably picking up slightly in 1987 at an estimated 9.5 per cent. Over the period 1983-1987 as a whole, the annual growth rate of manufactured exports (total exports excluding energy and agricultural exports) was about 8 percentage points higher than the estimated growth in markets. However, these market share gains became smaller as the growth of Portugal's domestic demand accelerated relative to that of its export markets. Since 1984, there has been a shift in the commodity structure of Portugal's exports towards consumer goods, up by 6 percentage points, and mainly away from intermediate goods.

Table 5. **Breakdown of changes in the current balance**

Esc. billion

	1982	1985	1987
End-of-period current balance	–254.6	65.5	94.5
End-of-period trade balance	–379.2	–255.3	–456.1
	1979-1982	1982-1985	1985-1987
Change in the current balance[1]	**–252.0**	**320.1**	**29.0**
of which:			
Change in the trade balance	**–250.5**	**123.8**	**–200.9**
of which:			
Ascribable to the terms of trade	–187.8	–125.8	150.9
Ascribable to volume changes	–62.7	249.6	–351.8

1. 1979-1982 shows the cumulative change on the previous year, in 1980, 1981, 1982, etc.

Sources: Banco de Portugal, *Annual Reports;* OECD Secretariat estimates.

The geographical pattern of exports (see Table K in the Statistical Annex) has changed radically in recent years, primarily on account of the entry of Portugal and Spain into the EEC. The share of European countries in Portugal's exports rose from under 75 per cent in 1982-83 to nearly 82 per cent during the first eight months of 1987. Much of this growth was due to Spain, which took between 3.5 and 4 per cent of Portuguese exports at the beginning of the 1980s and over 8 per cent during the first eight months of 1987[10]. The value of exports to the United States followed changes in the dollar exchange rate, falling from 10 per cent of exports in 1985 to 6.5 per cent in 1987.

Portuguese manufacturing exports grew faster than world demand between 1971 and 1973 and since 1977. Constant market-share analysis of changes in foreign

Table 6. **Foreign trade**
Percentage changes

	1983	1984	1985	1986	1987[1]
A. Total exports					
Volume	21.0	14.6	10.6	8.7	9.0
Average values	26.7	30.5	15.5	2.5	8.9
of which: Capital goods					
Volume	6.2	35.2	–10.0	10.7	
Average values	27.9	27.0	14.6	12.2	
Consumer goods					
Volume	15.2	18.8	13.3	12.7	
Average values	30.3	25.9	19.2	9.5	
Intermediate goods					
Volume	22.7	15.4	8.0	3.5	
Average values	25.2	34.8	12.7	–0.5	
Memorandum item:					
Growth in manufacturing markets	5.0	9.5	7.0	10.2	8.3
B. Total imports					
Volume	–7.4	–2.1	3.0	18.7	23.1
Average values	28.9	31.9	11.0	–8.4	6.0
of which: Capital goods					
Volume	–12.1	–23.8	3.4	27.0	
Average values	29.5	26.1	11.5	14.5	
Consumer goods					
Volume	–18.3	–1.2	35.4	36.6	
Average values	26.8	25.4	10.2	16.6	
Intermediate goods					
Volume	–6.6	–1.6	5.2	14.0	
Average values	30.5	35.5	9.7	1.6	
Energy					
Volume	–4.2	6.8	–9.5	20.1	
Average values	26.2	28.7	14.5	–47.7	

1. January-November of 1987 compared with January-November of 1986.
Source: Ministry of Trade and Tourism.

trade (see Annex I) confirms the paramount role played by price competitiveness in trade performance. The main findings are as follows:

- The geographical pattern of trade (i.e. the difference between the growth rate of Portugal's export markets and that of world trade) had a broadly positive effect between 1977 and 1981, but has turned negative since then, due to the slack in Europe;
- The effect of the commodity composition of trade, although positive during some periods (1971-73, 1976-78, 1983-85), has been, on average, virtually neutral;
- The residual (i.e. the difference unexplained by the commodity composition and geographical effects) has been positive since 1977 and is strongly correlated with variations in price competitiveness. But it should be noted that the periods of large competitive devaluations, in particular 1982 and 1983, were also periods during which domestic demand contracted, which certainly allowed supply to be channelled into exports.

Lower domestic demand and the devaluation of the escudo cut the volume of imports substantially in 1983 and 1984, thus helping to restore current payments equilibrium. Since 1986 imports have risen strongly again: with booming domestic demand and Portugal's entry into the EEC, the volume of imports has jumped, by about 20 per cent in 1987. The vigorous revival of domestic demand explains much of the import boom during the past two years. Relative price effects are hard to measure, given the lack of price indicators for both domestically produced and imported manufactures; however, such effects have probably been relatively small[11]. The impact on imports of accession to the EEC was felt in the form of lower duties, an easing of quotas and the simplification of administrative procedures, and also through the direct effects of the opening of the market to consumers. The factors that have influenced the pattern of imports in recent years are reflected in the changes in the commodity composition – with a large increase in imports of consumer and investment goods – and in the geographical structure – with the share of imports from Europe rising from 54 per cent in 1982 to 82 per cent during the first eight months of 1987. This was due to the decline in imports from the OPEC countries (down from 19 to 6 per cent of total imports) as well as in those from the United States.

Dollar movements against the escudo in 1985 and 1986 and lower oil prices in 1986 produced a large improvement in the terms of trade during both years; the difference between the cumulative increases in average import and export values was approximately 15.5 percentage points. In 1986, the unit value of fuel imports in escudos fell by 47.7 per cent, cutting the total value of imports by 8.5 per cent.

Terms-of-trade gains over both years amounted to 5½ per cent of GDP, and more than offset the deterioration in the real trade balance in 1986. The estimates for 1987 on the basis of the results for the first eight months are less favourable: with terms of trade remaining stable, the trade volume deterioration was reflected in an almost doubling of the trade deficit between the first half of 1986 and the first half of 1987.

The surplus on services (excluding investment income) has grown since 1982-1983, and could have reached nearly $1 billion in 1987 (Table 7). This favourable trend is due almost entirely to the growth in net receipts from tourism, which practically tripled in dollar terms between 1983 and 1987 (reaching perhaps $1.6 billion). The annual rate of growth of visits by foreign tourists – which was about 15 per cent between 1982 and 1986 – rose steeply during the first half of 1987 to 35 per cent. Most of these tourists were from Spain (75 per cent on average) while the share of tourists from other European countries remained moderate. On the other hand, visits by Spanish tourists are much shorter than other tourists. Net transfers

Table 7. **Recent trends of the balance of payments**
US$ million

	1982	1985	1986	1987 Jan-Sept	1987 Jan-Sept
Exports (Fob)	4 108	5 676	7 202	5 222	6 638
Imports (Fob)	8 941	7 177	8 674	6 477	9 127
Trade balance	**–4 833**	**–1 504**	**–1 672**	**–1 255**	**–2 489**
Services, net	**–1 092**	**–361**	**–84**	**–38**	**246**
of which: Tourisme	609	901	1 200	888	1 301
Investment income	–1 269	–1 152	–1 014	–722	–652
Transfers, nets	**2 680**	**2 251**	**2 915**	**2 177**	**2 804**
Current balance	**–3 245**	**386**	**1 159**	**884**	**561**
(as % of GDP)	(–13.9)	(1.9)	(4.0)		
Medium- and long-term capital	2 582	1 109	–315	39	678
Short-term capital and unrecorded transactions	786	–523	–1 068	–667	844
Balance on non-monetary transactions	123	972	–224	256	2 083
Changes in the short-term external position of other monetary institutions (– = an increase)	–15	4	199	251	–265
Changes in official liquid reserves (– = an increase)	–108	–976	25	–507	–1 818

Sources : Bank of Portugal.

received, which totalled nearly $3 billion in 1986, up by 30 per cent on the previous year, benefited from an increase in migrants' remittances of about $500 million, and also from EEC transfers of $264 million dollars. It is estimated that these transfers may have amounted to some $400 million in 1987, or 1¼ per cent of GDP. The net investment income deficit (essentially interest payments on external debt) narrowed slightly from $1.27 billion in 1982 to $1 billion in 1986, and may have stabilized at this level in 1987. The reduction of the external debt and the fall in interest rates both played a part.

Capital movements and external debt

Net non-monetary capital outflows in 1986 amounted to around $1.4 billion. External borrowing, which had peaked in 1982 at $3.3 billion, has since come down. As a result of the trend in the current balance, the Portuguese authorities were able to schedule the repayment of part of the external debt, starting from the fourth quarter of 1985. Repayment began with the short-term debt and was then extended, in 1986, to the long-term debt. In the first half of 1987, however, net non-monetary capital inflows totalled $517 million, most of which concerned the short-term debt. Inward

Table 8. **Main indicators of external debt**
Percentages, end-of-period

	1982	1983	1984	1985	1986	1987 June
Net foreign debt/GDP	34.4	49.7	52.6	41.1	29.2	25.3
Gross foreign debt/GDP	58.4	70.4	78.1	80.6	54.9	47.8
Gross short-term foreign debt/total debt	28.2	23.6	20.1	15.7	8.8	10.7
Debt interest/GDP	6.0	5.8	7.0	6.6	4.3	..
Breakdown in percentage:						
Dollar	79.1	78.8	74.1	58.9	47.5	45.1[1]
Yen	2.7	1.7	6.1	12.0	16.7	17.0[1]
Deutschemark	12.9	6.0	4.5	6.6	8.7	9.7[1]
ECU	..	0.7	2.4	6.0	8.9	10.5[1]
Swiss Franc	..	2.1	2.5	4.0	5.0	5.0[1]
Other	..	1.6	10.4	12.5	13.2	12.7[1]
Change in debt in US $ million		882	496	1 708	–399	722
due to :						
Capital movements		1 256	981	362	–1 897	131
Exchange rate changes		–374	–485	1 346	1 498	591

1. October 1987.
Source: Bank of Portugal.

direct investment fell by 25 per cent between 1985 and 1986 to $166 million, but this trend seems to have been reversed during the first half of 1987. Total external debt increased by $1.7 billion in 1985 as a consequence of the exchange rate changes (Table 8) and of the shift in the composition of the debt from the dollar towards currencies which appreciated. Even though the revaluation effect was unfavourable as in the previous year and for the same reasons, the debt was reduced by $400 million in 1986 and the debt/GDP ratio was brought down to 56.2 per cent. A large share of the external debt was renegotiated by the authorities in 1985 and in 1986 to improve its terms. Both the renegotiation of the debt and its reduction helped bring the interest burden from 7 per cent of GDP in 1984 to 4.3 per cent in 1986. Short-term debt was reduced to 10 per cent of total by 1986. Total debt increased again by $722 million in the first half of 1987, essentially under the effect of revaluation.

II. Economic policy and short-term prospects

Following the adjustment phase of 1983 and 1984, the overall thrust of economic policy became expansionary again. This was possible because of the easing of the external constraint due to the effects both of the adjustment and of the improvement in the terms of trade resulting from the decline in oil prices and the dollar. Hence considerable room for fiscal policy manœuvre was imparted by the increased resources obtained from higher taxes on oil products and the introduction of VAT. The authorities were therefore able to stimulate activity, in particular by substantially uprating social benefits and the minimum wage and by reducing the direct tax take. In addition, the State regularised its financial relations with public enterprises. The budget stance for 1988 remains broadly expansionary. Monetary policy was also made more expansionary until the first quarter of 1987 as a result of a steep fall in nominal interest rates and a considerable increase in credit due in part to the lesser effectiveness of the credit control mechanism.

Fiscal policy

The 1986 and 1987 budgets

The 1986 budget provided for a reduction of the deficit as a percentage of GDP. The main priorities were to:

- Hold growth of current expenditure excluding interest payments constant in real terms;
- Raise households' disposable income;
- Increase the share of public investment (infrastructure and construction) as a percentage of GDP;
- Promote private investment, directly by means of tax incentives and indirectly by reducing non-wage labour costs;

- Regularise financial transactions between the State, certain autonomous funds and public enterprises.

In the event, the favourable world economic situation and the buoyancy of domestic activity allowed most of these aims, some of which seemed incompatible, to be achieved and the general government deficit to be brought down by 2.4 points to 9 per cent of GDP[12]. Excluding interest payments, the general government account was thus almost balanced. At the same time, the borrowing requirement of public enterprises was considerably reduced, from 8 per cent of GDP in 1985 to 2 per cent, primarily owing to the slower growth of their operating costs and the partial decontrol of their prices.

The 1987 budget maintained the same stance: further promotion for public investment, support of private consumption through real wage increases and the curbing of price rises. According to the latest estimates the aim of stabilizing the general government deficit as a percentage of GDP was achieved.

However, a number of deliberately expansionary measures were implemented during the period. Expenditure on goods and services rose by 21½ and 16½ per cent in 1986 and 1987 respectively on account of the large pay increases in the civil service and the introduction of early retirement for civil servants, coupled with new recruitment to fill the posts thereby released (see Table 9). The overestimated inflation assumption in the budget was a contributory factor here. In line with the social policy aims pursued since 1985, pensions and unemployment benefits again rose steeply in real terms and their coverage was extended. This expenditure, along with transfers to the EEC (almost 8 per cent of current transfers in 1985), pushed up total current transfers by more than 40 per cent in 1986. However, owing to a fall in the absolute amount of subsidies to enterprises on account of their improved financial position, the government target with respect to current expenditure excluding interest payments was achieved, its share of GDP falling by nearly 1½ points between 1985 and 1987. Public investment also expanded very rapidly in 1986 and 1987. A large share of this consisted of counterpart funds linked to EEC aid for the development of infrastructures and various transport, communications, education, housing projects, water supply and sanitation.

A two-pronged policy was adopted with regard to revenue: lowering certain direct taxes, raising indirect taxes. The "professional" tax brackets were adjusted in 1986 (on the basis of a projected annual rate of inflation of 14 per cent for the year, 2 points higher than the actual rate) and again in 1987 (on the basis of the inflation target) and tax rates were lowered. The rate of social insurance contributions was also cut by 1 point. The fiscal incentives to investment that had been introduced in

Table 9. **Consolidated general government account**

	1985	1986	1987[1]	1987[2]	1988 Forecast
	Percentage change on previous year				
Current revenue	**20.9**	**32.6**	**5.8**	..	**16.0**
of which:					
Direct taxes and social insurance contributions	23.8	23.5	12.7	..	13.3
Indirect taxes	16.6	45.1	5.7	..	13.7
Current expenditure	**16.3**	**29.5**	**6.8**	..	14.6
Expenditure on goods and services	23.7	21.5	16.6	..	16.1
Subsidies to enterprises	–29.3	–1.8	–9.2	..	–13.5
Interest on the public debt	39.3	46.4	1.0	..	17.8
Current transfers	21.8	41.7	5.3	..	16.6
Capital receipts	**18.2**	**63.4**	**7.0**	..	**64.1**
Capital expenditure	**21.9**	**42.2**	**12.9**	..	**32.6**
Investment	18.8	47.0	30.8	..	16.0
Capital transfers	27.0	38.0	7.1	..	30.2
Loans	–5.6	37.5	–22.9	..	95.1
	As a percentage of GDP				
Current revenue	**30.5**	**36.0**	**32.3**	**35.3**	**37.9**
of which:					
Direct taxes and social insurance contributions	15.5	15.6	14.8	14.8	15.5
Indirect taxes	14.1	16.6	15.4	15.4	16.1
Current expenditure	**37.9**	**39.9**	**36.7**	**40.0**	**42.4**
Expenditure on goods and services	14.2	14.1	14.0	14.0	15.0
Subsidies to enterprises	4.9	3.9	2.9	2.9	2.4
Interest on the public debt	7.9	9.4	8.1	8.7	9.4
Current transfers	10.9	12.5	11.6	14.4	15.6
Current balance	**–7.3**	**–3.9**	**–4.4**	**–4.7**	**–4.5**
Capital receipts	**0.7**	**0.9**	**1.2**	**2.0**	**3.1**
Capital expenditure[3]	**5.2**	**6.0**	**5.9**	**6.5**	**7.9**
of which: Investment	2.5	3.0	3.0	3.9	4.2
Overall balance[4]	**–11.8**	**–9.0**	**–9.1**	**–9.1**	**–9.3**

1. Estimates of the 1987 outturn on the same basis as for 1985 and 1986.
2. Estimates of the 1987 outturn based on the new definition which takes greater account of transactions by the autonomous Funds and Services and which is compatible with the 1988 forecast.
3. Including loans.
4. Excluding financial transactions and other adjustments.

Source: Ministry of Finance.

July 1986 reduced revenue from the "industrial" tax from 1987[13]. The resultant shortfall in revenue is estimated at around one third in 1987, equivalent to about 1½ per cent of total current revenue. On the other hand, indirect tax revenue net of subsidies rose by over 60 per cent in 1986, for the following reasons:

- First, the introduction of VAT in 1986 yielded close to Esc 234 billion that year, i.e. 5.4 per cent of GDP, representing a net increase of 40 per cent on the revenue that would have been collected under the previous system of taxation[14]. VAT revenue was higher than forecast because demand itself expanded more rapidly than expected and also perhaps because there was little avoidance of the tax as it had just been introduced;
- The fall in the price of imported oil was offset by an increase in the tax on petroleum products, resulting in an 87 per cent rise in the indirect taxes collected under that heading in 1986 compared with 1985, or twice that budgeted;
- The fall in import prices of subsidised products (primarily food imports) was not passed on to the consumer, making possible a reduction in the absolute amount of subsidies to enterprises between 1985 and 1987.

But in 1987 indirect tax revenue grew more slowly than budgeted.

The package of tax measures broadened the tax base by introducing a general tax on the consumption of goods and services and simultaneously reducing income tax and social insurance contributions, whose marginal rates were among the highest in Europe (see Diagram 9 in the 1986 *Economic Survey*). The package thus points in the right direction so far as the tax system is concerned and represents the first step towards the reform currently before Parliament and which should be applied as from 1989.

The interest burden rose from an average of 6½ per cent of GDP in 1983-84 to nearly 9 per cent in 1986-87. This increase is ascribable not only to the build-up of past deficits, but to a number of special factors. First, the stock of debt began to increase in 1986 as the result of a number of exceptional financial transactions:

- Institutional changes were introduced as a result of which some public entities were closed down in 1986 and 1987[15], with the State taking over the debt that they had accumulated. Previously, the funds passing through these entities had eluded budgetary control by the State and the actual size of the general government borrowing requirement was partially obscured by delays in payments and deficits that continued to accumulate;
- The State and also some autonomous Funds regularised the arrears that they had accumulated in recent years *vis-à-vis* public enterprises and banks[16].

This caused the general government deficit to widen, but against this it helped to improve the financial position of public enterprises;

Second, changes were introduced in the system of debt management:

- The public deficit is being funded by increased borrowing on the capital market and by Treasury bill issues, i.e. at market interest rates, while funding from the Central Bank, at minimal rates, is declining.
- The progressive reduction in the external debt will probably also affect interest payments, but only from 1988 onwards.

This may have a favourable impact on future debt management since, by reducing the size of the external component, it limits the impact of exchange rate changes on the debt's real value. It does, however, add to the interest burden.

These transactions taken together resulted in an increase in the stock of public debt of close to Esc 400 billion between 1985 and 1987. As the implicit interest rate on the debt fell only moderately over the period, the Ministry of Finance estimates the interest burden arising from these transactions at about 1½ per cent of GDP in 1986 and nearly 2 per cent in 1987 and 1988.

To measure the overall impact of fiscal policy, it is necessary to isolate the structural component of the deficit, by excluding the built-in-stabilizers component, and to adjust for inflation. Account must also be taken of the exceptional transactions concerning the regularisation of arrears, which inflated some items of the general government account without actually involving new expenditure (or revenue). To make this admittedly very rough adjustment, the additional interest payments incurred were excluded from the general government borrowing requirement in 1986 and 1987. Thus "adjusted", the deficit fell from 13½ per cent of GDP in 1984 to 7½ per cent in 1987. Over half of this improvement was ascribable to cyclical developments. The remainder, the "structural" deficit, reflecting primarily the authorities' discretionary action, narrowed in 1985 and 1986, suggesting a deliberately restrictive policy stance (see Table 10). However, when the outturn is adjusted for the effects of inflation on the real value of the debt, this interpretation needs to be modified. Fiscal policy would then have been neutral only in 1986, and over the period 1985-87 as a whole its impact was clearly expansionary. Note that the reduction in the "structural" deficit in 1985 and 1986 does not signify a durable improvement in public finance, since it was partly due to one-off factors. For example, it is unlikely that revenue from the tax on petroleum products will again be increased so substantially. Also, these computations exclude the interest payments resulting from the improvement of budgetary transparency under way, although they will continue to have an adverse effect on the deficit in years to come.

Table 10. **Cyclical and structural changes in the general government balance**[1]

As a percentage of GDP

	1985	1986	1987
Change in the actual balance	-2.3	-2.8	+0.1
Change in the balance, excluding special factors	-2.3	-3.7	-0.6
of which:			
Change related to built-in stabilizers	-0.9	-1.3	-1.7
Change in the structural balance	-1.4	-2.4	+1.1
Change in the structural balance, adjusted for the effects of inflation on public debt	+0.9	-0.3	+1.6

1. The – sign indicates a reduction in the deficit, and thus a restrictive effect; the + sign indicates an expansionary effect. The first line corresponds to the year-on-year changes in the borrowing requirement shown in Table 9. For further details, see the Technical Annex.

Source: OECD Secretariat estimates.

The budget for 1988

The 1988 budget is again expansionary. Based on forecast real GDP growth of about 4 per cent and a 6 per cent rise in consumer prices, it projects that the general government deficit will attain 9¼ per cent of GDP, i.e. ¼ point higher than the estimated outturn for 1987 (see Table 9) and that the balance excluding interest payments will be in equilibrium. With the deficit of the public enterprises set to remain at 1¾ per cent of GDP, the borrowing requirement of the public sector in the broad sense would be close to 11 per cent, compared with 19 per cent in 1985. The slight worsening in the general government account is partly ascribable to the emergence of a deficit on the social security account (of 0.6 per cent of GDP) following on from a surplus, as a result of the extension of social cover that has been embarked upon in the past two years. This is reflected in an increase of nearly 16 per cent in current transfers by general government. Expenditure on goods and services should also rise at this rate, on account of the recent introduction of early retirement for civil servants, the impact of wage drift and the rise in the number of public sector jobs, especially in the education system. It seems that the growth in expenditure on goods and services (16 per cent of total general government expenditure) will be the most difficult to keep under control. Interest payments should rise further as a percentage of GDP, reflecting more costly but sounder debt management and the effects of measures improving budgetary transparency[17]. All told, taking account of the fall in the absolute level of subsidies, the share of current expenditure is set to rise by 2 percentage points of GDP. Against this, there will probably be a further increase in tax revenue (also of 2 points) as a result of the rise in the standard rate of VAT and the broadening of its base, higher stamp duty and heavier taxes on the interest earned on migrants' deposits[18].

The developments in the general government account projected for 1988 show the scale of the difficulties with which the authorities still have to contend. Admittedly, the broadening of the tax base as a result of the introduction of VAT and the implementation of a new incomes policy to slow wage increases in line with prices, are favourable features. The transfer of part of the autonomous Funds' transactions to the central government budget and the improved financial position of the majority of public enterprises are making it possible to keep a tighter rein on spending. On the other hand, in the light of the outturns in recent years, a large proportion of current expenditure is likely to continue to grow. First, it is still as difficult to stabilize the number of public sector jobs at the level desired. Second, the increase in social transfers reflects the government's declared social policy objectives, but these are hard to reconcile with the balancing of public finance. Lastly, the transfers to the productive sector required to back up EEC funding increase the State's involvement in economic activity. The budget objectives for 1988 seem ambitious insofar as, unlike what happened in recent years, the economic environment is likely to be unfavourable and the exceptional circumstances will have disappeared. Furthermore, the foreseeable slow-down in domestic growth and the persistence of factors conducive to a rapid rise in expenditure will probably make it difficult to contain the deficit.

Monetary policy

Since the mid-1970s, monetary policy in Portugal has centred on quantitative credit controls, with the main interest rates being set administratively, and on the crawling-peg devaluation of the Escudo coupled with controls on foreign borrowing. Overall limits to the expansion of bank lending to the productive sector are fixed by the Bank of Portugal on the basis of a "forecast" for L- (the broad money aggregate comprising money, quasi-money, and Treasury bills in the hands of residents), the public sector borrowing requirement and likely capital inflows (Table 11).

Developments in 1986

A tight credit squeeze was applied from mid-1983; however, administered interest rates remained low in real terms until recently (Diagram 6). From mid-1985,

Table 11. **Credit to the economy**[1]

Esc. billion; percentage changes in brackets

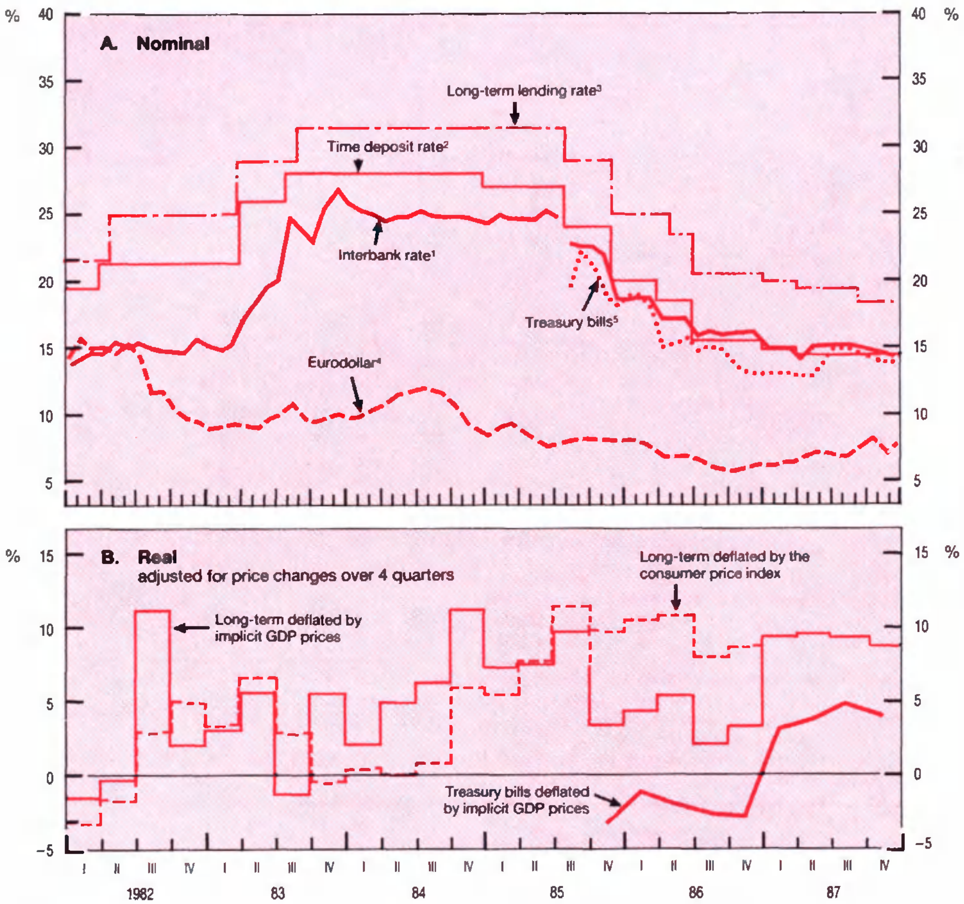
	1984	1985	1986	1987[2]
Banking system's external liquid assets	280.3	123.5	–78.5	239.6
Foreign credit	**128.2**	**173.2**	**–228.6**	**121.8**
	(16.6)	**(19.3)**	**(–21.4)**	**(7.8)**
Public sector	146.7	178.5	–233.6	86.2
General government	77.1	76.0	–7.8	130.4
Public enterprises	69.6	102.5	–225.8	–44.2
Private sector[3]	–18.5	–5.3	5.0	35.6
Domestic credit	**676.7**	**715.1**	**943.9**	**598.8**
	(23.6)	**(20.2)**	**(22.2)**	**(14.7)**
Public sector	408.9	433.8	665.0	346.9
General government	237.5	297.2	414.5	370.2
Public enterprises	171.4	136.6	250.5	–23.3
Private sector[3]	267.8	281.3	278.9	251.9
Total	**804.9**	**888.3**	**715.3**	**720.6**
	(22.2)	**(20.0)**	**(13.4)**	**(13.7)**
Memorandum items:				
Percentage share of private sector in total credit	31.0	31.1	39.7	39.9
Current balance	–85.6	59.9	169.0	91.5[4]

1. Adjusted for some payments or arrears and similar operations.
2. January-November: percentage changes are November 1987/November 1986.
3. Including non-monetary financial institutions.
4. OECD Secretariat estimates for the whole year.

Sources: Banco de Portugal, *Annual Report 1986 ; and Sintese Mensal de Conjuntura*, 1987 ; data provided by national authorities; OECD Secretariat.

monetary policy became expansionary and liquidity grew strongly. In 1986, the broad aggregate L- rose 25.9 per cent, against an initial target of 18.5 per cent. Growth was stronger for the narrower aggregate M1-, up by 35.1 per cent, as against an initial projection of 20.4 per cent (Table 12). With nominal GDP growing by 18 per cent at factor costs, there was a sharp decline in income velocity. There were two main reasons for this "overshooting". First, the current account registered a surplus of $1 billion, compared with an expected deficit of $0.5 billion – largely because of the drop in oil prices. Net residual inflows were also twice as large as expected. This trend was not entirely compensated by the reduction in credit to the economy. For one thing, the public sector borrowing requirement was as high as initially forecast since the unexpected net indirect tax revenue generated by the fall in import prices was

Diagram 6. **INTEREST RATE DEVELOPMENTS**



1. Average 60-90 day rate until July 1985; 31-90 day rate thereafter.
2. Six months to one year.
3. Over two years, index five years.
4. 3-months rate.
5. 182 days.

Source: Banco de Portugal, *Quarterly bulletin.*

offset by additional spending. Also, the authorities, anxious not to check the pick-up in investment, deemed it unwise to reduce the credit ceiling applying to the productive sector. Consequently, credit growth to private non-financial enterprises and households was much higher than envisaged: its share in total credit for the economy (foreign credit and domestic bank lending) rose to nearly 40 per cent, from 31.1 per cent in 1985 (Table 11).

Table 12. **Monetary aggregates**

Percentage changes on same period of previous year, end-of-period figures

	Esc. billion 31/12/86	1984	1985	1986	1987			
		December	December	December	March	June	September	November
M1-	1 305.7	15.1	28.4	35.1	35.9	27.0	23.7	21.1
Time deposits	2 226.9	28.5	22.0	10.7	9.1	10.5	..	..
L-	3 961.2	24.6	29.0	25.9	25.7	23.5	21.7	20.4
Migrants' deposits	1 248.0	36.1	25.6	10.9	8.1	3.4	3.7	3.5
L[1]	5 250.4	27.6	27.6	22.2	21.3	18.8	17.4	16.2

1. L is identical to the definition of M2 + up to the third quarter of 1985.
Source: Bank of Portugal.

Table 13. **Composition of credit to the economy**[1]

Percentage changes on same period of previous year

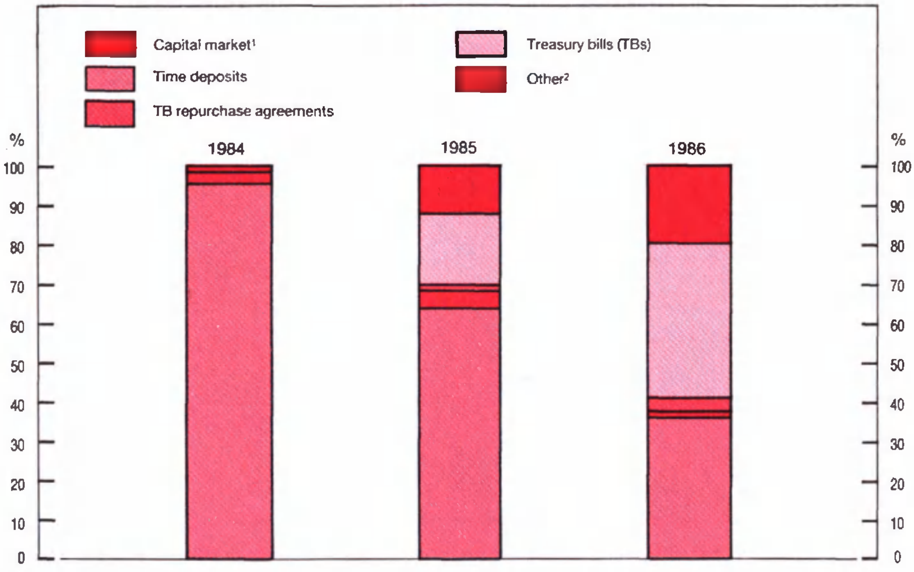
	Esc. billion December 1986	1985		1986		1987	
		June	December	June	December	June	November
Total credit	5 871.4	21.4	20.0	14.8	13.4	14.2	13.7
Domestic	5 030.0	19.6	20.2	22.4	22.2	18.7	14.7
Foreign	841.4	28.1	19.3	–11.1	–21.4	–7.4	7.8
Public sector	1 987.8	28.5	27.1	21.1	23.2	28.0	25.8
Domestic	1 588.7	24.0	28.4	27.8	30.9	30.6	26.4
Foreign	399.1	43.3	23.0	2.4	–1.9	18.9	23.4
Non-financial enterprises and households	3 785.1	18.6	17.0	11.9	8.4	6.9	7.3
Domestic	3 352.6	18.1	16.8	20.0	18.1	13.4	9.4
Foreign	432.5	20.5	17.8	–19.0	–33.8	–29.5	–7.6
of which:							
Public enterprises	1 474.7	20.3	19.7	7.5	1.7	–0.9	–2.1
Domestic	1 074.5	17.6	19.9	33.2	30.4	16.7	3.0
Foreign	400.2	23.4	19.6	–20.1	–36.1	–32.4	–14.4
Other enterprises and households	2 310.4	17.5	15.1	14.9	13.2	12.0	13.2
Domestic	2 278.1	18.3	15.6	15.2	13.1	12.0	12.2
Foreign	32.3	–15.2	–12.3	0.0	16.2	11.7	63.5

1. Adjusted for some payments of arrears and similar operations.
Source: Bank of Portugal.

The sharp decline in the income velocity of money in 1986 reflected lower inflationary expectations and lower nominal interest rates[19]. According to the Bank of Portugal, greater activity in capital markets may have increased the public's demand for cash balances, so contributing to the slowdown in velocity. The main effect of capital market development seems, however, to have been the substitution of quasi-monetary assets. It is estimated that purchases of stocks, bonds and other financial instruments, virtually non-existent in 1984, comprised about 20 per cent of the change in non-strictly monetary financial assets of the non-financial resident sector (Diagram 7). In fact, the increasing range and sophistication of financial instruments available to the public is likely to add to the instability of an aggregate such as L-, which includes only some of the non-liquid alternatives available to the public.

Nominal interest rates were sharply reduced. Lending and borrowing rates were cut by 11.5 points from mid-1985 to mid-1986. While these reductions tended to go in step with the decrease in consumer price inflation – so that real *ex-post* interest rates have not been substantially reduced – there was a large divergence between the evolution of consumer prices and that of the implicit GDP deflator, a consequence of the sharp terms of trade gains for Portugal during 1986. Hence, the underlying rate of

Diagram 7. **COMPOSITION OF CHANGES IN (NON-MONETARY) FINANCIAL ASSETS OF THE RESIDENT NON-FINANCIAL SECTOR**



1. Shares, bonds, etc.
2. Medium-term notes, guaranteed-price securities, etc.

Source: Banco de Portugal, *Annual report 1986*, 1987.

inflation for borrowers and lenders (in terms of domestic costs) was higher than observed CPI inflation. Using the GDP deflator gives a marked decline in real interest rates in 1986 (Diagram 6).

Developments in 1987

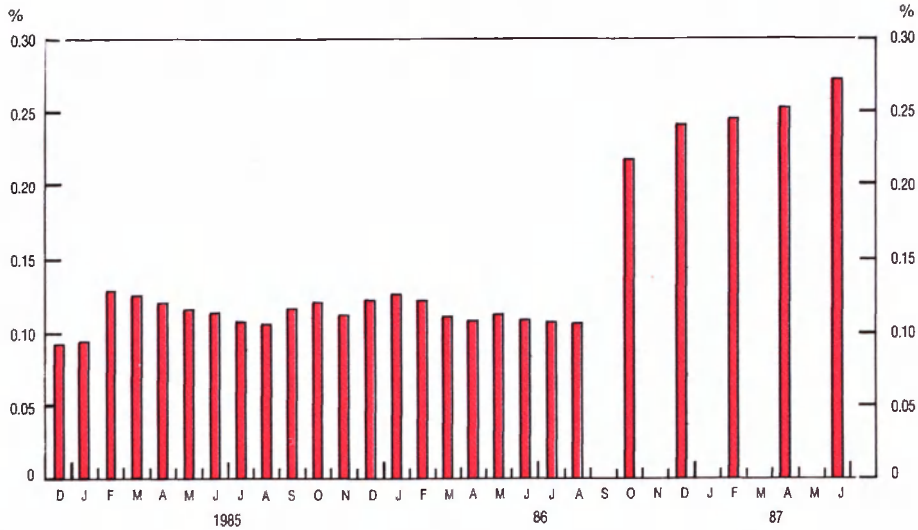
The expansionary stance of policy continued into the first quarter of 1987, with some deceleration of monetary aggregates after April becoming more marked in the second half of the year as credit ceilings were progressively tightened. On a year-to-year basis, growth of M1- fell from a peak of 36 per cent in January to 21.1 per cent in November; total liquidity L- also decelerated, somewhat less sharply, to 20.4 per cent, down from about 26 per cent in the first quarter of the year. While these rates are still above the underlying growth of nominal income, they seem to be broadly consistent with the desired degree of restraint on the growth of the monetary aggregates.

Developments in 1986 and 1987 suggest that the mechanism of control based on credit ceilings has become less effective. First, the curbs on domestic credit and the favourable exchange rate expectations regarding the Escudo have resulted in large and unforeseen net capital inflows. Second, development of the practice of direct central government financing of public enterprises (through Treasury operations) and the public sector's servicing of the foreign debt of a number of public bodies and enterprises that have been wound up, are complicating monetary management.

Fewer problems are posed – at present – by non-bank financing of private enterprises, but the development of capital markets and integration within the EEC may eventually allow private enterprises too to circumvent credit controls. Capital markets still remain a limited (though rapidly increasing) source of financing for the non-government sector: funds raised on the markets still contribute only a negligible amount to total financial flows to the private sector. For the first time since 1983, 29 corporations raised funds on the stock market, totalling Esc. 24.8 billion.

A third difficulty was the growth of credit exempt from ceilings (see Diagram 8). The difficulties created by this situation prompted the authorities to do away with any remaining exemptions applying to certain elements. A case in point was financing for medium-term productive investment (over five years) which had been exempted from the quantitative ceilings since October 1986; in February 1987, the process was replaced by a system redistributing credit allocations among banks on the basis of the relevance of investment projects to the authorities' medium-term strategy. However, the carry-over effect of prior commitment has prevented a quick reabsorption of credit outside the ceiling.

Diagram 8. **CREDIT NOT SUBJECT TO CEILINGS**[1]

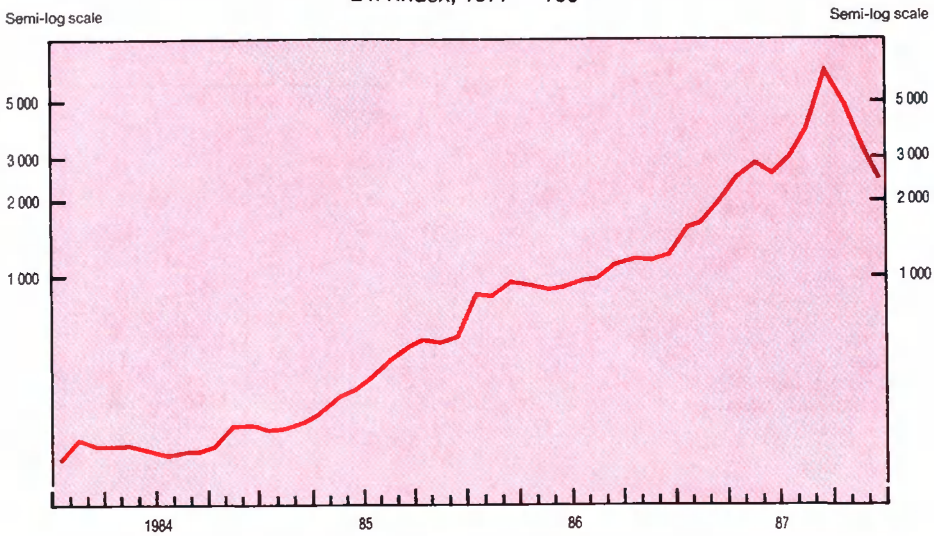


1. As a percentage of credit subject to ceilings; from October 1986 onwards these are set every two months.
Source: Banco de Portugal, *Annual report 1986*, 1987.

These problems underline the need – recognised by the authorities – to move to a more market-based operation of monetary policy where interest rates would play a greater role. However, interest rate reductions during Autumn 1987 may not have been consistent with this new orientation, nor with the desired restriction of credit growth. When rates were lowered in October, the main consideration was the progressive reduction in inflation; however, this move was at odds with the tightening of credit conditions and the general edging-up of interest rates in international markets prior to the stock market crisis. The medium-term issues raised by moving to a more market-oriented approach to monetary policy are reviewed in Part III.

Finally, financial markets were disturbed by the extraordinary pace at which Lisbon's stock market developed. By end-October, some 90 companies were listed with a total of 103 million shares (compared with 40 companies and 37 million shares one year earlier). With prices booming, total market capitalisation increased by a factor of about ten (Diagram 9). However, market operations were destabilized by the perverse workings of administrative rules which limited market trading[20]. Prices may thus have been artificially inflated. The rule preventing a change in prices of more than 5 per cent in any one day was abolished in November and share prices were

Diagram 9. **SHARE PRICES**
BTA index, 1977 = 100



Source: Banco Totto e Açores, *Informacão financiera.*

allowed to find their own level. A 15 per cent rule has recently been introduced. There is a need to better regulate the market and prevent trading abuses if investor confidence is to be sustained and a widely-held stock market develop.

Prospects for 1988 and 1989

Economic developments in Portugal in 1988 and 1989 will be influenced by two main forces pulling in opposite directions: the expected slowdown in foreign demand – since the rate of market growth will probably fall from nearly 8 per cent in 1987 to 7 per cent in 1988 and 5½ per cent the following year – and the continued expansionary fiscal policy stance. The restrictiveness of monetary policy should be limited by the general government borrowing requirement. The growth target for the broad monetary aggregate L- has been set at 10½ per cent for the period December 1987-December 1988, equivalent to an annual average of 12½ per cent, which is higher than the official forecast for nominal GDP growth (10 per cent). This target was coupled in the Budget document with projected growth of total credit of

Table 14. **Short-term prospects**

	1986	1987	1988	1989
	Current values Esc. billion	Percentage changes		
Demand and output volumes (at 1977 prices)				
Private consumption	2 849.2	7.3	4¾	3½
Public consumption	609.2	2.0	3	1¾
Gross fixed investment	936.1	19.0	9½	7½
Final domestic demand	4 394.5	8.9	5½	4¼
Stockbuilding[1,2]	50.5[2]	1.2	½	¾
Totam domestic demand	4 445.0	9.9	6	4¾
Exports	1 457.9	10.8	6½	5¼
Imports	1 569.5	24.0	11	8¼
Foreign balance[1]	–111.6[2]	–5.1	–2½	–2
GDP at market prices	**4 333.5**	**5.0**	**4**	**3¼**
Inflation				
GDP deflator	–	11.7	6¾	5¾
Private consumption deflator	–	9.5	6½	5¾
	Number in thousands			
Labour market				
Total employment	4 080	1.8	1	1
Unemployment rate	382	7.8	7½	7¼
		$ billion		
Balance of payments				
Trade balance		–3.2	–4.5	–5.3
Current balance		0.7	–0.1	–0.8
(as a percentage of GDP)		(1.8)	(–¼)	(–1¾)

1. Contribution to GDP growth.
2. Including statistical discrepancy.
Source: OECD Secretariat.

7¼ per cent, but of 13 per cent for general government, and of only 4¼ per cent for the private sector and 2 per cent for public enterprises. The burden of monetary aggregate control will continue to fall solely on the productive sector. The authorities have announced a reduction in the rate of crawling-peg devaluation of the escudo to 3.5 per cent during the year, which will ease the pressure on import prices but could impair competitiveness.

Insofar as the exceptionally rapid growth of total domestic demand for the past two years was largely due to lost ground being made up and to a very favourable external environment, it is probable that it will slow down. However, the scale and speed of the adjustment are highly uncertain. Households' real disposable income could rise by nearly 2 per cent in 1988 which, in view of the probable continued decline in the savings ratio, would once again boost growth of private consumption by over 4½ per cent. Stimulated by tax incentives and EEC transfers, investment should continue to increase at a rate of over 9 per cent in 1988. With the projected slowdown in the growth of external markets, exports could expand by 6½ per cent. It has been assumed that, after the initial shock caused by entry into the EEC has worn off, the elasticity of imports with respect to overall demand will return to more customary levels. The external balance's contribution, albeit still negative, would thus be reduced so that GDP should grow by 4 per cent in 1988 and a little over 3 per cent in 1989. The inflation target (6 per cent for 1988) on which incomes policy is based could allow the slowdown in nominal wage increases to take hold. With the disappearance of external sources of disinflation, the continuing strong pressures of domestic demand will act as a brake on price deceleration. By continuing the present policy of decontrolling prices and cutting subsidies, the authorities will have less scope for acting directly on the price level. This being so, the rate of increase in the private consumption deflator could again average close to 6½ per cent in 1988, falling to under 6 per cent in 1989[21]. However, with policy continuing expansionary, there is still a risk of a surge in wages and prices. The projected deterioration in the real foreign balance will widen the trade deficit, with no offsetting terms-of-trade gains. All told, the current account balance is likely to post a deficit amounting, probably, to some 3½ per cent of GDP in 1989.

III. Medium-term strategy and problems

Medium-term strategy and the PCEDED

Economic policy in Portugal since the early 1970s, by turns expansionary and restrictive, accentuated the fluctuations in the economy. The authorities' resolve to promote rapid growth of domestic demand, in order both to bring up to date its infrastructures which have lagged well behind and to boost household consumption were hampered by a major external constraint. The government was thus obliged in 1977-1978 and 1983-1984 to embark on vigorous short-term corrective programmes which achieved or helped to achieve a return to current balance-of-payments equilibrium by reducing household incomes and reining back domestic demand growth. When equilibrium was restored on current account, in 1979 and 1985, the thrust of economic policy again become expansionary.

Since 1973, except for the periods when the adjustment programmes were in force, demand in Portugal has consistently run ahead of national income. This situation, ascribable to a number of factors (the disruption of production in the wake of the revolution, the return of the former colonial settlers, the oil shocks), has had the effect of increasing the foreign debt and eroding reserves. The net foreign debt, which was virtually nil in 1976, was equivalent in 1984 to 24.5 per cent of GDP, reflecting major domestic imbalances, particularly in the public sector broadly defined (general government and public enterprises) whose spending has persistently outstripped receipts since the mid-1970s, resulting in an enlarged borrowing requirement. While, admittedly, mounting inflation did help to reduce central government and public enterprises indebtedness in real terms, this adjustment only applied to domestic debt, and the slowdown in inflation since 1984 is now having the opposite effect.

Even following the 1978-1979 adjustment period, private saving was still insufficient to meet the public sector's borrowing requirement and foreign borrowing represented some 2 per cent of GDP (Table 15). The position worsened steadily up to 1982 when, despite the expansion in household saving, borrowing abroad totalled

Table 15. **Saving and borrowing requirement**
As a percentage of GDP

	1979	1982	1984	1986	1990 PCEDED
General government					
Gross saving	-1.3	-5.2	-8.1	-4.4	-0.2
Gross investment	3.8	3.4	2.6	2.4	3.3
Net capital transfers to other sectors	2.8	3.1	2.7	2.5	2.2
Borrowing requirements	-7.9	-11.8	-13.5	-9.0	-5.7
Households and enterprises					
Gross saving	29	28.1	28.2	30.7	26.8
of which: Households	28	28.8	27.4	25.4	
Net capital transfers received	2.8	3.1	2.7	2.5	2.2
Gross investment	26	30.5	20.5	20.2	24.4
Lending capacity (+) or borrowing requirements (–)	6.0	0.7	10.4	13.1	4.6
of which: non-financial public enterprises	-6.4	-11.4	-8.1	-2.1	..
Foreign					
Saving	1.9	11.1	3.1	-4.1	1.1

Sources: Ministry of Finance; Bank of Portugal; PCEDED; OECD Secretariat estimates.

11 per cent of GDP. In 1986, following the second adjustment programme and with the help of a sharp improvement in the terms of trade, the overall public sector borrowing requirement fell quite substantially as a proportion of GDP. A surplus equivalent to 3 per cent of GDP was achieved on domestic saving, though this was not as much as the gains accruing from the terms of trade improvement. The need for Portugal to maintain a high rate of investment growth over the next few years in order to boost employment, means that domestic saving must be sufficient to avoid any recurrence of the external constraint and increased borrowing from abroad. The authorities' strategy for achieving this outcome in the medium term is to trim excess general government demand relative to resources and to the nation's lending capacity. The following paragraphs appraise the broad lines of the Portuguese government's medium-term strategy and then go on to focus more particularly on the problems posed by the public sector and on selected aspects of the financing of the economy.

The programme

The Portuguese government's medium-term economic strategy is set out in the "Programme for the structural adjustment of the foreign deficit and unemployment"

(PCEDED)[22]. This programme, adopted by the Council of Ministers in March 1987, is not intended to replace the annual Plan which is a legislative document. It is one of the instruments of the government's "controlled development strategy", intended to promote economic and hence employment growth and to bring the standard of living closer in line with that of the other European countries. Also, susceptibility to external shocks is to be reduced by upgrading and developing such sectors as energy and agriculture. The programme is to be implemented in two stages: in the first, covering the period 1987-1990, the strategy will be brought into play; in the second, 1991-1994, the main imbalances in the economy should be rectified as a result of the economic policies applied in stage one. Every year during stage one, the government will update the programme in the light of performance so far and any changes in the international environment.

Recognising that the Portuguese economy was faced at the beginning of 1987 with three major structural macroeconomic problems – a public sector deficit, a current payments deficit and unemployment (the authorities considered that the problem of inflation would be resolved by 1988) – the programme set the main macroeconomic targets. It adopted a relatively high growth target for the economy as a whole, dependent on a major investment drive (Table 16). This investment effort would lead to rising annual rates of productivity and help rectify the imbalance between total demand for goods and services and domestic output. On the growth targets set, 32 500 new jobs ought to be created every year from 1987 to 1990, i.e. 3 per cent of the total labour force. After 1988, the rate of inflation in Portugal is projected to be on a par with the EC average, which would facilitate membership of the European Monetary System. Reducing the public deficit to close to 5 per cent of GDP by 1990 is considered a prime objective, since only by so doing can savings be reallocated to finance productive investment. With respect to foreign payments, the programme is designed to restore equilibrium on current account by 1993, with the trade deficit set to widen until 1991 under the effect of the rapid growth of investment.

While recognising the essential role that the private sector will have to play in economic development, the PCEDED assigns special responsibility to central government in implementing this strategy. This will mainly involve pursuing a "stable, consistent and transparent" economic policy that will engender confidence; strengthening the social security system so as to mitigate the effects of restructuring; upgrading civil service infrastructures and improving efficiency; and introducing incentives for domestic and foreign investment. Despite this policy of active intervention, the government has no intention of telling investors in which sectors

Table 16. **Summary of PCEDED projections**
Percentage changes, in volume

	1987-1990[1] Annual average	1991-1994 Annual average	*Memorandum item:* 1980-1986	Outturn 1987	1988-1990[2]
Private consumption	2.9	3.3	1.7	7.3	1.5
Public consumption	1.0	1.0	3.0	2.0	0.7
Gross fixed investment	7.9	5.3	-0.8	19.0	4.4
Final domestic demand	**3.8**	**3.4**	**1.3**	**8.9**	**2.1**
Exports of goods and services	5.4	5.6	7.9	10.8	3.7
Total demand	4.2	4.1	2.7	10.1	2.3
Imports of goods and services	5.8	3.6	3.9	24.0	0.3
GDP	**3.7**	**4.3**	**2.0**	**5.0**	**3.3**
Private consumption deflator	5.6	4.0	21.0	9.5	4.3
Export prices	7.0	5.5	18.1	9.5	6.2
Import prices	8.4	5.5	18.0	6.5	9.0
Real wages	2	2.8	-1.3	2.5	1.8
Cumulative current balance (US$ million)	80	-440	-6 528		
Current balance/GDP (end-of-period)	-0.8	0.3	4.0		
Gross foreign debt/GDP (end-of-period)	35.2	26.2	56.2		
General government borrowing requirement/GDP (end-of-period)	-5.6		-9.0		
of which: Excluding interest	-0.6		-0.4		

1. The 1987 outturn used in the scenario was projected at end-1986 and differs appreciably from the actual outturn.
2. This column shows the growth rates that would be required during the three years 1988-1990 for the PCEDED projections to be realised, given the actual outturn for 1987 and all other things remaining equal.
Source: PCEDED.

they should invest. Medium-term economic policy will apply to four main areas: the labour market, investment, the public sector and money and finance.

The labour market

The employment policy prescribed in the PCEDED is three-pronged:

- To promote job creation by way of high rates of investment and GDP growth, more moderate growth of real wages which must remain under that of productivity, and lower non-wage labour costs;
- To curb the rising supply of labour by raising the school-leaving age to 15 (though the effect of this measure will only be felt in 1995), encouraging

voluntary early retirement under certain conditions in the civil service[23] and ailing enterprises, and introducing greater flexibility in the number of hours worked;

- To launch regional development, training and industrial restructuring programmes financed jointly with the EEC.

These measures could help bring down the rate of unemployment to 5½ per cent in 1992, which will certainly entail some major changes in the way the labour market operates over the coming years. In the first place, labour supply will inevitably be constrained by less labour-force flexibility than in recent years. Portugal has a relatively young population. The cohort due to come onto the labour market in the next few years is among the largest in Europe: 23 per cent of the population is under the age of 15, as it is in Spain, Greece and, to a lesser extent, France. In several other European countries the ratio is between 17 and 19 per cent. The participation rate of the 15-24 year old age group – 50 per cent – is also one of the highest in Europe. Given growth prospects in neighbouring countries, a reversal of recent migratory trends seems unlikely and the balance looks set to remain slightly positive over the next few years. However, it is worth noting that workers returning to Portugal tend to be fairly skilled and have substantial savings, which enhances their prospects of finding work, particularly as one-man businesses. In the past, the fluctuating size of the farm population tended to depress participation rates when times were hard. Employment in farming has even increased. As regards the future, EEC membership makes it imperative to modernise the agricultural sector and productivity may be expected to grow more briskly.

The forecast of a steady rise in employment at a rate of almost 1 per cent a year seems ambitious. Civil service job creation can hardly increase significantly in view of present staffing levels and the need to curb budget expenditure. In agriculture, as noted above, employment is expected to decrease in the medium term. Hence, the projection implies an expansion in employment in the non-farm productive sector of over 1¼ per cent a year, which would seem difficult to achieve. The restructuring now in progress in industry, as is evidenced by recent trends in employment in that sector, could be given added impetus by EEC membership and will inevitably depend on investment that boosts productivity. Thus, quite reasonably, the PCEDED forecasts that the elasticity of employment in relation to output will be lower than in recent years (¼ over the period against around ¾ over the past five years).

The new method of wage-setting (see Part I) is appropriate in a period of slowing inflation, since it is lessening the rigidity of nominal wage trends and has set in motion a system of labour/management consultations that had never before existed in

Portugal. However, it will inevitably limit any decline in real wages which in the past was the main factor of adjustment. Reference to productivity in wage bargaining is a new and useful development. There nevertheless remains the problem of differentiating between enterprises and between sectors in determining wage trends; differential wage increases would be desirable. The partial catch-up clause to be brought into effect at end-1988, if effective inflation is higher than targeted, could temporarily introduce an element of rigidity into the wage-setting process. Last, the increase in the national minimum wage and its payment in full to 18-20 year old workers are liable to discourage employers from hiring the least skilled categories of labour, young people, women and the long-term unemployed.

Investment policy

The programme proposes a dynamic investment policy based essentially on tax incentives and active public sector participation. The incentives extended to the private sector (tax credits, exemptions from stamp duty of bank loans for investment purposes, investment credit at preferential rates, subsidies for job-creating or energy-saving investment, subsidies for industrial restructuring, etc.) will be calculated in a manner designed to give preference to investment that meets a profitability criteria and generates a net inflow of foreign exchange. It is planned also to boost public sector investment (public utilities and general government) in order to develop the country's infrastructures, notably transport, telecommunications and energy. Foreign investment is to be encouraged by simplifying authorisation procedures and by means of incentives similar to those for domestic investment provided they meet the same criteria with respect to job creation and bringing the current external balance back into equilibrium[24]. In furtherance of this overall policy of stimulating investment, notably for the purpose of modernising infrastructures, the programme will rely on financial assistance from the EEC, two-thirds of which is for investment. For the period 1986-1992 as a whole, it is estimated that this contribution should amount to around Esc 440 million at 1987 prices, or nearly 5½ per cent of cumulative investment (at 1987 prices) as projected in the macroeconomic scenario accompanying the programme. Again according to the scenario, the gross capital formation/GDP ratio is set to rise from 22.8 per cent in 1986 to 27.7 per cent in 1990. Assuming that inventory investment could amount to some 2 per cent of GDP, this would put the gross fixed capital formation/GDP ratio at 25.5 per cent in 1990, i.e. 5 points higher than in the smaller OECD countries in 1982-1985.

The surge in investment and its growing share in GDP implies a major change in the structure of savings (Table 15). In the first place, the scenario is based on the assumption of foreign borrowing still accounting for some 1 per cent of GDP in 1990 when the first phase of the programme comes to an end. Second, total savings of enterprises and individuals (essentially households) could fall by one percentage point of GDP between 1986 and 1990 owing to a fall in migrants' remittances (which for the most part are saved), the share of the latter shrinking from 9 per cent of disposable income in 1986 to 6 per cent in 1990. A necessary condition for achieving the investment growth target by the end of the decade is thus the reduction of the general government borrowing requirement, assuming there is no resurgence of the external constraint.

Table 17. **Changes in the structure of the central government budget under the PCEDED**

As a percentage of GDP

	1986[1]	1991[2]
Current expenditure	28.0	24.5
Current receipts	20.7	23.4
Current balance	–7.3	–1.1
Current balance excluding interest	1.1	4.8
Total expenditure	32.4	28.6
Total receipts	22.0	24
Overall balance	–10.4	–4.6
Overall balance excluding interest	–2.0	1.3
Balance on capital account	–3.1	–3.5

1. Budget outturn
2. PCEDED scenario.

Sources: Ministry of Finance, PCEDED.

The public sector and fiscal policy[25]

The central medium-term fiscal policy objective is to reduce the general government deficit. As Table 17 shows, it is planned to cut the central government deficit from 10½ per cent of GDP in 1987 to 4½ per cent in 1991[26] by rapidly reducing the current deficit. The balance on capital account is expected to be virtually unchanged at around –3½ per cent of GDP. Tax pressure (current receipts as a proportion of GDP) will probably increase slightly due to a widening of the tax base; this should make it possible to reduce the highest marginal tax rates. Expenditure should fall by almost 4 per cent of GDP, on the assumption that nominal debt interest payments fall by 1 per cent a year to approximately 6 per cent in 1991. Current consumption (excluding compensation of civil servants) and subsidies are set to decline by 2 to 3 per cent in real terms. Social security expenditure is scheduled to rise by 3.5 per cent per year in real terms and receipts by close to 4 per cent. Also, public enterprises are to borrow increasingly at market rates and central government subsidies, notably interest-rate relief, will diminish appreciably.

Implications of the surge in growth in 1987

Growth was much more buoyant in 1987 than expected when the PCEDED was being prepared. As noted in Part I, both domestic demand and exports increased more rapidly than forecast. Some indication of the magnitudes involved can be provided by calculating the growth rates that would be required over the period 1988-1990, in the light of likely 1987 outturns, for the scenario envisaged in the PCEDED to materialise (see last column of Table 16). Another salient feature of the economy in 1987 was that imports increased twice as fast as exports. Thus, for import and export growth to remain in line with the PCEDED framework, exports will have to outstrip imports for the rest of the decade. These figures highlight the importance of the external constraint and hence the need to curb domestic demand growth – mainly by restoring public finance equilibrium.

Medium-term problems of the public sector

General government

As in most other OECD countries, the relative weight of general government has increased steeply in Portugal in the past twenty years. At the time of the change in political regime, it played a lesser role in the economy than in the other smaller OECD countries, with the exception of Spain. This was reflected in government sector employment which accounted for only 8 per cent of total employment in Portugal. The difference between the relative size of general government in Portugal and that in other countries has diminished sharply since 1973. By 1986 the share of total general government expenditure in GDP had risen to 45 per cent, 3 points below the average for the other smaller OECD countries. The surge in government spending since the early 1970s corresponded to a catch-up in the administration's traditional areas of responsibility (education, social welfare) and to a widening of the central government's sphere of activities (employment, financial assistance to public enterprises, measures to ease the repercussions of decolonisation, etc.) The growth of

Table 18. **General government: some elements of international comparison**

	Portugal		Spain		Greece		Ireland		Small OECD European countries	
	1974	1986	1974	1986	1974	1986	1974	1986	1974	1986
As a percentage of GDP										
Total expenditure	27.1	46.3	22.0	41.5	32.5[1]	46.7	43.0	62.2	36.9	51.2
Current receipts	25.0	37.0	22.4	36.1	29.6[1]	36.0	35.2	49.7	37.5	47.5
Borrowing requirements	–2.2	–9.3	0.4	–5.4	–3.0[1]	–10.7	–7.8	–12.5	1.1	–3.7
Government debt	18.0	65.6	1.3	29.9	20.3	55.1	36.9	107.1	9.5	43.9
As a percentage of total employment										
Public sector employment	8.0[1]	14.1	6.8	11.4	8.8[1]	10.1	18.8	20.3	13.8	19.8

1. 1977.
Source: OECD, *National Accounts* and OECD Secretariat estimates.

public expenditure was accompanied by a shift in the pattern of spending. The first big change resulting from decolonisation was a drop in defence spending which was reduced from 50 per cent of current expenditure in 1970 to less than 10 per cent in the second half of the 1980s. Current expenditure showed the greatest increase (rising by 30 per cent a year from 1973 to 1986), with its share in GDP up from 19.5 to 41.4 per cent.

Spending on goods and services rose at an annual average rate of 30 per cent between 1973 and 1986, by 5.7 per cent in real terms. Most of this increase was due to a surge in civil service employment, particularly over the period 1973-1983 (6.8 per cent a year), as a result of the expansion of the health and education systems which are a part of the general government and of the reincorporation in the national public service of former colonial civil servants. Since 1983, civil service growth has slowed to 2.6 per cent a year, but the official target of zero growth in numbers proved difficult to achieve, particularly in local government. In 1986, general government employment accounted for 14.1 per cent of total employment in Portugal, some 5 percentage points less than the average for the smaller OECD countries. The rate of increase in the public consumption price deflator (which in part reflects the growth of per capita civil service pay) lagged behind that of GDP over the period 1973-1986 (16.5 per cent a year, against 20.5 per cent). Altogether, the share of general government final consumption in GDP contracted slightly between 1981 and 1986, from 15 to around 14 per cent. This trend was similar to the average for the smaller OECD countries, Portugal numbering among those with the smallest share, alongside Spain, Switzerland and Turkey in particular.

Table 19. **General government: its structure and weight in the economy**

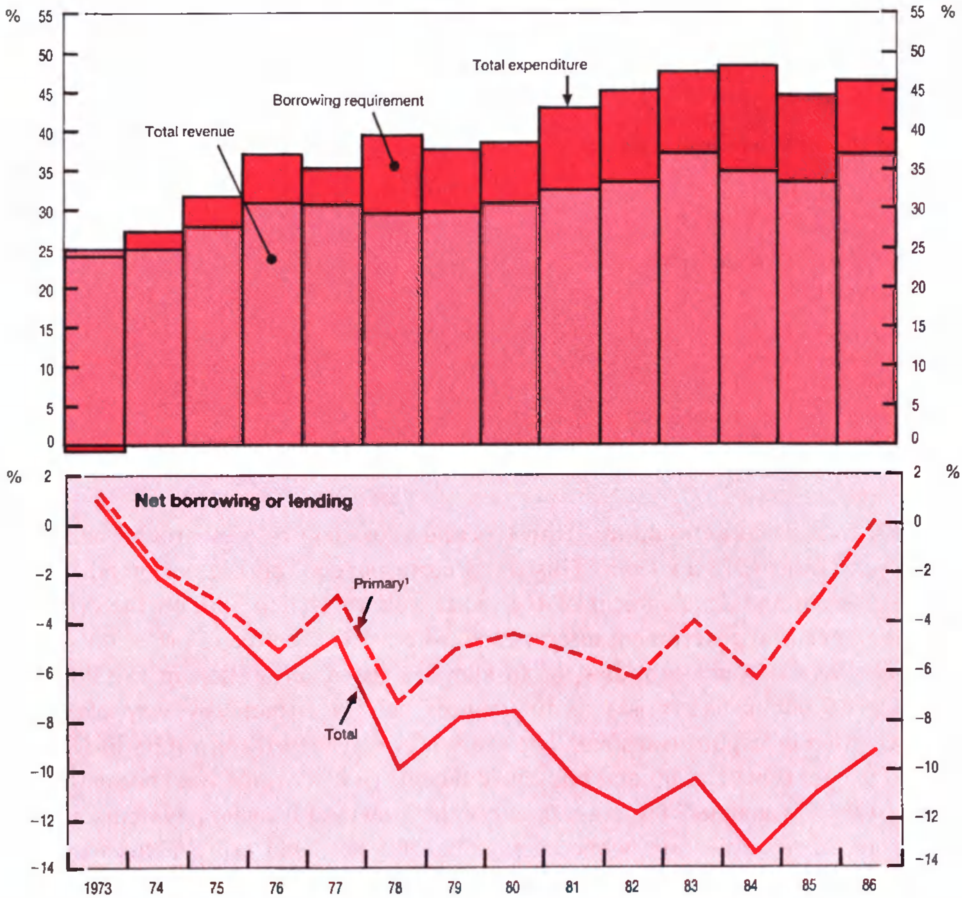
	1970	1974	1980	1986
Percentage of GDP				
Total receipts	26.0	25.0	30.9	36.9
Total expenditure	24.5	27.1	38.5	45.9
Interest	0.5	0.5	3.1	9.4
Borrowing requirement	1.5	–2.2	–7.6	–9.0
Structure of receipts (percentage in total)				
Direct taxes	24.0	20.1	20.7	21.2
Indirect taxes	46.5	45.2	45.5	46.1
Social insurance contributions	25.2	31.9	31.2	30.0
Structure of expenditure (percentage in total)				
Consumption	58.0	53.4	33.4	30.7
Interest	2.2	1.7	8.1	20.4
Transfers and subsidies	23.2	32.2	40.4	35.7
Capital transfers (net)	–6.2	–4.3	–7.3	–4.6
Investment	10.3	8.5	10.8	6.5

Sources: OECD, *National Accounts;* Banco de Portugal, *Annual Reports.*

Distributional expenditure (transfers and subsidies) rose by around one third each year from 1973 to 1986. This trend corresponded, on the one hand, to the establishment and development of the social welfare system and, on the other, to increasing central government intervention, whether in the area of price controls by way of direct product subsidies, or to alleviate the deterioration in the financial position of public enterprises or to finance their investment by way of equity participation or capital transfers. The share of social security transfers in GDP in 1974 (5.3 per cent) and in total household income (6.8 per cent) was the smallest of all the OECD countries. The main factor in the growth of transfer payments was the extension of social welfare, while average benefits per head (all benefits together) remained stable in real terms until 1985 (deflated by consumer prices). The number of persons covered by the social security system increased by 40 per cent from 1974 to 1980, rising somewhat more slowly over the period 1980-1986 (Table 20). In the first period, this process covered all areas, with the introduction in particular of unemployment benefits and a twofold rise in the number of recipients of old-age pensions. Since 1980, the number of recipients of family allowances and health benefits has levelled off, though the number of those receiving disability allowances and old-age pensions has continued to grow apace. Although increasing rapidly, the number of recipients of unemployment benefit was still small in 1986 – 69 600 persons out of a total of around 385 000 jobless. Average unemployment benefit per head doubled between 1985 and 1986 to 70 per cent of the minimum wage. Social

Diagram 10. **GENERAL GOVERNMENT REVENUE, EXPENDITURE AND BORROWING REQUIREMENT**

As a percentage of GDP



1. Total less interest on debt.
Source: Bank of Portugal.

insurance was further extended in 1986 and benefits were substantially increased (by around 25 per cent in nominal terms). Even so, their share in GDP (14 per cent) was still considerably smaller than the average for the smaller OECD countries (18.5 per cent).

Consolidated current subsidies to the corporate sector, which accounted for less than 5 per cent of current expenditure in 1973, rose rapidly as of 1974, peaking in

Table 20. **Transfer payment indicators**

	1975	1980	1986
Number of beneficiaries (thousands)	**2 695.1**	**3 857.6**	**4 328.3**
Annual growth rate		(7.4)	(2.0)
of which: Unemployment insurance	–	58.7	69.6
Old-age insurance	511.7	1 061.1	1 181.8
Annual growth rate		(15.7)	(1.8)
Total transfers (Esc. million)	**32 700**	**99 800**	**371 100**[1]
Annual growth rate		(25)	(24.5)
Annual growth rate deflated by consumer price increases		(2.6)	(2.3)

1. The amount for 1986 includes 11.1 million escudos, which are transfers to the budget of some entities (the Institute for Employment and Professionnal Training, for example) and are not in fact social transfers.
Sources: Ministry of Labour and Social Security; OECD Secretariat estimates.

1984 at 18 per cent of current expenditure (7.7 per cent of GDP). The following years saw a relative decline and in 1986 the figure was down to 10 per cent. These current transfers were accompanied by capital transfers to finance investment by authorities outside general government (motorways, the Sines independent port authority, the housing development fund, etc.), bringing total public resources allocated to the corporate sector to 8.5 per cent of GDP in 1985 and 7 per cent the following year. The increase in subsidies was closely bound up with the role assigned by the government to public enterprises up to the mid-1980s. They were not free to set their own charges, which they had to keep low so as to curb price inflation. Also, many food prices were directly subsidised via autonomous Funds. In recent years there has been a sharp shift in policy (see "Fiscal Policy" in Part II).

Table 21. **Subsidies to the corporate sector and transfers to households**

	Subsidies as percentage of GDP					Social transfers as percentage of total households' income				
	1970	1975	1980	1985	1986	1970	1975	1980	1985	1986
Portugal	**1.5**	**2.0**	**4.8**	**4.3**	**2.7**	**13.5**	**15.8**	**20.9**	**20.9**	**21.6**
Spain	0.9	1.1	2.1	2.4	2.0	10.5	11.3	15.9	18.3[1]	..
Greece	0.8	2.5	2.4	3.0	2.8	12.3	11.7	12.3	17.2	17.0
Ireland	4.8	6.8	8.2	9.4	9.1	9.1	13.0	13.4	16.7	16.9

1. 1984.
Sources: OECD, *National Accounts* and OECD Secretariat estimates.

Financing public expenditure

Since the early 1970s general government revenue has lagged behind expenditure and its share in GDP remains among the lowest in the OECD area. The Portuguese tax system in the mid-1970s was characterised by the very low weight of income tax and profits tax (24 per cent of total tax revenue, compared to an OECD average of some 37 per cent). Despite having increased, particularly after 1980, they still accounted for only 26 per cent of total revenue and 8 per cent of GDP in 1985. Over the period 1975-1985 as a whole, their elasticity in relation to GDP was roughly 1.55. The two categories of direct taxes whose yield has risen most rapidly were the "professional" tax on earned income and tax on interest. The share of social insurance contributions in GDP remained virtually unchanged between 1975 and 1986 at around 8 per cent, depressing the rate of growth of overall direct taxation and reducing its elasticity relative to GDP to around 1.2. Despite the low proportion of direct taxation (inclusive of social insurance contributions) in tax revenue and above all in GDP, the average amount paid per person liable to taxation would seem to be very high, with marginal rates of up to 68 per cent on wages.

Indirect taxation accounts for a relatively large proportion of total general government current revenue. Its share – 42 per cent of total revenue in 1970 – remained unchanged up to and including 1985, and then surged by 4 percentage points in 1986 when VAT was introduced and fuel taxes were raised. Since the early 1980s, revenue from the transactions tax, an indirect tax on all consumption accounting for around one-third of revenue, had been rising less rapidly than GDP (its elasticity over the period 1979-1985 was 0.93) mainly owing to the increasing scale of tax evasion. Revenue from import taxes also declined with the liberalisation of foreign trade. On the other hand, indirect taxes on financial transactions (stamp duty on banking or insurance transactions) rose steeply, accounting for almost 10 per cent of indirect revenue in 1986 (against less than 4 per cent in 1975). All told, in 1973-1981 when the rate of growth of general government spending was fastest, it was financed primarily from indirect revenue whose elasticity relative to GDP was around 1.5. From 1981 to 1985, the elasticity of receipts from goods and services fell back to around the same level – 1.2 – as that of direct tax revenue, so that the gap between the growth of expenditure and revenue widened and the general government deficit increased.

The mounting deficit

In equilibrium in 1973, the general government financial account moved into a deficit which increased almost uninterruptedly as a proportion of GDP up to 1984

Table 22. **Structure of tax revenue**

	Total		Income and profits tax		Employees' social insurance contributions		Employers' social insurance contributions		Property wealth tax		Tax on consumption		Other	
	1970	1985	1970	1985	1970	1985	1970	1985	1970	1985	1970	1985	1970	1985
	As a percentage of tax revenue													
Portugal	**100**	**100**	**24**	**26**	**9**	**10**	**15**	**15**	**4**	**2**	**42**	**41**	**6**	**6**
Spain	100	100	20	28	8	8	30	31	7	3	36	25	0	4
Greece	100	100	12	18	..	14	..	15	10	3	46	41	..	10
Ireland	100	100	27	35	4	5	5	9	12	4	50	43	2	4
Turkey	100	100	33	45	2	1	4	4	11	6	49	44	..	..
OECD average (unweighted)	100	100	37	39	8[1]	9[2]	12[3]	15[4]	7	5	33	28		
	As a percentage of GDP at market prices													
Portugal	**23**	**31**	**6**	**8**	**2**	**3**	**3**	**5**	**1**	**1**	**10**	**13**	**1**	**1**
Spain	17	29	4	8	1	2	5	9	1	1	6	8	0	1
Greece	24	35	3	6	..	5	..	5	2	1	11	14	..	4
Ireland	31	39	9	14	1	2	1	4	4	2	15	17	1	1
Turkey	18	16	6	7	0	0	1	1	2	1	9	7	..	..
OECD average (unweighted)	30	37	11	15	2[1]	4[2]	4[3]	6[4]	2	2	10	11		

1. Excluding Australia, Finland, Greece, Italy, New Zealand, Norway.
2. Excluding Australia, Finland, New Zealand, Sweden.
3. Excluding Australia, Greece, Italy, New Zealand.
4. Excluding Australia, New Zealand.

Source: OECD, *Revenue Statistics of OECD Member Countries (1965-1985)*, 1987.

when it stood at 12.1 per cent. Though by 1987 it had declined to 9 per cent, it is still one of the highest among the OECD countries. On Secretariat estimates aimed at identifying the cyclical and structural components of the change in the general government borrowing requirement, it would appear that the increase in the deficit was due to the impact of each of these two components in turn. In the aftermath of the first oil shock and under the effect of the corrective programme in 1983-1984, cyclical factors were predominant in increasing the deficit. By contrast, the deliberately expansionary thrust of fiscal policy was clearly apparent in the three years 1980-1982, and rather more sporadically between 1974 and 1978 and since the end of the last adjustment programme (see Table A1 in Annex I). Other factors that contributed to the increase in the borrowing requirement included the rise in interest payments resulting from the higher level of public debt and mounting interest rates. From 0.5 per cent of GDP in 1974, debt interest payments had by 1986 outstripped the general government borrowing requirement (9 per cent of GDP). The general government financial deficit was compounded by that of public enterprises which rose to 11½ per cent of GDP in 1982, bringing the total borrowing requirement of the public sector broadly defined to an all-time high of almost 25 per cent of GDP.

The public enterprises

The expansion in the public productive sector is a recent development in Portugal. Before the 1974 revolution, there were only a handful of public enterprises, which included the post office, the armaments industries and the ports. Central government also had holdings in the transport, electricity, oil refining and marketing industries and the telephone system. 1975 saw a wave of nationalisations, with much of industry and virtually the entire financial sector brought within the public sector. The nationalised sector encompasses a variety of enterprises and institutions: *i)* a core of 50 non-financial enterprises, entirely State-owned, making up the public non-financial enterprises group (EPNF); *ii)* a national corporation (Investimentos e Participaçoes do Estado) controlling 70 subsidiary enterprises in which it holds between 2 and 100 per cent of the equity; *iii)* a number of government agencies manufacturing or selling goods and services, which are grouped with nationalised enterprises for national accounts purposes (their sphere of activity being arms, agriculture, public infrastructures, ports, etc.); *iv)* a large number of EPNF subsidiaries operating under private law[27]. The non-financial enterprises group (EPNF, public agencies and over 50 per cent EPFN-owned subsidiaries) accounted for around 25 per cent of value added, 52 per cent of investment and 12 per cent of total employment at the end of the 1970s. Looking simply at the trend for the EPNFs,

Table 23. **The place of non-financial public enterprises in the economy**

Percentages

	1977	1980	1982	1984	1986
Total					
Gross value added/national value added	10.0	13.0	14.8	17.7	15.1
Gross fixed investment/national gross fixed investment	20.0	18.3	17.1	19.4	14.7
Employment/national employment	4.5	5.2	5.2	4.9	4.6
Borrowing requirement/GDP	..	–9¼	–11½	–8	–2
Industrial public enterprises					
Value added/value added in industry	11.6	15.8	17.1	16.1	10.0
Employees/employees in industry	4.9	5.0	5.4	5.0	4.7
Components of value added					
Compensation of employees	53.3	34.8	36.5	34.5	51.4
Financial expenses	27.4	41.7	57.8	84.1	71.4
Depreciation	15.5	16.4	23.2	27.7	38.9
Result	–7.2	0.3	–23.6	–58.3	–63.5

Source: Ministry of Finance.

a homogeneous group for which consistent statistical data are available (Table 23), it is apparent that their weight in the economy, in terms of value added, increased sharply between 1977 and 1985, though their share in investment and employment shrank slightly. The decline in the share of public enterprises in total employment divides in fact into two distinct phases: up to 1982 these enterprises played a dynamic role, generating employment particularly in the industrial sector; the subsequent phase has been marked by an adjustment in the size of the workforce concurrent with the implementation of the corrective programme.

Public enterprises experienced a significant worsening of their financial position in the late 1970s and early 1980s. Their borrowing requirement had risen to 11½ per cent of GDP in 1982 against some 6½ per cent in 1978. It has since been declining. There were a number of reasons for this deterioration. One of the aims behind the nationalisation of the productive sector in Portugal was to improve the standard of living by way of rapid growth and a redistribution of national income in favour of wage-earners. Between 1973 and 1976 real wages rose by 20 per cent, notwithstanding a significant deterioration in the terms of trade (equivalent to 8 per cent of GDP) as a result of the first oil shock, which itself put upward pressure on corporate costs. At the same time, output and sales were seriously disrupted by the social repercussions of the revolution (from 1973 to 1976 annual GDP growth was less than

Table 24. **Indicators of the financial position of non-financial public enterprises**

	1976	1980	1982	1984	1985	1986	1987[1]
Liquid assets/short-term liabilities	0.74	0.91	0.90	0.88	1.02	1.16	1.19
Short-term liquid assets-stocks/liabilities	0.52	0.60	0.66	0.68	0.77	0.91	0.93
Total debt/total assets	0.79	0.76	0.79	0.83	0.82	0.77	0.77
Short-term debt/total debt	0.53	0.60	0.59	0.56	0.45	0.37	0.32
Sales/fixed assets	0.50	0.85	0.72	0.69	0.70	0.58	0.53
Sales/total assets	0.35	0.50	0.42	0.41	0.44	0.39	0.38
Compensation of employees/sales	0.35	0.21	0.19	0.17	0.18	0.23	0.26
Financial expenses/sales	0.11	0.16	0.20	0.26	0.25	0.29	0.24

1. Estimate.
Source: Ministry of Finance.

1 per cent in real terms). In the subsequent period, public enterprises were encouraged to embark on major investment programmes both to boost demand and expand supply. Thus, between 1977 and 1978, the share of public enterprise investment in total investment rose from 20 to 21.5 per cent, causing their indebtedness to grow. At the same time, the increased rigidities affecting the way they operated compounded their financial disequilibrium. In the first place, employment legislation had an inhibiting effect on the growth of productivity, particularly in the hardest hit sectors (steel, shipbuilding, petrochemicals). Also, just when operating costs were rising, public utility charges and the prices of a number of goods (fertilizers, cereals, cement among others) were controlled in order to curb general price inflation.

Another source of disequilibrium was the special nature of the relations between central government and public enterprises. Up to the early 1980s, central government had allowed a backlog of debts to build up *vis-à-vis* public enterprises obliging them to resort to borrowing with all the costs that this entailed[28]. In the aftermath of the second oil shock, the authorities encouraged public enterprises to borrow abroad to finance the current payments deficit, leaving them temporarily exposed to the attendant exchange rate risks and mounting interest rates on international markets. Some of these enterprises later received compensation. But others which had borrowed abroad on their own initiative had to bear the exchange rate risks in full. The Ministry of Finance estimates the backlog of payments due to the four main public enterprises at Esc 395 billion, or around 23 per cent of total public enterprise debt in 1984. Financial costs surged, doubling relative to turnover between 1976 and 1983. The situation of the non-financial public enterprises reached a crisis point in the first half of the 1980s, under the combined effect of the earlier imbalances deriving from the particularly unfavourable international situation (rise in interest rates and appreciation of the dollar) and the adjustment plan. Losses tripled between 1982 and 1983, reaching Esc 94 000 billion or 3 per cent of GDP; and the total debt of the public corporate sector increased by 27 per cent between 1983 and 1984. In 1985 the general situation of the nationalised sector began to improve. On the international front, the fall in commodity and then oil prices, the dollar depreciation and lower interest rates eased the EPNFs' operating costs despite substantial wage increases (between 1984 and 1985 operating costs rose by only 5.5 per cent against 28 per cent a year earlier). On the domestic front, public enterprises benefited from partial decontrol of their prices and utility charges which then rose faster than costs; also, central government began to settle its payments arrears. Under the combined effect of these favourable developments and a slowdown in their investment, the EPNF were able to trim their borrowing requirement from 8 to 2 per cent of GDP in 1986.

The improvement in the position of public enterprises in the last two or three years, which was facilitated by largely exceptional factors, still seems very tenuous. Efforts have been made since 1984 to give them more management flexibility through programme contracts with central government and greater administrative autonomy. However, further progress remains to be made in increasing the efficiency of the nationalised sector and making it more independent of central government. The situation also varies widely from enterprise to enterprise, some (public utilities, electricity, transport, telecommunications) still being heavily subsidised and charging for their services at below cost, while others (steel, petrochemicals, shipbuilding) have to contend with worsened financial structures and are positioned on ailing markets. Restructuring programmes have been put in hand for the latter enterprises, with the aim of reorienting and diversifying their products, while central government has embarked on the task of consolidating their financial position. Lastly, in sectors operating in the competitive market, the financial position of many enterprises has improved, though the structure of some is still precarious and their performance wanting. Their main problem is a chronic lack of liquidity, as evidenced by their low ratio of short-term liquid assets to short-term debt (Table 24).

A partial privatisation programme was put in hand early in 1988. The purpose of the legislation is to promote the incorporation of public enterprises as limited liability companies by means of new equity issues; the State would remain the majority shareholder, since full privatisation of nationalised enterprises is not permitted under the Constitution. Up to 49 per cent of the shares of these enterprises may be held by individuals or private institutions, providing the former hold the largest share and that the State's initial capital remains unchanged. The main rules regarding the sale of new shares are the following:

- Small shareholders and company employees will be given priority regarding at least 20 per cent of the new shares;
- No institution may purchase more than 10 per cent of the shares issued;
- The amount of shares bought by foreign groups or institutions may not exceed 10 per cent of the amount of the issue.

The revenue from these transactions will be mainly used to consolidate the financial position of loss-making public enterprises and to repay the public debt. Initially, the enterprises concerned by this programme will be selected from among those with a sound financial base, operating according to market rules in sectors free of any particular adjustment problems.

Public debt and financial reforms

General government debt, which in 1973 was equivalent to 18 per cent of GDP, expanded very rapidly as the borrowing requirement grew. By the end of 1987 it had risen to almost 72 per cent of GDP. While not among the highest in the OECD area, this figure is well above the average. In the second half of the 1970s, the authorities had to borrow heavily from abroad to finance the public deficit and the share of foreign debt in total public debt rose from 27 per cent in 1973 to 39 per cent in 1984. This had the effect of increasing the amount of debt, particularly in 1981-1986 as a result of the escudo's depreciation against the currencies in which it was denominated (revaluation effect). In the past two years, the authorities have taken advantage of the current account improvement to reduce the share of government foreign borrowing in total debt.

Analysis in the previous OECD *Economic Survey* of Portugal showed that the interest burden of financing the debt was in the past considerably reduced by the fact that real interest rates have almost always been negative. But this is changing. The decline in inflation has not been fully reflected in lower nominal interest rates owing to the increase in the proportion financed at market rates. More fundamentally, moving away from quantitative ceilings will require that real interest rates remain positive.

Table 25. **Financing of the public deficit**

Percentage

	1982	1983	1984	1985	1986	1987[3]
I. Total deficit of the general government[1] (as percentage of GDP)	**12.9**	**11.1**	**13.4**	**11.5**	**9.7**	**9.2**
Structure of financing (as % of total)						
Foreign	22.5	31.7	20.6	18.6	–1.6	8.4
Domestic bank	70.5	53.1	62.5	85.8	53.7	30.9
Domestic non-bank	1.0	4.4	2.9	38.3	64.2	58.3
of which: Treasury bills	–	–	–	25.7	48.2	31.7
Other	1.0	4.4	2.9	13.6	16.0	26.6
Arrears	4.5	12.6	15.7	–44.7	–17.2	0
Other	1.5	–1.8	–1.7	–0.9	0.9	2.4
II. Total deficit of non-financial public enterprises[1] (as percentage of GDP)	**11.4**	**6.2**	**8.1**	**7.6**	**2.1**	**1.7**
Structure of financing (as % of total)						
Foreign	82.0	18.3	33.7	38.1	–248.9	22.8
Domestic bank	11.4	76.1	48.7	–3.8	71.6	–29.1
Domestic non-bank[2]	6.6	5.6	14.1	106.6	171.1	96.1
Foreign debt counterpart deposits	–	–	3.5	–40.9	106.2	10.2
III. Total deficit of the public sector (as percentage of GDP)	**24.3**	**17.3**	**21.5**	**19.1**	**11.8**	**10.9**

1. Including adjustments and financial transactions.
2. Including the settlement of arrears and Treasury transactions.
3. Ministry of Finance estimates.

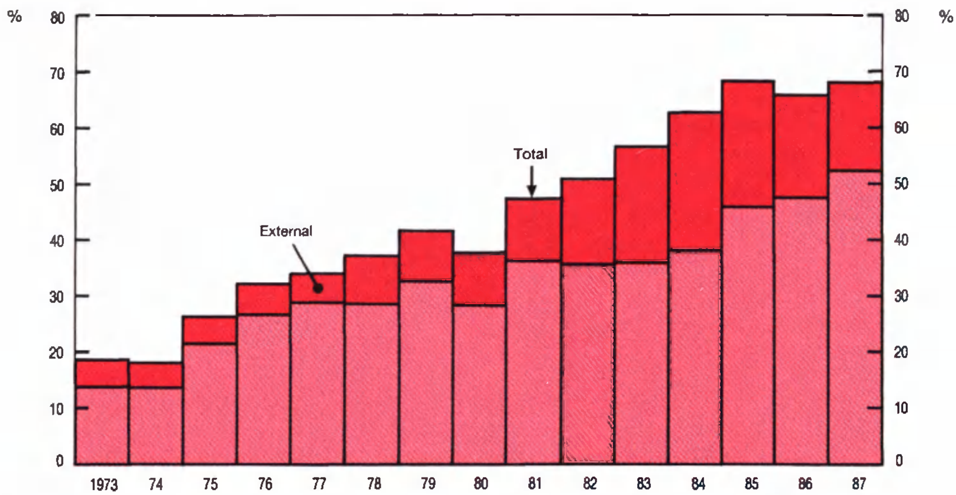
Sources: Ministry of Finance; Banco of Portugal.

Greater reliance on interest rates

The Portuguese financial system is still relatively underdeveloped, with the operation of market forces inhibited[29]. To remedy this, the PCEDED stresses the need to develop financial markets and to adopt more market-oriented operating procedures for monetary policy. Continued progress – desirable to enhance efficiency and to fully exploit EEC integration – will necessitate important changes in the traditional mechanisms of credit control. These are in any case under increasing strain.

The standard procedure is to set a ceiling for bank credit to the nongovernment sector (public enterprises and the private sector). This ceiling is meant to be consistent with projected liquidity growth given assumptions about bank financing of the government deficit and external credit[30]. But three elements crucial to this approach are becoming increasingly difficult to determine:

Diagram 11. **TREND IN THE PUBLIC DEBT**
As a percentage of GDP

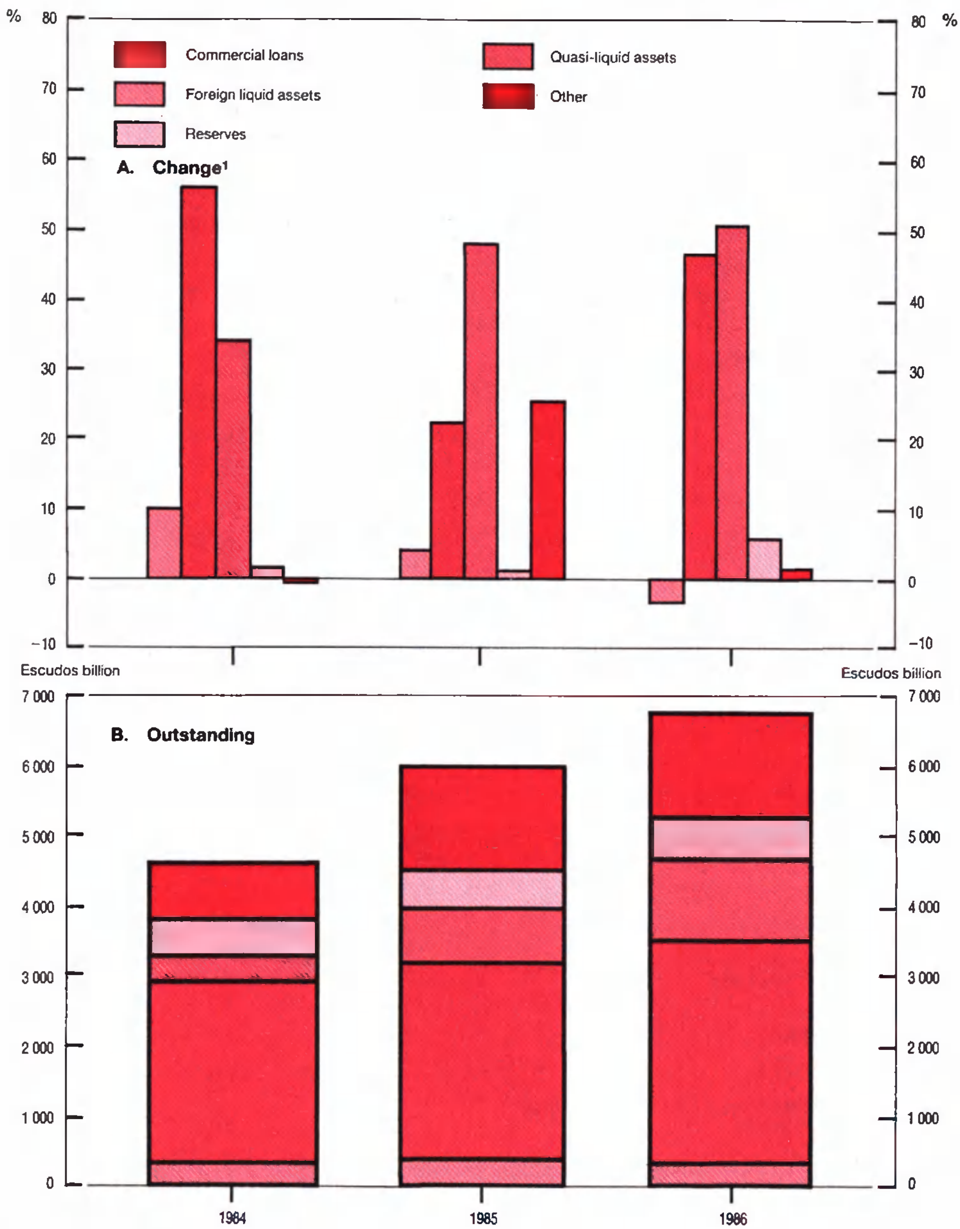


Source: Bank of Portugal.

- First, the demand for L- should be a stable function of income. However, the demand for various components of L- has been rather unstable recently and such variability can be expected to increase as more marketable financial assets become available and as the public's sensitivity to changes in the relative profitability of assets increases;
- Secondly, the non-bank financing of the public sector and of public enterprises should be relatively predictable. Because recourse to direct capital market borrowing is not fully predictable, and because of the practice of financing public enterprises in ways that escape the bank credit ceiling, the usefulness of credit ceilings is reduced;
- Thirdly, net foreign borrowing should be controllable. However, substantial unregistered short-term capital movements can inflate total credit creation. Greater integration within the EEC can be expected to lead to progressively weaker controllability of capital flows.

Moving to a more market-oriented approach involves important short-term adjustment problems. As a result of credit ceilings and sizeable deficits of the public sector, the banking sector holds about one quarter of its assets in short-term, quasi-liquid securities (Diagram 12). A sudden abolition of ceilings (without higher

Diagram 12. **COMPOSITION OF BANKING SECTOR ASSETS**



1. For each year the sum of the components is equal to 100.
Source: Banco de Portugal, *Annual report.*

yields on government securities) would lead to a sharp expansion of credit and a lowering of interest rates on loans, with undesirable consequences for inflation and for external equilibrium. The provision of government debt instruments with positive real interest rates will be required to gradually absorb the excess liquidity of the banking system.

An important innovation along these lines was the introduction, in August 1985, of negotiable short-term Treasury bills (with maturities of three and six months, subsequently extended to one year)[31]. This instrument provided households with an alternative to bank time deposits (on which interest rates are regulated), and banks with an alternative to money market instruments. Outstanding Treasury bills rose fourfold: from Esc 150 billion at end-1985 to Esc 715 billion in August 1987, of which Esc 536 billion directly or indirectly held by the public[32]. For the first time, most of the government deficit in 1986 was financed outside the banking system. As other sectors began to tap capital markets, the process of disintermediation of the banking system accelerated. Accordingly, direct capital market financing by the private enterprise sector rose rapidly (Table 26). As noted in Part II, reliance on the stock market also increased. Only one public issue of shares was undertaken in the

Table 26. **Capital market activity: issues**
Esc. billion

	1983	1984	1985	1986	1986 Jan.-Oct.	1987 Jan.-Oct.
Shares[1]	0.2	–	–	29.2	16.9	29.5
Mixed equity bonds[2]	–	–	–	20.0	14.0	18.5
Government securities[3]	209.7	306.3	710.3	646.5	468.1	424.1
Non-financial public enterprises bonds	9.0	8.6	46.9	25.1	15.6	54.7
Public subscription	6.0	6.0	26.4	17.5	10.5	42.0
Private subscription	3.0	2.6	20.5	7.6	5.1	12.7
Other non-financial enterprises	–	1.6	8.4	7.2	4.8	10.0
Public subscription	–	–	2.1	0.6	0.6	–
Private subscription	–	1.6	6.3	6.6	4.2	10.0
Financial institutions	12.0	11.1	19.1	10.6	8.9	32.5
Public subscription	4.7	7.6	16.3	10.6	8.9	24.6
Private subscription	7.3	3.5	2.8	0.0	0.0	7.9
Total	230.9	327.6	784.7	738.6	528.3	569.3

1. Share issues by companies listed on the Stock Exchange.
2. Public subscription.
3. Saving certificates and Treasury bills at market value and redeemable domestic loans.
Source: Banco de Portugal, *Sintese Mensal de Conjuntura.*

period 1975-85; in 1986 thirty public issues were launched. Total non-bank financing of enterprises grew from virtually zero to about 5 per cent of total flows[33].

Market financing of the government deficit remains entirely short term: The long-term bond market is as yet relatively underdeveloped. Issuing longer-term financial instruments would be desirable to reduce the vulnerability of government financing to movements in short-term interest rates.

Interest rate policy might be further constrained by the effects of possible integration into the EMS and continued liberalisation of capital movements. The scope for artificially depressing nominal interest rates is less with a more fixed exchange rate system than with an exchange rate that depreciates steadily as at present. If borrowing requirement of the public sector remains high, it is likely to strain the absorptive capacity of the markets, pushing up domestic interest rates. Since real interest rates are thus likely to be significantly positive in the future, instead of negative as in the past, the task of stabilizing the debt/GDP ratio will become harder.

The dynamics of the public debt

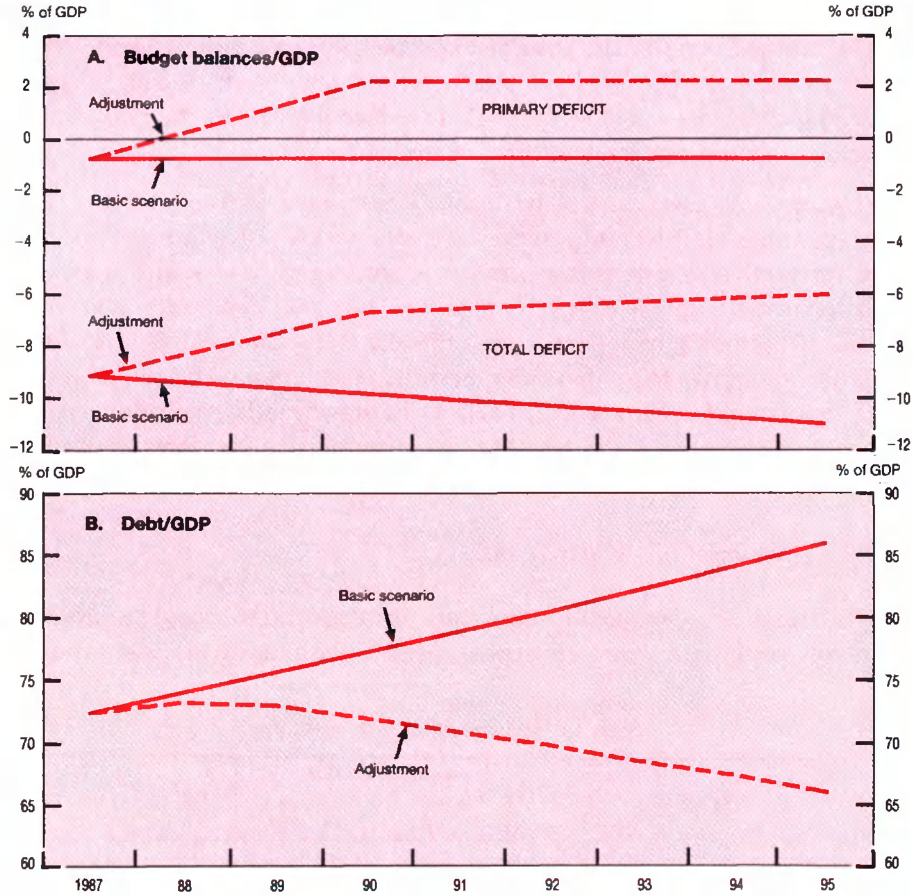
To avoid the debt/GDP ratio from increasing, the budget must show a "primary" surplus, the size of which will depend on the initial debt/GDP ratio and the

Table 27. **Underlying trend in the public debt**

	As percentage of GDP Average 1976-1980	Average 1981-1986	1985	1986	1987[1]
1. General government lending capacity (+) or borrowing requirement (–)	–7.3	–11.1	–11.8	–9.0	–9.1
2. Ditto, excluding interest payments	–5.0	–4.2	–3.9	0.4	–1.0
3. Nominal GDP growth rate	27.9	23.6	25.7	22.8	17.2
4. *a)* Average nominal interest rate[2]	8.2	15.7	15.8	16.9	14.5
b) Effects of revaluation	0.5	1.9	–0.1	0.3	..
5. Difference between GDP growth rate and:					
Average nominal interest rate [3] – [4*a*]	19.7	7.9	9.9	5.9	2.7
Interest rate adjusted for effects of revaluation [3] – [4*a* + 4*b*]	19.1	6.0	10.0	5.6	..
6. Debt/GDP	37.0	58.5	68.0	65.6	72.0

1. Estimates.
2. Interest payments/debt.
Sources: Bank of Portugal; Ministry of Finance; OECD Secretariat estimates.

Diagram 13. **SCENARIO FOR A MEDIUM-TERM REDUCTION IN THE PUBLIC DEBT**[1]



1. On the assumption that the average nominal rate of interest on the debt is 2 points higher than the rate of GDP growth.
Basic scenario: The primary deficit is constant as a percentage of GDP.
Adjustment: It is reduced by 1 per cent of GDP a year for 3 years.
Source: OECD Secretariat.

interest rate-growth rate differential[34]. The difference between nominal GDP growth and the average rate of interest on the debt has narrowed appreciably over the past few years (see Table 27) and, with nominal GDP growth projected to slow, could even become negative in 1988.

Under these circumstances, stabilizing the debt/GDP ratio will involve achieving a primary surplus and building it up. The scenario depicted in Diagram 13 assumes that, from 1988 onwards, the interest rate on the public debt will be 2 points higher than the rate of nominal GDP growth. Maintaining a primary deficit of around –1 per cent of GDP (as in 1987) would imply a 2 percentage point increase in the deficit relative to GDP between 1987 and 1995, bringing the debt up to almost 85 per cent of GDP. On the other hand, were the primary balance to improve by 1 GDP point a year for three years and then stabilize – giving a surplus of 2 per cent of GDP in 1990 – the size of the debt relative to GDP would continue to increase up to 1989, declining slightly thereafter.

IV. Conclusions

The successful completion of a major stabilization programme accompanying the IMF stand-by arrangement reduced Portugal's external deficit from 13½ per cent of GDP in 1982 to virtual balance by 1985. This was mainly achieved by monetary restriction and by devaluation. Since 1985, there has been a major improvement in economic performance. Stronger growth has reduced unemployment; inflation has come down; and the current external surplus has enabled some net repayment of external debt. But this improvement owes much to factors that may not be repeated and policies that cannot be sustained. First, lower oil prices and the depreciation of the dollar have together implied a terms-of-trade gain of over 5 per cent of GDP that explains part of the deceleration of inflation and which has masked a large deterioration in the external balance in volume terms. Secondly, fiscal stimulus has been significant, with the cyclically-adjusted budget deficit (corrected for inflation) rising as a per cent of GDP, and with government debt over 70 per cent of GDP by end-1987. Finally, monetary policy was expansionary until early 1987. The overall result was that domestic demand grew at an annual rate of around 9 per cent in 1986 and 1987, more than twice the rate of the rest of the OECD. Assuming unchanged policies, present Secretariat projections suggest continued growth in domestic demand exceeding that of trading partners in both 1988 and 1989. On this basis, the current account deficit could reach 1¾ per cent of GDP by 1989.

Portugal's experience with "stop-go" policies over the last decade or so underlines the importance of setting policy in a coherent medium-term framework. In this respect, the Programme for structural correction of the external deficit and unemployment – the PCEDED – represents a major step forward. The broad macroeconomic orientation of this programme is to release the resources needed to maintain a high investment ratio by reducing the government budget deficit and by using incomes policies to hold down inflation and prevent excessive growth of consumption. At the same time, microeconomic reforms will seek to reduce the heavy role of the State in economic life and to encourage greater responsiveness to competition and to market forces.

Because the investment requirements of developing the Portuguese economy are likely to be very heavy (especially as further large investment in the country's infrastructures will be needed), it is of key importance that investment funds are concentrated where the returns are highest. In the last couple of years, aid to investment has been considerable: a significant investment tax credit; tax exemptions for investment and privileged borrowing from banks. In general terms, such measures risk artificially depressing the cost of capital to business, enabling projects with low real returns to be undertaken and encouraging the substitution of capital for labour. It is thus important that investment projects in a labour-abundant and capital-scarce economy such as Portugal earn a high return on capital. Similar considerations apply to foreign direct investment. Simplifying complicated administrative regulations has facilitated foreign investment; however, the experience of other OECD countries is that high fiscal or other incentives to foreign investment are not always very effective in fostering the sort of development appropriate to relative factor scarcities. The recognition in the PCEDED of the need to avoid excessive capital intensity of investment is welcome, as is the decision to phase out the investment tax credit.

Reducing the budget deficit will be essential if domestic savings are to be put to more productive use. The public sector borrowing requirement in 1986 amounted to almost 12 per cent of GDP (of which, government close to 10 per cent) and outstanding debt was over 70 per cent of GDP, a quarter held externally. Some steps towards adjustment were taken that same year:

- Taking advantage of lower oil prices and a current account surplus to strengthen government revenues and actually reduce external government debt was clearly prudent;
- The introduction of a value-added tax provided a much-needed broadening of the tax base;
- The government took over past public sector debts and moved to financing at more market-oriented interest rates. These reforms, although desirable, had the immediate effect of inflating the government borrowing requirement in the last two years.

As growth received a powerful stimulus from sizeable terms-of-trade gains, greater fiscal adjustment may have been desirable. Fiscal policy turned out to be expansionary in 1987 and the 1988 Budget envisages virtually no change in the size of the budget deficit relative to GDP. Corrective measures are needed in the near future – otherwise the government's economic strategy could well run into difficulties.

Powerful upward pressures on public expenditure will have to be resisted if ambitious developmental objectives are not to be compromised. While infrastructure investment remains necessary – inherently and also to benefit from EC grants – it is still essential to choose those projects with the greatest return. Second, better control of local spending will be important: during 1986 and 1987 a very large increase in local government receipts permitted a big rise in their expenditure. Third, there is widespread overmanning in the public service and in public enterprises. Hence, the long-standing embargo on public sector employment must be applied. It is also important to limit public sector pay increases. At the same time, improving the quality of the public administration would require greater selectivity. Government expenditure on goods and services is relatively high internationally, when account is taken of the poor provision of major public services such as health and education. Fourth, spending on social transfers (which rose in 1986 by about 17 per cent in real terms) will need to be kept broadly in line with real economic growth. Recent measures to broaden the coverage of social welfare protection may make this hard to achieve. Finally, tax reform is an urgent priority. A wider and a better-enforced tax system is needed in the medium term. In the short term – before measures to cut expenditure can be expected to bite – tax increases may well be necessary.

Monetary policy will also have an important role to play in containing domestic absorption. Policy was expansionary in 1986, overall liquidity (L-) growing by 26 per cent. Despite the adoption of objectives implying markedly slower growth in credit subject to ceilings, some important elements of credit creation escaped control. This inadequacy of monetary control over the last two years is a matter of concern. To the extent that reliance is placed on quantitative ceilings, it is obviously important that monetary management be co-ordinated with the financial programming of government and public enterprises as well as external financing so that major sectors do not escape control. Over the medium term, it is desirable that more reliance be placed on the interest rate mechanism in allocating credit. This is necessary to ensure scarce investible funds are used efficiently; and the greater internationalisation of financial markets within the European Community will, sooner or later, make it inevitable. Long-standing quantitative ceilings on bank credit and many years of heavy government borrowing have left a difficult legacy of excess liquidity in the banking system. The recent rapid development of a Treasury bill market – allowing the public to hold government debt directly at market-determined interest rates – is a useful first step to dealing with this problem. Moving to a system where interest rates play a greater part in monetary control will imply – during the transitional period – setting administered rates more in line with the market. In this respect, lowering administered rates in October 1987 may have run counter to the intended tightening of policy. A more general problem is that concentrating too much government debt in short-term instruments increases the authorities' vulnerability to interest-rate and other shocks. The development of a market for long-term government bonds would therefore appear desirable. A history of very high rates of inflation may mean that the market would, in the immediate future, require a sizeable inflation premium. One possibility that deserves serious attention would be to issue index-linked bonds (i.e. bonds whose coupon is related to the rate of inflation). The United Kingdom's experience of such bonds is rather encouraging in this respect.

The greater openness of the Portuguese economy and the improved access to European markets that result from Portugal's accession to the European Community reinforce the need to maintain international competitiveness. The depreciation of the escudo in 1986 may not have fully offset inflation differentials between Portugal and the rest of the world. Maintaining international competitiveness will be essential if growth is not to be externally constrained in the medium term. Short-term capital inflows apparently rose sharply in 1987, but such flows can easily reverse and should not be allowed to create a temporary overvaluation of the currency. None the less, it remains important that inflation be brought – and kept – down to levels prevailing in partner countries. The rate of exchange rate crawl can be modified in line with durable reduction in inflation differentials.

Achieving this hinges critically on limiting nominal wage increases. The Government sets great store by incomes policy to secure the agreement of the social partners that would facilitate lower wage inflation. In Summer 1986, the social partners agreed to negotiate wages in terms of prospective, rather than past, price increases. This strategy of using external disinflation to generate a simultaneous deceleration of nominal wage increases was very effective. According to collective wage agreements, nominal wages rose by 12 per cent in 1987 compared with 17 per cent in 1986. The inflationary spiral that has beset Portugal since 1974 thus appears to have been broken. Acceptance of this policy was obviously made more palatable by substantial real wage growth and by the payment of wage arrears. Policy will be more severely tested in the years immediately ahead. The outlook for world demand has deteriorated significantly in recent months, and terms of trade gains do not appear likely. These factors and the likely reemergence of a current account deficit mean that real wages will need to rise less than productivity to create room for higher investment. Wage moderation is essential and here incomes policy may continue to have a role to play.

Fear of directly adding to prices or costs should not inhibit the pursuit of appropriate macroeconomic policies:

- Reducing the budget deficit may well require higher indirect taxes, especially in view of the difficulty of controlling public expenditure in the short term and given the country's outdated income tax system;

- Making public enterprises stand on their own feet should ultimately increase efficiency and lower costs. But in the short run higher real prices may be required on commercial grounds;
- Improving the allocation of scarce investible funds and absorbing excessive liquidity in the banking system will require the maintenance of interest rates significantly positive in real terms, implying higher borrowing costs;
- Present levels of domestically-generated inflation, above the international average, require a continued downward crawl of the escudo.

Although such policies directly add to the price level, they are needed for the achievement of noninflationary growth in the medium term. Not taking the necessary measures in time would produce only a spurious and transient decline in measured inflation, but complicate the task of eventual adjustment.

Structural adjustment policies can contribute to better economic performance. Previous OECD Economic Surveys have stressed the rigidities of the labour market. A heritage of rather rigid labour legislation has damaged productivity and made employers too cautious in hiring. Recent proposals to make it easier for firms to lay off excess labour are a move in the right direction. Also measures to enhance labour mobility as well as the better functioning of public employment services should improve labour market flexibility.

The time is ripe for tackling the rigidities that blight Portuguese economic performance. The new Government – a single party enjoying an overall Parliamentary majority for the first time since the Revolution – is committed to reorienting economic activity from State control to the market. Entry to the European Community presents an opportunity and a challenge: indeed, greater exposure to more flexible and competitive economies in the rest of Europe makes structural adjustment more urgent. And the provision of EC grants gives Portugal a chance to rapidly improve the country's capital infrastructure. Steps have been taken to make public enterprises more efficient and to make interest rates play a bigger role in allocating credit. Still more are under active consideration – tax reform and denationalisation are two central themes. Privatisation is a key plank of Government policy. At present, the Constitution prohibits the full denationalisation of any public enterprise, even those providing goods or services outside the traditional public utilities. Public enterprises are in the process of being opened to private capital. The Government's intention to use the proceeds from the sale of assets to retire debt, and not finance additional government consumption, is clearly appropriate. A healthy and stable stock market will also be required. Some companies and other operators were able to artificially inflate prices by "cornering" a very thin market, often without any actual trade taking place. Such practices, combined with the worldwide stock market crisis, could have damaged the prospects of establishing a robust, broadly-based market for equities. The authorities have therefore adopted some regulatory measures to protect investors (including steps to audit corporate accounts and monitor market manipulation). Further reforms may be needed if the Government's privatisation programme is to be smoothly implemented.

The orientation of policy to greater reliance on the market is in line with structural adjustment policies in many OECD countries. Experience has shown that chances of success are highest if the authorities can take advantage of favourable conditions to implement reforms rapidly. And the last few years have provided ample evidence of the dynamism and responsiveness of the Portuguese economy: in the five years to 1987, the volume of exports rose by over 80 per cent, a bigger rise than in any other OECD country. But past experience in Portugal, with very abrupt "stop-go" policies, underlines the need for a stable macroeconomic stance, to avoid a relapse to demand-depressing measures dictated by external deficits or by accelerating inflation. The authorities' intention – enshrined in the PCEDED – is to reduce public borrowing. Early action in this direction is necessary if the Government's ambitious medium-term objectives are not to be frustrated by more drastic, but delayed, correction.

Notes and references

1. Data are available for migrants' apparent propensity to deposit remittances (ratio of change in these deposits in banks to change in remittances); it averaged 70 per cent between 1975 and 1985, but is estimated to have fallen to 10-20 since then. This trend reflects in part changes in the method of statistical classification, but also a shift in migrants' savings towards investment in securities and the purchase of goods.
2. On the consumption function estimates made by the Bank of Portugal and the OECD Secretariat, a fall of 1 point in the nominal rate on short-term deposits results in a rise of about 0.4 per cent in private consumption, whereas the negative impact of the income effect is smaller (0.2 to 0.3 per cent) and above all slower.
3. Government-controlled prices currently represent 15 per cent of the products that make up the consumer price index. They relate to public services (water, gas, electricity and public transport) and certain food items (milk, bread and potatoes). In 1981-82, they still represented about 30 per cent of all the products in the index.
4. See OECD, *Economic Survey of Portugal*, May 1986, pp. 34-47, "Structural aspects: the labour market".
5. These data are based on the narrowest definition of unemployment; they thus take account only of people who were actively seeking a job during the four weeks prior to the employment survey. This definition is the closest to the standardised definition. On a broader definition that is also used by the national authorities, the rate for 1986 was 10.1 per cent.
6. The trend of employment by sector differs depending on the source. According to the survey conducted by the National Statistics Institute, growth of the number of dependent workers was concentrated mainly in the distributive trades, hotels and catering, and banking and insurance, while employment in the processing industries, which was already bolstered in 1985 by the export industries, rose by less than 1 per cent. In contrast, the business survey conducted by the Ministry of Employment and Social Security indicated that only the clothing and footwear industries, which export a large proportion of their output, were expanding. However, the scope of this survey is narrower, since it does not include agriculture and government; also, it is confined to dependent workers, and perhaps does not record all non-permanent jobs.
7. Fixed-term contracts are traditional in the construction industry, in which they accounted for 40 per cent of all jobs at the beginning of 1983 compared with 11 per cent in the economy as a whole, according to the survey by the Ministry of Employment and

Social Security. The proportion in the construction industry fell slightly, but it rose to nearly 15 per cent for the whole economy at the beginning of 1987, which is comparable with the average for OECD Europe.

8. The Bank of Portugal's nominal effective escudo exchange rate index is a weighted average of the bilateral exchange rate indices of Portugal's thirteen main trading partners. The current weighting roughly corresponds to the share of these partners in Portugal's total trade (imports + exports) in 1985-1986.
9. Between the first quarter of 1986 and November 1987 the escudo depreciated by about 15.7 per cent against the ECU.
10. *Vis-à-vis* Spain, with whom Portugal signed a trade treaty in 1972, duties are lower and administrative procedures simplified.
11. The Bank of Portugal calculates, as a residual, a price deflator for non-energy and non-agricultural imports. The prices of these imports are estimated to have risen by 7.6 per cent in 1986, i.e. by about the same amount as the wholesale prices of manufactures.
12. This outturn was made possible by the surplus on the autonomous Funds account and the social security account, which had not been built into the budget. The former was generated by the revenue from the tax on petroleum products, while the latter derived from social insurance contributions that were higher than budgeted because of the rise in nominal wages and the agreements reached with enterprises with arrears of social insurance contributions. The data referred to are taken from the general government accounts drawn up by the Ministry of Finance in accordance with the system of national accounts. They are compiled on the same basis as the budget and differ slightly from the estimates of the Bank of Portugal.
13. The system of tax relief is as follows: the industrial tax liability for 1987 is reduced by 10 per cent of the amount of investment made in 1986, and thereafter at a diminishing rate of 8 per cent, 6 per cent and 4 per cent respectively for investment carried out in 1987, 1988 and 1989. A double tax credit is applied to investment projects that come under the PCEDED (see Part III), which will affect government revenue from 1988 onwards. Reinvested profits can also be deducted from the tax base during a period of three years after the investment.
14. The standard rate of VAT was set at 16 per cent, the EEC average. The highest and lowest rates are respectively 30 and 8 per cent. There is also a zero rate as in the United Kingdom and Ireland, which applies to certain food items and agricultural products.
15. Principally the Supply Fund abolished in 1986, the Fund for the Sines region (GAS), and an entity administering subsidies to olive producers (IAPO).
16. Arrears paid to public enterprises and banks totalled Esc 363 billion in 1986, or nearly 8 per cent of GDP.
17. The budget provides for a debt of Esc 4 500 billion at the end of 1988, equivalent to 82 per cent of GDP, of which some 5 per cent due to further regularisation of financial transactions in the public sector in 1988.
18. Also, the budget provides for the taxation of civil servants to be offset by an equivalent increase in their income. The measure will thus have no impact on the deficit.

19. The strong growth of money demand may also be linked to problems of classification of emigrants' savings and to the steps taken by banks to restrict terms and conditions of time deposits (the minimum deposit size introduced in 1985 was increased and interest is no longer automatically added to these deposits, as it was previously).

20. Under the "20 per cent rule" – now abolished – if shares supplied numbered less than 20 per cent of shares demanded (or vice versa) then no trade took place. Instead, prices were marked up (or down) by a maximum of "5 per cent" for the next day's trade – "the 5 per cent rule". If the demand and supply imbalance remained below this 20 per cent threshold, then again no trade would take place. And so on. Because the bulk of shares of an individual company was concentrated in a few hands (often the company itself), these shareholders could push up the price by placing orders which they knew well to be in excess of possible supply.

21. The OECD Secretariat's forecast relates to the private consumption deflator, which is weighted differently from the consumer price index; for incomes policy the latter index is used as the reference target.

22. This programme has been published under the title "Estratégia de Progresso Controlado, PCEDED – Programa de correcçao estrutural do défice externo e do desemprego". It is in three volumes: summary, the macroeconomic context and the sectoral context.

23. The present age of retirement is 65 for men and 62 for women and younger in the case of certain particularly unpleasant occupations; it is 60 in the civil service after 20 years' service and for all those with 30 years' service. This option was also available in the 1986 and 1987 Budgets, but the conditions were slightly more stringent.

24. Openness to direct inward investment is one example of the considerable progress Portugal has made towards liberalising capital movements, in conjunction with its entry to the EEC. This development is in line with the lifting by Portugal of many of its reserves and derogations with respect to the Codes of Liberalisation of Capital Movements and Current Invisible Operations.

25. In Portugal, the public sector comprises the administrative public sector (general government on the national accounts definition) and public enterprises. The administrative public sector comprises the central administration (central government, autonomous Funds and autonomous Services), the social security system and local government. Each of these entities has its own budget, but among them and between them and the public enterprises there is a network of financial links, notably via transfers and subsidies, which have increased in complexity as the public sector has grown in size. Also, institutional changes, in particular concerning the breakdown of responsibilities between central and local government, have occurred in recent years and thus made it difficult to analyse how the public sector has evolved over the longer term. An analysis of the administrative public sector on the basis of the new national accounts appeared in the Banco de Portugal *Quarterly Bulletin*, Volume 5, No. 1, March 1983. The autonomous Services number some 200 but the most important is the autonomous health Service. Among the autonomous Funds may be cited the Supply Fund which, until its winding up

in 1986, was responsible for subsidising prices of industrial fuel oil, fertilizers, cereals, oilseeds and milk and whose main revenue came from the tax on oil products (some of its responsibilities have devolved to INGA, the national agricultural guarantee institute, a newly established autonomous authority).

26. When the PCEDED was drawn up, preliminary estimates of budget outturns were available; these have since been extensively revised. The most recent estimates concerning the 1987 budget variables are given in Table 9.

27. These enterprises are considered to be national enterprises if the government holds more than 50 per cent of the equity.

28. The four main sources of the payments backlog were the Supply Fund, which was supposed to award suibsidies to enterprises in return for price controls, the Exchange Rate Guarantee Fund, which was designed to protect small and medium-sized enterprises from exchange rate risks incurred in connection with the purchase of capital goods from abroad, as well as for risks incurred in connection with foreign borrowing by enterprises above and beyond their normal business requirements, for the purpose of financing the current balance. A Special Fund was also set up to regulate electricity prices between the periods of heavy rain when there is an abundance of cheap hydroelectric power and periods of drought when thermal electricity is costly. Finally, some municipal authorities (in particular the city of Porto) did not pay in full for their electricity.

29. In the setting of credit ceilings and interest rates, the government pursues a variety of non-financial objectives. In 1985, bank credit granted on preferential terms amounted to 28 per cent of total, down from over 35 per cent three years before. Credit is granted on preferential terms to housing, energy saving investment, agriculture and exports.

30. Total liquidity (L) is related to credit expansion by:

$$dL = dDC^{g} + dDC^{pr} + (X\text{-}M) + F + DIV$$

where d = change
DC^{g} = domestic credit to government
DC^{pr} = domestic credit to the private sector and to public enterprises
X-M = current account surplus
F = net foreign capital inflows (borrowing)
DIV = miscellaneous

Setting credit ceilings involves a forecast of the demand for liquid assets (L) (more precisely, a forecast of L-, which excludes emigrants' deposits, is made), an estimate of the bank financing of the government deficit (DC^{g}) and limits to foreign borrowing (F). Given a target for the current account (X-M), permissible bank credit to the private sector and public enterprises (DC^{pr}) is therefore a residual.

31. Banks handle the primary market, with the Central Bank defending a reservation price; banks can then resell to the public either outright or with repurchase agreements.

32. Other financial instruments were introduced from 1986, such as mixed equity bonds (titulos de participaçào), zero coupon bonds and bonds with automatic capitalisation of interest (titulos de capitalizaçào automatica).

33. Government policy for capital markets has also included fiscal incentives. Decree Law 172/86 (June 1986) granted substantial fiscal advantages to both issuers and subscribers of shares; these exemptions were later (in March 1987) much reduced (for enterprises) or abolished (for subscribers). This contributed to the bunching of share issues at the end of 1986.

34. If it is wished to reduce the debt/GDP ratio, the primary surplus (as a percentage of GDP) should exceed the product of the initial debt/GDP ratio by the difference between the nominal interest rate and GDP growth. See Annex I.

Annex I

Technical notes

A. FISCAL POLICY INDICATORS

The indicators of fiscal policy stance were prepared by the OECD Secretariat from the general government accounts drawn up by the Ministry of Finance for 1986 and 1987 and by the Bank of Portugal for earlier years. The general government borrowing requirement (including capital transfers but excluding other financial transactions) used to measure the degree of expansionary impact of fiscal policy excludes interest payments made in 1986 and 1987 under the exceptional regularisation of a number of transactions (see Part II). The stock of public debt on which the adjustment for inflation was made also excludes the payments directly attributable to the latter transactions. Table A.1 shows the indicators in terms of changes in the budget balance. A reduction in the deficit (–) indicates a restrictive impact while an increase (+) indicates an expansionary impact.

Table A.1. **Breakdown of changes in the general government financial balance**

	Change in actual balance	Change related to built-in stabilizers	Change in structural balance	Change in structural balance adjusted for inflation
1975	1.7	2.9	–1.2	–1.4
1976	2.4	–0.8	3.2	2.6
1977	–1.2	–1.0	–0.2	–3.2
1978	4.9	0.1	4.8	5.9
1979	–2.0	–1.3	–0.7	–2.4
1980	1.3	–0.7	2.0	3.2
1981	1.3	0.4	0.9	0.4
1982	1.3	–0.2	1.5	1.2
1983	–1.4	1.4	–2.8	–4.1
1984	3.0	2.0	1.0	0.2
1985	–2.3	–0.9	–1.4	0.9
1986[1]	–3.7	–1.3	–2.4	–0.3
1987[1]	–0.6	–1.7	1.1	1.6

1. Adjusted for the effect of special factors from 1986 onwards.
Source: OECD Secretariat.

Built-in stabilizers are cyclical sources of changes in the budget deficit, measured by the fiscal response to the difference between the actual growth rate of real GDP and the underlying trend. Thus, the budget deficit tends to increase automatically when private sector demand turns down because tax revenue falls and expenditure on unemployment compensation rises. The calculations were based on an underlying GDP growth rate of 3¼ per cent up to 1980 and of 2¼ per cent thereafter, and on a tax revenue elasticity with respect to GDP of 1.2. These assumptions – a relatively low underlying growth rate since 1980 and a relatively high tax revenue elasticity – result perhaps in an overestimation of the impact of built-in stabilizers, and thus in an underestimation of the structural balance since 1980.

The change in the *structural balance* reflects the impact of the authorities' discretionary action, but also the automatic effects of changes in the inflation rate on taxation and the effects of changes in nominal interest rates on the cost of debt servicing.

The change in *the structural balance adjusted for inflation* takes account of the effect of price increases on outstanding net public debt. The latter's real value falls when inflation is accelerating. However, with the recent slowdown of inflation, the effect is smaller so that a reduction of the same magnitude in the structural deficit has a less restrictive impact than during periods of high inflation, while an increase in it has a more expansionary impact. A detailed analysis of adjustment for inflation for the period 1974-85 is set out in the Technical Annex of the *Economic Survey of Portugal*, May 1986.

B. CONSTANT MARKET SHARE ANALYSIS FOR PORTUGAL

The main results of the constant market share analysis[1] are the following:

- The differential between world imports and Portuguese exports growth showed no definite pattern during 1966-1973. It became very negative in 1973-74; this movement was reversed in 1975 and since 1977 it has been positive, resulting in market share gains for Portugal (Diagram A1, panel A);
- The *product effect* shows that the commodity composition of Portuguese exports has had a varying influence on the growth differential over the period considered. The product effect was positive in 1971-73, in 1976-78 and in 1983-85. The positive contribution is, however, modest in percentage terms, except for 1972;
- The contribution of the *market effect* was more markedly negative. Although positive changes occurred in 1966-68 and in 1977-81, they were small if compared to the average for the period. Overall Portugal's export structure appears to have failed to take full advantage of the fastest-growing areas of world demand;

1. For a description of the methodology followed, see Leamer-Stern. In the present case, fourteen areas of export destination have been selected for each of the twenty-two industries chosen according to the ISIC classification, category 3, comprising a wide classification of manufactured goods. The diagrams represent, respectively, growth rates of two-year moving averages of exports and world imports and their decomposition over two-year periods.

- A close analysis of the *residual* bears interesting results: in fact, it has largely dominated the movements of the growth differential since 1973. In the period after 1981, the gains in world market shares are entirely due to residual influences, the market and the product effects being respectively negative or only slightly and temporarily positive. Furthermore, unlike in other countries, the residual for Portugal has remained positive since 1977.

Analysing in more detail the product effect (Diagram A1, panel B), one notes that chemicals, foodstuff, paper, wood products and textiles have accounted for about 65 per cent of Portuguese exports since 1966, textiles alone being 30 per cent of the total. The importance of food and wood products in total exports has decreased by more than a half since 1966, that of paper has doubled and that of chemicals and textiles has remained stable.

Given the size of these industries in Portuguese exports, it is important to assess how these goods affected the product effect and hence contributed to the growth differential. Overall, these main five industries contributed negatively to the product effect, while the opposite was true for the other components of trade, except for 1978. This might be interpreted as showing a very sluggish adjustment of Portuguese exports to take advantage of the more rapidly-growing sectors of world demand. However, the behaviour of exports of foodstuff shows that Portugal has been shifting resources away from that production into sectors whose world demand grows faster, a "proper" pattern of adjustment. Thus, although negative throughout almost the entire period, the product effect of foodstuff has become less of a burden since the second half of the 1970s, as this indeed lost importance in Portugal's total exports (from 25 per cent in 1966 to 10 per cent in 1985).

Another key product in Portuguese exports is textiles which has accounted for about 33 per cent of Portuguese total exports over the period considered. Overall, textiles also contributed negatively to the growth differential, and the share of textiles in Portuguese total exports has not appreciably changed.

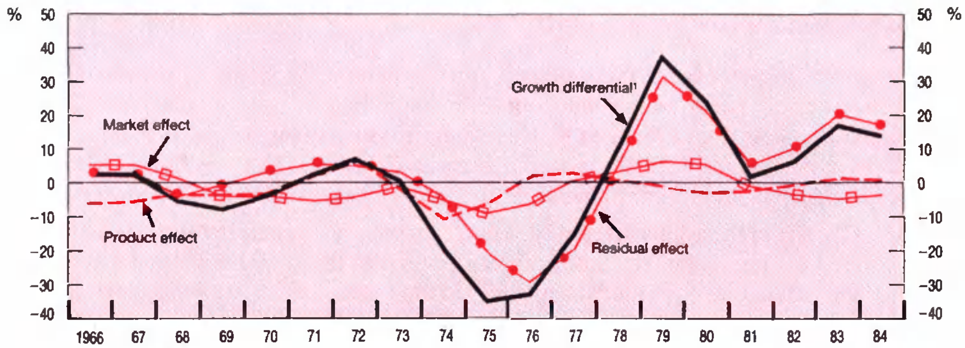
The Constant Market Share analysis provides more disaggregated information on the market effect (Diagram A1, panel C). The United Kingdom, France, Germany, Sweden, the United States and the Escudo area are Portugal's main export markets. Swings in some of Portugal's major export market growth were the main determinants of the market effect.

Over the 1968-77 period, the negative contribution of the market effect to the growth differential was largely determined by the falling market growth of the Escudo area. A partially offsetting influence was provided by the OECD area – excluding the United States – which contributed positively in the 1970-73 period; its influence is clearly shown in the movement of the market effect over those three years. The fall in the OECD contribution after 1973 was caused by the first oil shock and the economic activity slowdown in industrial countries. On the other hand, the effect due to the rest of the world was positive in the 1973-76 period, mainly for the strong import growth in OPEC countries; this latter influence was not however sufficient to compensate for the other depressing factors, as Portugal could not shift its market distinction accordingly.

From 1977 to 1981, the market effect was positive (all the markets contributed positively to the growth differential, except for the United States whose contribution became negative in mid-1978). It has turned negative since 1981 as all of Portugal's main export markets have

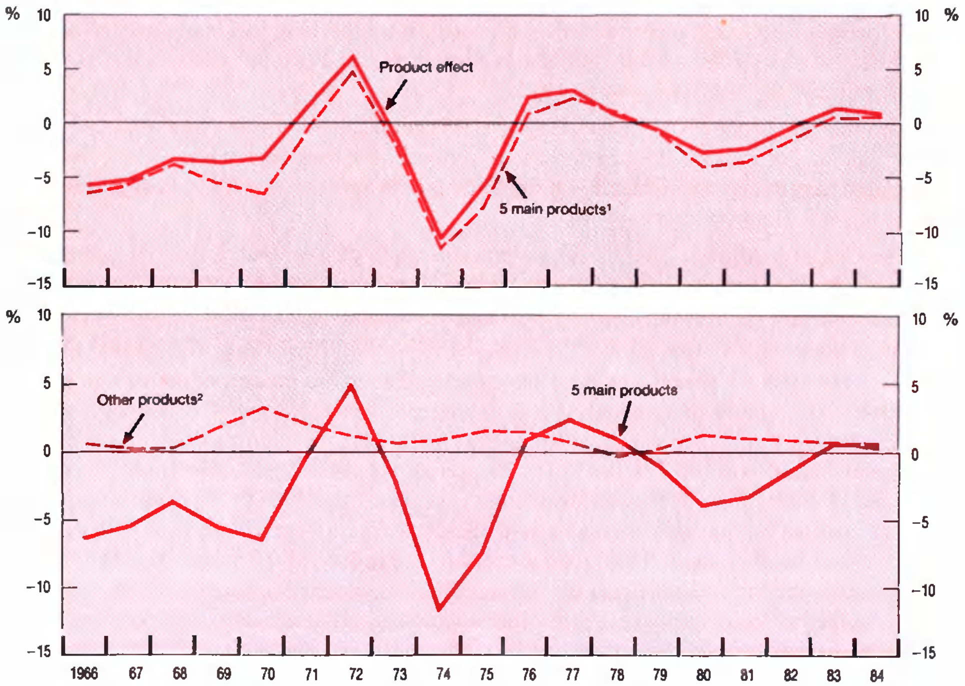
Diagram A1. **PORTUGUESE EXPORT CONSTANT MARKET SHARE ANALYSIS**

A. Decomposition of the growth differential



1. Excess growth of Portugal's total exports over world total imports.

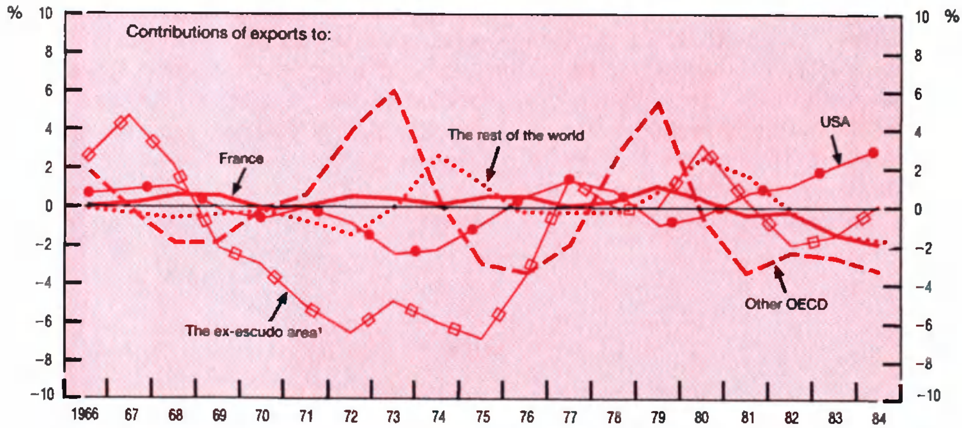
B. Decomposition of the product effect



1. Sum of contributions of chemicals, foodstuff, paper, wood products and textiles.
2. Sum of contributions of all commodities excluding the 5 main products.

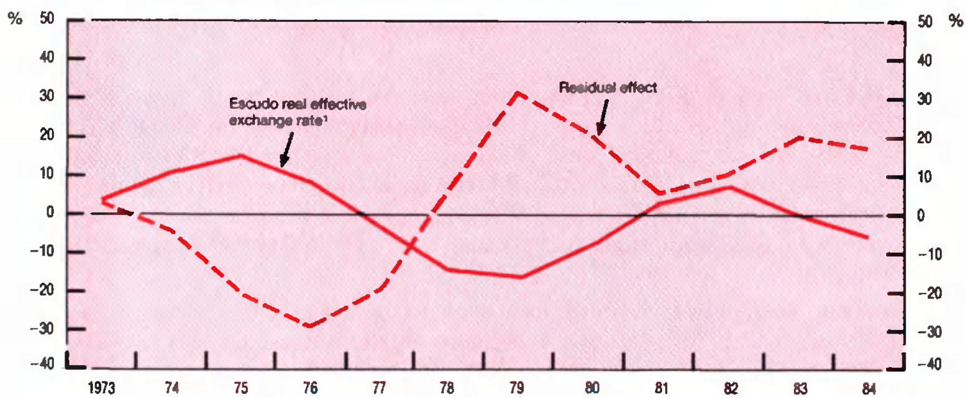
Diagram A.1 (cont'd)

C. Decomposition of the market effet



1. Mozambique, Angola, Guinea-Bissau, Cape Verde Islands, Sao Tome, Principe.

D. Residual effect from 1973



1. Percentage change over 2 years, lagged 1 period, deflated by the CPI.

Source: OECD Secretariat.

brought a negative contribution with the only exception being the United States. As a general remark, since 1970 this country has always exerted an opposite influence on the market effect as compared to the whole OECD area.

If volume data was available in this analysis, a positive (negative) residual over time could be interpreted as a gain (loss) of competitiveness. Although such a straightforward conclusion cannot be drawn in this case, as value data was used, interesting inferences are suggested by the correlation coefficient between the residual and the change in the escudo real effective exchange rate (lagged one period); this was in fact negative and statistically significant, with a point estimate of about 0.70 over the 1973-85 period. The sign is "right", as a downward movement of the exchange rate index indicates a real devaluation which, in turn, stimulates export growth. This supports the conclusion that in the case of Portugal, despite the use of value data, changes in the residual may be interpreted as gains or losses in price-competitiveness. This relationship is depicted by Diagram A1, panel D, where the residual and the lagged exchange rate are plotted against time. There are two large swings in the schedules. The first one is a loss of competitiveness due to the high inflation period following the revolution, matched by a downward movement of the residual. The second is the rise in the residual due to the 1977-79 devaluation in the context of the stabilization plan.

C. DEBT DYNAMICS IN PORTUGAL

This annex discusses the interrelationship between deficits, debt and interest payments.

Theoretical debt dynamics

Traditional analysis of the relationship between budget deficits and debt/GDP ratios starts from a framework of some very simple Domar-type dynamic models. Domar's Theorem about stability (in a mathematical sense, i.e. tends to some finite limit) is that, if the nominal rate of interest exceeds the nominal rate of GDP growth, the debt/GDP ratio will always explode for any deficit. Hence deficits financed by debt cannot go on indefinitely. Only if the nominal interest rate equals or is less than the nominal rate of GDP growth will the debt/GDP ratio be stable[1].

However, these limits apply in the long run – and possibly the very long run: for policy analysis, the path of debt/GDP ratios is more interesting. An interesting result here is that, for the debt/GDP ratio to decline, the primary surplus must exceed the product of the debt/GDP ratio and the difference between the rate of interest and the rate of growth.

The Domar method: standard version

The standard version assumes constant GDP growth; that tax and non-interest expenditure by government are both constant proportions of GDP; and that all deficits are financed by issuing debt. This system can be described:

(1)	$Y_t = Y_0 e^{gt}$	where Y	=	nominal GDP, growing at constant rate g
(2)	$T_t = sY_t$	T	=	tax revenue
		s	=	tax rate

(3) $G_t \quad = aY_t$

(3*a*) $G_t - T_t \; = (a-s)Y_t \; = \; pY_t$

G = non-interest expenditure by government

a = G, as share of GDP

p = non-interest or "primary" deficit

D = debt

r = Interest rate

(4) $\dfrac{dD_t}{dt} \quad = G_t + rD_t - T_t$

(4*a*) $\quad = pY_t + rD_t$

= Non-interest deficit + interest payments

Integrating this differential equation yields the general solution

(5) $D_t = Ce^{rt} + \dfrac{pYt}{g-r}$

where C is the constant of integration [its actual value would depend on initial debt conditions as well as the other constants and would be given by writing $t = 0$ in (5)]

Dividing through by Y_t and using (1)

(6) $\dfrac{D_t}{Y_t} = \dfrac{C}{Y_o} e^{(r-g)t} + \dfrac{p}{g-r}$

The existence of a limit for D_t/Y_t generally requires strict inequality[2]. If $g = r$ *and* $p = 0$ the second term on the right-hand side becomes indeterminate.

If $g > r$ [i.e. growth in Y exceeds the nominal interest rate],

(7) then $\text{Lim}_{\; t \to \infty} \left[\dfrac{D_t}{Y_t}\right] = \dfrac{p}{g-r}$

But if $g \leqslant r$, D_t/Y_t increases without limit (if $g = r$, second term is infinite).

This proposition is Domar's Law[3]. For instance, a primary deficit of 5 per cent of GDP and growth 2 per cent above the interest rate, would imply an ultimate debt/GDP ratio of 2.5 (i.e. 5 divided by 2).

In the period 1976-80, nominal GDP growth in Portugal exceeded the nominal interest rate by 19.7 percentage points (see line 5*a* in Table 27): a "primary deficit" of 5.0 per cent of GDP (line 2) would have implied an ultimate debt/GDP ratio of "only" 0.25. Over the period 1981-86, nominal growth exceeded the interest rate by 7.9 per cent (5*a*): a smaller primary deficit (4.2 per cent of GDP) was associated with an ultimate debt/GDP ratio of 0.58. In Table 27, the effects deriving from exchange rate changes on debt held abroad are taken into account and are regarded as interest rate components (line 4*b*).

To see how the debt/GDP changes, differentiate (6) with respect to t:

(8) $\dfrac{d}{dt}\left[\dfrac{D_t}{Y_t}\right] = (r-g)\,\dfrac{C}{Y_o}\, e^{(r-g)t}$

(9) $\quad = (r-g)\left[\dfrac{D_o}{Y_o} - \dfrac{p}{(g-r)}\right] e^{(r-g)t}$

by writing $t = 0$ in (5) to define the constant of integration.

Examining the sign of (9), if $r > g$ (the normal case), then (9) is negative if and only if

$$(10) \quad \frac{-p}{r-g} > \frac{D_o}{Y_o} \quad (D_o > 0)$$

That is, to get the debt/GDP ratio to decline, the primary surplus must exceed the product of the debt/GDP ratio and the difference between the rate of interest and the rate of growth of GDP. For instance, if the debt/GDP ratio is 1.5 and the rate of interest is two percentage points above the rate of growth of GDP, then a primary surplus equal to 3 per cent of GDP will be required.

Deficits and debt/GDP ratios: graph scenarios

The assumptions underlying the illustrative scenarios are:

i) Nominal GDP increases at a constant rate *(9 per cent)* from 1987 onwards;
ii) The initial debt (at the beginning of 1988) is Esc.3 383 *billion;*
iii) The interest rate (including the revaluation effects) is constant (*11 per cent*), and interest payments are defined as this interest rate multiplied by the initial debt of the year;
iv) Debt/GDP ratio is calculated as *average* debt (i.e. average of initial and year-end debt) divided by GDP.

Under such assumptions:

i) The primary deficit is held constant at the 1987 level (1.0 per cent);
ii) Under the adjustment scenario, the primary deficit is reduced by 1 per cent per year over a three-year period and then it is held constant.

Notes and references

1. This is inconsistent with an optimal inter-temporal allocation of resources. According to Phelp's Golden Rule of Economic Growth, if the marginal product of capital (i.e. the interest rate) is below the growth rate, then consumption per capita can be permanently increased by investing less until the marginal product of capital equals the growth rate. The normal assumption is indeed that nominal interest rates exceed nominal GDP growth: with the exception of periods of unusual inflation, this has been broadly true historically.
2. Equality is possible if the non-interest deficit is held constant while GDP rises (in other words a more restrictive fiscal policy is adopted). If the non-interest deficit is constant, the (4) can be modified as

   $$\frac{dD_t}{dt} = K + rD_t$$

   Integrating gives a general solution of

   $$D_t = Ce^{rt} - \frac{K}{r}$$

   Hence $\frac{D_t}{Y_t} = \frac{Ce^{(r-g)t}}{Y_o} - \frac{K}{rY_t}$

   As $t \rightarrow \infty$,

   $- r > g$, the first term dominates and explodes;

   $- r = g$, the first term dominates and tends to $\frac{C}{Y_o}$. This limit depends purely on initial debt conditions.

   $- r < g$ the second term dominates, and tends to zero.
   In this case, then, a positive limit exists also for $r = g$ (strict inequality is not required as before). If $r < g$, this policy would imply continuous reductions in debt/GDP ratios.
3. But it might be noted that the original Domar formulation was much simpler. This assumed that the total deficit (non-interest plus interest) was maintained as a constant proportion of GDP.

[4**] $\frac{dD_t}{dt} = (b - s) \quad Y_t$ where b is total government expenditure as a per cent of GDP.

Integrating,

[5**] $D_t = \frac{b-s}{g} Y_t + C$

The debt/GDP ratio tends to a finite limit unless $g = 0$ (constant GDP), positive if $b > s$ [i.e. government runs a deficit] and negative if $b < s$ [i.e. government runs a surplus].

D. DEMAND FOR MONEY IN PORTUGAL

The demand for money in Portugal was estimated using standard partial adjustment models. The estimated variables were:

M1 = currency and demand deposits

L = M1 plus time deposits and, starting from August 1985, short-term Treasury bills and

LM1 = the ratio of M1 to total liquidity, L

Yearly data were used: data on quarterly GDP do not exist and regressions based on interpolations performed poorly. In addition, specifications with dummies, to take into account the dramatic political and economic changes over the period 1974-76, were not statistically significant and were therefore disregarded.

The main findings for the three monetary aggregates are shown in Table A2. The main difference between M1 and L is the opportunity cost variable, which is the short-term interest rate for M1 (equation I) and the inflation rate for L (equation III*a*) reflecting the substitution between real and financial assets. The nominal interest rate is not an argument of the L equation because of aggregation of time deposits (positively related to interest rate) and M1 (negatively related). Previous regressions including the interest rate in III*a* resulted in a statistically insignificant interest rate coefficient. However, the real interest rate was positive and significant in equation III*b*.

All coefficients have the expected sign and are statistically significant, except for real GDP in IIIb. The results of this equation will be discussed below. A Chow test provides evidence of long-run stability in the demand for money (Table A3).

The detailed findings of each specification are the following:

- The equation for M1 assumes linear homogeneity. In order to verify whether this hypothesis holds in the specific sample, two alternative tests were carried out following Goldfeld[1]. In the first one, CPI was included in the original equation. The homogeneity assumption should not be rejected since the B4 (the CPI coefficient) was not significantly different from zero; in addition, the other coefficients differ and only to a small extent from those of equation I. The above findings were confirmed by the second test, which involves re-estimating the same equation in nominal terms and testing the hypothesis B4=1-B3 (B3 is the nominal income coefficient), and by the long-term price elasticity which is close to unity (0.96). In equation I, the H-statistic shows no serial correlation and both the coefficients and the long-run elasticities seem plausible. The long-run income elasticity is almost one (0.95) and it would imply a constant income velocity of money. However, Portugal's velocity has been constantly increasing until 1984 and it has begun to fall in mid-1985. The same trend is shown by the short-term interest rate (Diagram A2). It emerges that, besides being very responsive to the interest rate, M1 adjusts very rapidly to changes in the short-term interest rate. Both the mean lag of the model and the coefficient of adjustment point to rapid adjustment of the actual to the desired demand for money: 53 per cent of actual holdings of money adjusts to the desired level in little over a year (0.53/(1-0.53) and total adjustment is completed in three years. Using the Chow test for long-run stability, but without imposing a specific sample split, the only F statistic which is slightly above the 5 per cent significance level (3.36) occurred in 1974-75, during the revolutionary period.

Table A.2. **Results of Portugal's estimated demand for money**

Dependent variable: (I) log of real demand for M1 (RM1)
(II) log of M1 share in total liquidity (M1/L = LM1)
(III) log of real demand for total liquidity (RL)
(t – statistics in parenthesis)

Estimation period: 1968-1986

Coefficients	Constant	GDPV	IRS	INFL	IRS-INFL	RH01	RH02	RM1 (–1)	LM1(–1)	RL(–1)
I.	0.60	0.45	–0.28					0.53		
	(0.38)	(2.3)	(–4.36)					(4.15)		
				SEE	0.066					
				ADJ.R²	0.907					
				H-Stat	0.06					
II.		–1.15	–0.16					0.86		
		(–0.98)	(–2.6)					(8.63)		
				SEE	0.068					
				ADJ.R²	0.973					
				H-Stat	0.83					
III. *a)*	–1.13	0.52		–0.15						0.76
	(–3.50)	(5.00)		(–6.37)						(8.60)
				SEE	0.036					
				ADJ.R²	0.974					
				H-Stat	0.83					
b)	1.12	0.11			0.10	0.85	–0.54			0.72
	(2.0)	(0.53)			(3.48)					(4.05)
				SEE	0.042					
				ADJ.R² corrigé	0.898					
				H-Stat	0.18					

Définition of variables: GDPV: log (GDP/GDP deflator)
IRS: log short-term interest rate
INFL: log (CPI/CPIt–1)
IRS-INFL: log IRS – log INFL

Source: OECD Secretariat on the basis of data from OECD, *Main Economic Indicators, Financial Statistics Monthly;* Bank of Portugal.

– Two specifications are used for L: one using inflation as the explanatory variable, the other using the real interest rate. In equation III*a*, the assumption of lack of money illusion is not fully confirmed by the formal tests. While the condition B4 = 0 is met in the first test, since the CPI coefficient is close to zero, the second test cannot be performed because the regression using nominal variables results in a negative CPI coefficient, a finding which is not economically acceptable. Institutional arrangements are partially responsible for this result. In Portugal, administered prices have a large weight in the CPI index. In the context of the IMF stand-by agreements – 1978-79 and 1983-84 – restrictive monetary policies were combined with administered price hikes. This policy mix brought about a contemporary fall in money demand and an increase in the CPI index and it was reflected in a negative CPI coefficient. Apart from doubt about linear homogeneity, the rest of the results are satisfactory in that all the coefficients are statistically significant, there is no serial correlation and the standard error is acceptable. The long-run income elasticity

Table A.3. **Test of stability of the estimated parameters in the demand for money**[1]

	1968-72 1973-86	1968-73 1974-86	1968-74 1975-86	1968-75 1976-86	1968-76 1977-86	1968-77 1978-86	1968-78 1979-86	1968-79 1980-86	1968-80 1981-86	1968-81 1982-86
I.[2]	2.48	2.67	4.06	0.45	0.42	0.68	0.83	1.11	1.08	1.18
II.[2]	8.26	8.04	3.83	1.01	1.00	0.82	0.51	0.44	0.53	0.12
III.*a*[2]	1.31	2.85	2.05	2.91	1.86	1.44	1.64	1.86	3.25	3.26

1. Chow test: $\dfrac{[\text{RSS (constrained)} - \text{RSS (unconstrained)}]/K}{\text{RSS (unconstrained)}/(T_1 + T_2 - 2k)}$

RSS = residual sum of squares
K = number of parameters estimated
T1 = number of observations in the first period
T2 = nomber of observations in the second period
Valeur de F(4, 11) value at 5 per cent = 3.36

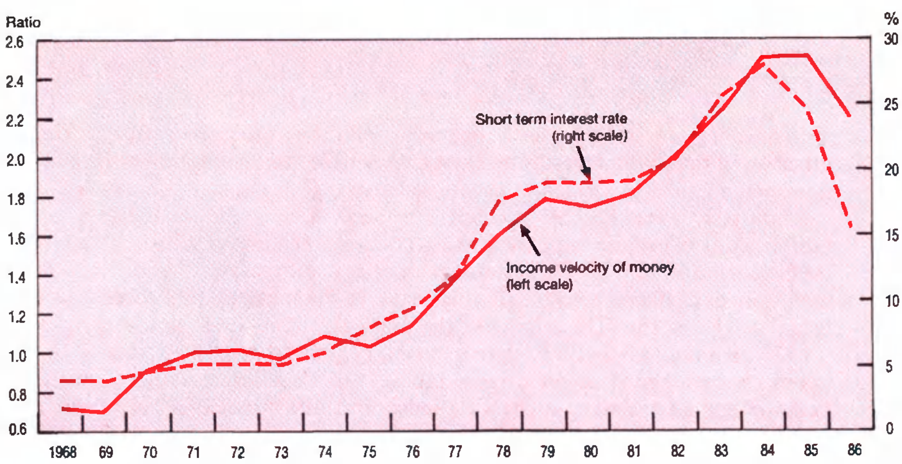
2. See previous table for equation specification.

Source: OECD Secretariat.

(2.16) and the time of adjustment (4½ years) seem too large. Dynamic simulation tests imposing lower income elasticities did not however suggest lower values performed better (Table A4). The results are similar to those presented in a recent study on Portugal's demand for money[2]. Finally, the Chow test provides no evidence of instability (Table A3).

– In equation III*b*, where inflation is replaced by the real interest rate, real income is not statistically significant. Although one may see this problem rising from the

Diagram A2. **INCOME VELOCITY OF MONEY AND SHORT TERM INTEREST RATE**



Sources: Bank of Portugal; OECD Secretariat.

Table A.4. **Results of historical simulations based on different income elasticity assumptions**
(equation III*a*)

Income elasticity	Mean of RL	RMSE[1]	RMSPE[2]	Mean error	Mean per cent error	U[3]
2.16	7.24	0.31	4.5	0.30	4.41	0.43
2.10	6.80	0.15	2.1	0.13	1.96	0.45
2.05	6.57	0.37	5.34	0.35	5.10	0.58
2.00	6.35	0.60	8.60	0.58	8.27	0.76
1.9	5.91	1.06	15.14	1.02	16.61	1.2

1. Root mean square error.
2. Root mean square per cent error.
3. U = Theil inequality coefficient. If U = 0 simulated equals actual dependent variable. If U = 1 there is not fit between simulated and actual dependent variable.

Source: OECD Secretariat.

relationship between real income and the interest rate, multicollinearity is nonetheless excluded by the correlation coefficient (0.45) calculated between income and interest rate. Two and a half years are needed for the actual money demand to adjust to its desired level and total time of adjustment is about four years. Serial correlation correction using Cochrane-Orcutt used up the degrees of freedom so that they were no longer sufficient for the Chow test. An alternative test of stability, the recursive residuals analysis, testing whether the prediction errors show a random movement around the expected mean value, was used. Residual movements showing a strong pattern imply a change of the independent variable coefficients over time and this is detected by ad hoc statistics. One statistic used to test this is the cumulative sum of squared residuals (cusum). The cusum test result (0.187) was below the critical value at 5 per cent significance (0.31) and therefore the stability assumption could not be rejected.

Notes and references

1. S.M. Goldfeld, "The Demand for Money Revisited", *Brookings Papers on Economic Activity*, 1973:3, Washington DC, The Brookings Institution, 1973.
2. M. Antao, "External Disequilibrium Problems in Portugal in the 70's – Some Evidence from a Monetary Approach", *Quatrième Journée Internationale d'Economie Monétaire et Bancaire*, Aix-en-Provence, 11th-12th June 1987.

Annex II

Main economic policy measures

1986

January

Introduction of VAT at rates of 8, 16 and 30 per cent.

Minimum wage increased by 17 per cent and public sector pay and pensions by 16.5 per cent.

Abolition of prior authorisation requirement for investment by EEC Member countries under ECUs 1.5 million. This limit will be raised by ECUs 300 000 a year up to 1990 when the authorisation requirement will be completely abolished.

The 1 per cent per month crawling-peg devaluation of the escudo temporarily halted, until 1st April 1986.

1 per cent reduction in social security contributions for 1986.

Social insurance exemptions for employers who hire young workers on fixed long-term contracts.

The Central Bank authorised to issue short-term bonds on the money market and to pay interest on certain deposits by government departments and banks.

February

Financial assistance to the 18-25 year old unemployed who have already been employed for at least one year.

March

Commercial and investment banks conditionally authorised to offer housing loans.

Credit institutions authorised to offer deposit facilities other than those already in existence.

May

Supply Fund abolished.

Fuel prices cut by 6.5 per cent.

April

Reintroduction of the monthly devaluation of the escudo.

June

Discount rate lowered by 1.5 percentage points, and the minimum bank lending rate by 3 percentage points.

Removal of the ceiling on investment credits of five years and over.

The effective monthly rate of depreciation of the escudo set at 0.7 per cent for the third quarter and at 0.6 per cent for the fourth quarter.

Introduction of tax incentives for investment.

July-August

Supplementary budget of Esc 7.1 billion for defence expenditure and civil servants' early retirement scheme, met out of additional VAT revenue.

September

Old-age and disability pensions raised (at a cost of Esc 9 billion in 1986 and Esc 26 billion in 1987).

October

Presentation of draft budget for 1987.
- Current expenditure up by 13 per cent
- Capital expenditure up by 15.8 per cent
- Budget deficit equivalent to 8.9 per cent of GDP.

December

Minimum wage raised by 12 per cent in industry, by 14.9 per cent in agriculture and by 15 per cent in the domestic services sector.

Adoption of a structural reform programme for agriculture.

1987

January

The effective monthly rate of devaluation of the escudo cut to 0.5 per cent.

Discount rate lowered from 16 to 15½ per cent. Other controlled interest rates cut by ½ percentage point.

Compulsory reserve ratio on sight deposits raised to 15 per cent. Ratios on other types of deposits unchanged.

February

Introduction of a forward exchange market.

Creation of certificates of deposit with maturities ranging from 180 days to 5 years; the interest rate is not controlled.

March

Tax incentives (industrial tax relief) to firms issuing listed securities.

Discount rate cut from 15½ per cent to 15 per cent. Other controlled interest rates also lowered by ½ percentage point. Top rate on loans set at 19½ per cent.

Ceiling on Treasury bills in circulation in 1987 set at Esc 700 billion.

Approval of the "Programme for the Structural Adjustment of the Foreign Deficit and Unemployment" (PCEDED).

April

Introduction of tax incentives for investment that meets the objectives of the PCEDED.

Maximum length of time set for Interbank money market transactions.

May

The Interbank securities market rate raised to 15½ per cent on 90-day transactions.

Settlement procedure for stock market transactions simplified.

June

Stock-exchange-listed firms required to disclose information on their trading during the first half of each year.

August

Industrial tax relief for enterprises that take on workers in high-unemployment regions.

Creation of monetary intervention bills (TIMs) for issue by the Bank of Portugal; credit institutions authorised to place time deposits with the Bank. Rates set at 15.94 and 15.88 per cent respectively for time deposits and TIMs.

Regulations governing the Interbank market in Treasury bills amended: insurance companies allowed to participate in the primary market.

Supplementary unemployment benefits introduced for young first-job-seekers.

Suspension of tax relief on share purchases and Investment Fund certificate subscriptions.

Clarification of the tax arrangements (capital gains and industrial tax) applicable to income and capital gains accruing from the carry-over of securities.

October

Controlled rates, the discount rate and time-deposit rates cut by ½ percentage point.

Ceiling on lending rates lowered by 1 percentage point.

Surtax on consumer credit raised.

Abolition of the Compensation Fund.

November

Abolition of the 5 per cent limit on daily fluctuations in stock prices.

Creation of a medium-term Treasury bond market.

December

Progressive liberalisation of capital movements started. Institutions authorised to engage in foreign exchange dealing may, under certain conditions, transfer funds corresponding to "capital movements of a personal nature" without the prior authorisation of the Bank of Portugal.

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STATISTICAL ANNEX

Selected background statistics

	Average 1977-86	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
A. Percentage changes											
Private consumption [1]	1.0	0.6	–2.0	–0.2	3.9	1.9	2.1	–1.0	–3.0	1.0	7.0
Gross fixed capital formation [1]	1.1	12.0	7.1	–2.2	8.6	5.1	2.9	–7.5	–18.0	–3.0	9.5
GDP [1]	2.9	5.6	3.4	6.1	4.8	1.3	2.4	–0.3	–1.6	3.3	4.3
GDP price deflator	21.4	26.4	21.7	18.9	20.7	18.0	20.4	24.9	23.9	21.7	17.8
Industrial production	4.8	13.3	6.8	7.2	5.4	0.4	4.7	1.6	–0.1	4.1	5.0
Employment	0.7	–0.1	–0.3	2.2	2.2	–0.6	0.3	5.5	–1.9	–0.5	0.2
Compensation of employees (current prices)	21.1	20.5	18.9	22.7	28.4	22.2	22.4	19.6	16.1	22.3	18.7
Productivity (real GDP/employment)	2.2	5.7	3.7	3.9	2.5	1.8	2.1	–5.5	0.3	3.8	4.1
Unit labour costs (compensation/real GDP)	17.7	14.1	15.0	15.6	22.5	20.7	19.6	20.0	18.0	18.4	13.8
B. Percentage ratios											
Gross fixed capital formation as percent of GDP at constant prices	24.7	26.5	27.5	25.3	26.2	27.2	27.3	25.4	21.1	19.9	20.8
Stockbuilding as percent of GDP at constant prices	3.4	2.5	1.9	4.9	5.9	6.1	6.3	1.2	0.8	1.5	2.6
Foreign balance as percent of GDP at constant prices	–7.5	–15.0	–11.7	–8.5	–10.3	–12.2	–12.4	–5.3	–0.4	1.8	–1.4
Compensation of employees as percent of GDP at current prices	50.4	55.2	52.2	50.7	51.5	52.6	52.3	50.3	47.9	46.6	45.0
Direct taxes as percent of disposable income	5.7	5.1	5.1	5.3	5.1	5.9	6.0	7.0	5.8	6.3	5.6
Household saving as percent of disposable income	26.9	20.0	25.5	28.8	28.6	27.2	28.7	27.7	28.0	28.5	26.3
Unemployment rate [2]	8.1	7.5	8.1	8.2	7.8	7.6	7.5	8.3	8.5	8.6	8.6
C. Other indicator											
Current balance (billion dollars)	–1.0	–1.5	–0.8	–0.1	–1.3	–2.9	–3.2	–1.6	–0.6	0.4	1.2

1. At constant 1977 prices.
2. Data based on the narrowest definition of unemployment.

Sources: National Institute of Statistics (INE); Bank of Portugal; OECD Secretariat.

Table A. **Expenditure on gross domestic product, current prices**

Billion escudos

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Private consumption	450.4	535.4	670.3	845.5	1 045.4	1 287.1	1 596.2	1 979.0	2 378.6	2 849.2
Public consumption	87.8	109.7	137.6	182.6	225.9	276.2	348.4	405.5	501.9	609.2
Gross fixed investment	165.8	219.8	264.0	358.8	463.0	574.8	671.5	669.9	766.7	936.1
Final domestic demand	704.0	864.8	1 071.8	1 387.0	1 734.3	2 138.0	2 616.1	3 054.4	3 647.2	4 394.5
	(31.9)	(22.8)	(23.9)	(29.4)	(25.0)	(23.3)	(22.4)	(16.8)	(19.4)	(20.5)
Stockbuilding	15.9	20.2	29.1	53.2	55.8	56.4	–20.9	–20.4	2.4	50.5
	(2.5)	(0.7)	(1.1)	(2.4)	(0.2)	(0)	(–4.2)	(0)	(0.8)	(1.4)
Total domestic demand	720.0	885.0	1 100.8	1 440.1	1 790.2	2 194.4	2 595.2	3 034.0	3 649.6	4 445.0
	(33.9)	(22.9)	(24.4)	(30.8)	(24.3)	(22.6)	(18.3)	(16.9)	(20.3)	(21.8)
Exports	115.3	158.4	268.7	344.0	389.5	488.5	721.2	1 020.1	1 316.2	1 457.9
Imports	209.4	256.1	376.3	528.0	678.5	832.5	1 014.7	1 248.6	1 439.5	1 569.5
Foreign balance	–94.1	–97.8	– 107.5	– 184.1	– 289.0	– 344.0	– 293.5	– 228.5	– 123.3	– 111.6
	(–6.6)	(–0.6)	(–1.2)	(–7.7)	(–8.4)	(–3.7)	(2.7)	(2.8)	(3.7)	(0.3)
GDP (market prices)	625.8	787.3	993.3	1 256.1	1 501.1	1 850.4	2 301.7	2 805.5	3 526.3	4 333.4
	(31.8)	(25.8)	(26.2)	(26.5)	(19.5)	(23.3)	(24.4)	(21.9)	(25.7)	(22.9)
Net factor income from abroad	–6.9	–14.5	–21.4	–30.6	–61.0	– 103.0	– 119.6	– 177.3	– 196.4	– 153.0
GNP (market prices)	619.0	772.7	971.9	1 225.4	1 440.1	1 747.4	2 182.1	2 628.2	3 329.9	4 180.4
	(31.5)	(24.8)	(25.8)	(26.1)	(17.5)	(21.3)	(24.9)	(20.4)	(26.7)	(25.5)

Note: Figures in parentheses are annual growth rates; for stockbuilding and the foreign balance they are contributions to GDP growth.
Sources: 1977-1983: OECD *National Accounts*; INE; 1984-1986: Central Planning Department; Bank of Portugal.

Table B. **Expenditure on gross domestic product, constant 1977 prices**

Billion escudos

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Private consumption	450.4	441.4	440.5	457.7	466.4	476.2	471.4	457.3	461.8	494.2
Public consumption	87.8	91.7	97.5	105.2	108.1	111.2	114.2	117.0	119.0	120.2
Gross fixed investment	165.8	177.6	173.7	188.7	198.3	204.0	188.7	154.8	150.1	164.4
Final domestic demand	704.0	710.7	711.7	751.5	772.8	791.4	774.3	729.0	731.0	778.7
	(4.4)	(0.9)	(0.1)	(5.6)	(2.8)	(2.4)	(–2.2)	(–5.9)	(0.3)	(6.6)
Stockbuilding	15.9	12.0	33.4	42.6	44.8	47.3	8.8	6.0	11.5	20.8
	(2.4)	(–0.6)	(3.3)	(1.3)	(0.3)	(0.3)	(–5.2)	(–0.4)	(0.8)	(1.3)
Total domestic demand	720.0	722.7	745.1	794.1	817.6	838.7	783.1	735.1	742.5	799.5
	(6.5)	(0.4)	(3.1)	(6.6)	(3.0)	(2.6)	(–6.6)	(–6.1)	(1.0)	(7.9)
Exports	115.3	130.4	165.7	173.2	168.0	178.1	207.8	237.3	263.4	281.9
Imports	209.4	206.1	224.0	247.5	256.7	270.5	247.0	240.3	249.7	292.7
Foreign balance	–94.1	–75.7	–58.3	–74.3	–88.7	–92.5	–39.2	–3.0	13.7	–10.8
	(–2.7)	(2.9)	(2.7)	(–2.3)	(–2.0)	(–0.5)	(7.1)	(4.9)	(2.3)	(–3.4)
GDP (market prices)	625.8	647.0	686.8	719.8	728.9	746.2	744.0	732.0	756.2	788.7
	(5.6)	(3.4)	(6.1)	(4.8)	(1.3)	(2.4)	(–0.3)	(–1.6)	(3.3)	(4.3)

Note: Figures in parentheses are annual growth rates; for stockbuilding and the foreign balance they are contributions to GDP growth.
Sources: 1977-1983: OECD *National Accounts*; INE; 1984-1986: Central Planning Department; Bank of Portugal.

Table C. Gross domestic product, by kind of activity

Billion escudos and percentage changes

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
At current prices										
(Billion escudos)										
Agriculture, forestry and fishing	74.6	94.0	115.0	129.9	134.6	162.9	195.0	259.4	315.8	384.3
Industry[1]	166.4	214.3	284.5	376.4	449.3	521.0	656.0	835.9	1 080.6	1 330.0
Electricity, gas and water	12.0	16.5	19.9	27.0	16.1	33.0	47.2	63.6	80.3	99.7
Construction	47.9	58.8	65.4	88.9	113.0	149.4	174.0	177.6	202.9	244.5
Services	336.0	432.9	531.4	678.4	841.6	953.8	1 204.7	1 488.6	1 892.5	2 206.6
of which: Public administration	69.5	87.7	108.5	144.7	176.7	214.7	265.2	320.4	395.7	479.1
Trade	117.9	147.9	188.4	235.1	280.2	357.4	449.3	556.4	705.3	885.9
Subtotal	636.9	816.5	1 016.2	1 300.6	1 554.6	1 820.1	2 276.9	2 825.1	3 572.1	4 265.1
GDP (at market prices)	625.8	785.4	986.9	1 256.0	1 501.1	1 850.4	2 301.7	2 805.5	3 526.3	4 333.5
At 1977 prices										
(Percentage changes)										
Agriculture, forestry and fishing	..	6.0	20.6	2.3	–6.9	6.0	–7.2	2.7	1.9	4.0
Industry[1]	..	5.5	4.5	6.6	1.4	–0.8	1.5	–0.5	5.1	5.1
Electricity, gas and water	..	1.7	7.3	–15.6	–19.9	34.8	10.0	10.0	6.0	7.0
Construction	..	12.7	2.9	7.0	4.6	2.0	–3.0	–12.0	–4.0	3.0
Services	..	4.8	1.1	6.3	3.1	3.1	0.2	–0.8	4.0	4.3
of which: Public administration	..	5.9	6.7	15.3	4.6	3.8	2.6	2.3	1.3	1.4
Trade	..	–1.0	2.5	5.4	1.8	0.9	–1.0	–2.5	3.9	4.5
GDP (at market prices)	..	3.4	6.1	4.8	1.3	2.4	–0.3	–1.6	3.3	4.3

1. Manufacturing and mining.

Sources: 1977-1981 National Statistics Institute; OECD, *National Accounts*; 1982-1986, estimates, Central Planning Department.

Table D. **Household appropriation account**

Billion escudos

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Compensation of employees	345.3	410.6	503.8	646.8	790.3	967.3	1 157.1	1 343.4	1 643.3	1 941.9
Property and entrepreneurial income	199.4	269.5	366.1	437.4	532.7	687.1	912.5	1 208.2	1 493.8	1 642.3
Domestic transfers	70.0	81.6	97.1	136.8	176.3	250.0	314.2	706.8	827.7	999.7
Foreign transfers	43.5	72.6	121.3	150.1	178.6	215.0	242.0	0	0	0
Gross total income	658.2	834.2	1 088.4	1 371.2	1 677.9	2 119.4	2 625.8	3 258.4	3 964.8	4 583.9
Direct taxes	28.5	36.8	50.4	60.6	84.6	108.5	155.1	160.4	209.8	215.4
Social security contributions	66.7	79.3	96.4	126.4	157.5	205.5	264.0	348.9	427.4	488.4
Disposable income	563.0	718.2	941.6	1 184.2	1 435.7	1 805.4	2 206.7	2 749.1	3 327.6	3 880.1
Consumption	450.4	535.5	670.1	845.1	1 045.4	1 286.7	1 597.4	1 979.6	2 377.4	2 850.0
Savings ratio[1]	20.0	25.4	28.8	28.6	27.2	28.7	27.6	28.0	28.6	26.5
Real disposable income, percentage change	3.4	5.1	4.6	3.6	–0.1	4.3	–2.5	–2.5	1.8	4.1

1. As a percentage of disposable income.

Sources: Ministery of Finance; Bank of Portugal.

Table E. **General government account**

Billion escudos

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Current receipts	191.1	231.9	294.6	387.5	486.4	617.9	852.7	973.3	1 176.6	1 603.7
Direct taxes	37.6	48.0	65.5	80.2	112.8	141.7	196.1	233.8	293.8	339.8
Social security contributions	58.3	69.8	84.2	109.8	136.4	177.6	228.7	263.5	321.9	374.1
Indirect taxes	81.5	96.6	118.1	176.5	213.7	261.9	358.1	426.6	497.6	739.1
Other current receipts	13.7	17.5	26.8	21.1	23.6	36.7	69.8	49.4	63.3	150.7
Current expenditure	192.8	250.0	308.0	396.0	550.1	714.5	949.6	1 200.9	1 396.8	1 793.9
Expenditure on goods and services	87.8	109.7	140.9	161.4	217.6	266.6	333.6	405.5	501.8	606.0
Subsidies	23.7	36.1	40.5	60.9	82.7	104.4	158.9	212.8	150.4	118.9
Interest paid	10.7	21.1	28.5	39.3	77.0	101.1	147.0	199.5	277.9	405.3
Current transfers	70.4	83.1	98.2	134.4	172.8	242.4	310.1	383.1	466.7	663.7
Current balance	–1.7	–18.1	–13.4	–8.5	–63.7	–96.6	–96.9	– 227.6	– 220.2	– 190.2
Capital income	1.3	2.1	1.9	1.7	1.6	7.3	6.4	7.7	9.1	42.1
Capital expenditure	28.7	38.5	49.2	67.7	77.2	102.6	117.9	117.9	143.7	212.9
Fixed investment	18.8	25.8	36.7	52.1	63.4	62.9	70.3	73.5	87.3	102.8
Transfers	9.9	12.7	12.5	15.5	13.8	39.7	47.6	44.4	56.4	110.1
Net loans	2.7	23.9	18.0	21.1	18.2	25.9	30.9	39.3	37.1	41.7
Net lending	–28.9	–78.4	–78.7	–96.0	– 157.4	– 217.8	– 239.3	– 377.1	– 391.9	– 402.7
(as a percentage of GDP)	–4.6	–10.0	–7.9	–7.6	–10.5	–11.8	–10.4	–13.4	–11.1	–9.3

Note: These data, the only long time series available, differ slightly from those from the Ministry of Finance for 1985,1986, and 1987 which are shown in Table 9.
Source: Bank of Portugal.

Table F. Prices and wages

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Indices										
Consumer prices[1]										
1976 = 100										
Total[2]	127.3	156.0	192.8	225.0	269.9	330.3	414.6	536.1	639.6	714.3
Food and drink	131.6	162.8	207.5	228.3	272.8	338.6	423.5	553.9	651.9	711.4
Clothing and footwear	118.7	139.6	173.4	238.4	287.3	332.1	397.8	494.9	610.2	753.3
Housing costs	126.6	156.3	175.6	223.7	269.3	323.5	417.3	558.3	665.4	736.1
Miscellaneous	119.9	145.5	172.5	209.8	253.3	310.8	397.3	495.6	605.9	689.6
Wages in manufacturing industry										
1980 = 100										
Nominal	59.5	69.3	80.4	100.0	121.7	143.5	169.1	199.7	240.5	288.6
Real	105.1	100.4	93.8	100.0	101.4	97.8	91.8	83.8	84.6	88.1
Percentage changes										
Consumer prices[1]										
Total[2]	27.3	22.5	23.6	16.7	20.0	22.4	25.5	29.3	19.3	11.7
Food and drink	31.6	23.7	27.5	10.0	19.5	24.1	25.1	30.8	17.7	9.1
Clothing and footwear	18.7	17.6	24.2	37.5	20.5	15.6	19.8	24.4	23.3	23.5
Housing costs	26.6	23.5	12.3	27.4	20.4	20.1	29.0	33.8	19.2	10.6
Miscellaneous	19.9	21.4	18.6	21.6	20.7	22.7	27.8	24.7	22.3	13.8
Wages in manufacturing industry										
Nominal	16.4	16.5	16.0	24.4	21.7	17.9	17.8	18.1	20.4	20.0
Real	–8.5	–4.5	–6.6	6.6	1.4	–3.6	–6.1	–8.7	1.0	4.1

1. Mainland.
2. Excluding rent.

Sources: INE, *Boletim mensal de estatistica*; Bank of Portugal.

Table G. **Employment indicators**[1]

Indices, 1st quarter 1974 = 100
4th quarter 1983 = 100[2]

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Fishing	88.8	87.7	77.1	75.9	75.0	68.2	63.1	96.4	..	..
Mining	95.1	95.7	96.0	93.1	92.8	91.0	87.0	99.7	100.2	95.5
Manufacturing	99.7	100.0	100.5	101.7	101.3	99.7	97.1	98.9	97.1	95.6
Construction	90.0	91.7	89.0	88.6	93.6	94.4	89.8	89.5	78.4	72.1
Electricity, gas and water	108.5	120.4	129.2	139.5	140.9	143.5	..	102.3	109.9	111.1
Transports and communications	110.9	109.6	107.4	106.7	106.2	105.8	105.5	96.8	92.5	90.8
Trade	98.6	98.0	98.0	99.1	100.0	99.3	97.2	98.6	95.2	93.3
Banking, insurance, real estate	118.9	123.9	129.6	146.1	152.7	157.2	161.3	100.2	97.9	94.3
Personal services	100.1	102.2	103.2	103.6	104.8	106.2	104.6	100.7	100.2	100.4
Total	99.8	100.2	100.3	101.7	102.4	101.5	99.5	98.1	95.1	93.2

1. Wage earners, excluding agriculture and civil service.
2. New series as from 3rd quarter 1983.

Source: Ministry of Labour, Quarterly Employment Survey.

Table H. **Money supply ans its counterparts**

Billion escudos at end of period

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Total money supply (L)	567.4	726.6	996.8	1 345.6	1 730.8	2 190.1	2 637.6	3 365.6	4 295.2	5 250.4
Money (M1-)	274.8	314.9	391.5	478.6	518.6	601.9	654.0	752.9	966.8	1 305.7
Notes and coins in circulation	113.8	122.0	142.1	165.2	188.4	219.5	240.1	267.4	319.0	399.3
Sight deposits, households and enterprises	161.0	192.9	249.4	313.4	330.2	382.4	413.9	485.5	647.8	906.4
Quasi money	292.6	411.7	605.3	867.0	1 212.2	1 588.2	1 983.6	2 612.7	3 328.4	3 944.7
Counterparts										
Net foreign assets	–33.5	–18.9	42.3	339.6	411.7	569.0	759.0	1 039.3	1 162.8	1 084.3
Net lending to the public sector	123.3	171.7	251.2	172.3	314.6	486.2	639.5	877.0	1 331.4	1 829.6
Lending to the private sector	579.3	703.2	852.9	1 077.3	1 348.6	1 681.0	2 065.6	2 469.4	2 731.3	3 070.0
Miscellaneous, net	– 101.7	– 129.4	– 149.6	– 243.6	– 344.1	– 546.1	– 826.5	–1 020.1	– 930.3	– 733.5

1. Including migrant deposits and Treasury bills.

Source: Banco de Portugal, *Quarterly bulletin.*

Table I. **Breakdown by nationality of foreign visitors**

Thousands

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Total	3 055.4	3 389.3	5 287.4	6 977.0	7 277.0	7 299.3	8 875.0	9 811.0	11 691.7	13 056.9
Spain	1 599.5	1 755.2	3 514.8	5 051.1	5 226.9	5 173.3	6 512.6	7 308.8	8 798.2	9 960.2
United Kingdom	292.8	327.9	399.8	483.9	548.5	570.6	629.5	709.7	880.4	1 069.1
Germany	204.2	259.3	286.7	300.1	306.6	289.5	355.3	344.0	413.0	430.3
France	172.4	179.6	183.2	237.4	239.0	288.4	327.9	326.6	347.3	350.1
Netherlands	92.3	111.1	129.8	127.7	128.7	124.7	156.2	151.9	163.8	171.7
United States	141.5	161.5	153.8	135.5	141.7	154.2	186.8	209.4	229.5	149.8
Italy	65.4	72.4	70.1	72.7	68.3	72.5	66.1	71.8	93.4	108.5
Brazil	35.5	45.0	52.1	60.9	64.4	80.2	57.4	60.2	69.2	82.5
Canada	32.0	36.9	40.7	40.3	43.5	42.0	46.8	56.1	70.3	73.8
Sweden	61.0	56.3	51.4	62.7	71.3	71.1	65.5	71.5	54.1	69.4
Belgium	50.7	46.9	48.2	45.6	48.4	48.6	61.4	59.1	67.6	67.7
Switzerland	32.8	31.7	36.0	40.0	41.3	41.2	46.1	53.2	61.1	66.4
Other countries	275.3	305.5	320.8	319.1	348.4	343.0	363.4	388.7	443.9	457.3

Source: INE, *Boletim mensal de estatistica.*

Table J. **Foreign trade by main commodity groups**

Million US dollars

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Imports, total	4 964	5 142	6 529	9 271	9 787	9 541	8 257	7 975	7 650	9 454
Food and beverages	733	679	895	1 104	1 360	1 075	883	920	838	1 040
Basic material and semi-finished goods	1 417	1 399	2 054	3 146	3 264	3 428	3 064	3 376	2 993	2 362
Manufactures	2 812	3 060	3 573	5 015	5 153	5 014	4 289	3 666	3 795	5 998
Chemicals	558	627	794	997	959	880	828	786	779	1 072
Goods classified chiefly by material	789	829	934	1 412	1 271	1 273	1 021	955	1 111	1 673
Machinery and transport equipment	1 285	1 423	1 634	2 305	2 589	2 521	2 158	1 686	1 653	2 772
Miscellaneous	179	181	212	301	333	340	282	240	252	482
Unspecified	2	5	6	6	11	24	21	14	23	54
Exports, total	2 013	2 426	3 478	4 633	4 147	4 173	4 601	5 208	5 685	7 205
Food and beverages	304	350	444	517	430	406	440	457	446	589
Basic material and semi-finished goods	286	296	387	772	764	634	716	789	822	877
Manufactures	1 388	1 732	2 586	3 286	2 899	3 057	3 342	3 921	4 321	5 652
Chemicals	103	129	208	286	247	343	346	403	400	437
Goods classified chiefly by material	667	836	1 236	1 464	1 306	1 247	1 322	1 461	1 577	1 900
Machinery and transport equipment	298	328	429	617	522	584	708	899	885	1 132
Miscellaneous	320	439	713	918	824	882	965	1 157	1 459	2 183
Unspecified	35	48	61	58	54	76	103	40	96	86

Source: OECD, *Foreign Trade Statistics, Series B.*

Table K. **Geographical breakdown of foreign trade**

Billion escudos

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Exports, total	77.7	106.5	176.1	231.6	256.9	331.7	508.6	760.6	971.7	1 082.3
OECD countries	61.4	86.2	142.6	186.9	199.1	271.3	419.9	637.3	828.4	960.2
OECD Europe	54.0	75.6	127.1	168.5	179.6	243.8	374.3	552.8	716.7	864.0
Germany	9.2	14.0	21.6	31.4	32.0	42.9	67.8	104.0	133.3	158.6
France	6.2	9.6	17.1	24.5	32.3	44.1	68.8	94.6	123.7	164.2
Italy	2.9	6.1	10.4	13.2	10.9	15.9	20.6	32.8	38.3	42.9
United Kingdom	14.2	19.4	31.4	34.3	37.1	49.1	75.3	116.9	141.5	154.0
Spain	1.6	2.3	5.1	8.3	7.3	11.7	20.3	33.5	40.3	71.7
Other OECD Europe	21.6	26.5	46.6	65.1	67.3	91.8	141.8	204.5	279.9	344.3
United States	5.2	7.5	10.8	13.2	13.4	20.4	30.9	67.2	89.6	75.6
Other OECD countries	2.1	3.1	4.2	5.2	6.1	7.1	14.7	17.3	22.1	20.6
Non OECD countries	16.3	20.3	33.5	44.7	57.8	60.4	88.7	123.3	143.3	122.1
of which: OPEC	1.4	1.5	3.4	..	9.4	9.7	18.0	18.9	24.2	17.5
Previous Escudo Area	5.0	5.9	9.0	13.8	19.4	16.5	22.7	33.8	37.9	23.3
Imports, total	190.7	230.1	331.9	475.5	609.0	754.0	899.3	1 160.6	1 326.5	1 442.5
OECD countries	138.7	177.4	243.3	325.9	418.1	523.6	625.9	768.6	890.6	1 128.8
OECD Europe	109.9	140.3	188.6	253.4	318.7	408.0	462.6	567.6	698.3	955.2
Germany	23.7	31.9	41.8	55.8	66.9	89.3	102.7	117.9	152.4	205.4
France	15.4	20.7	28.4	34.5	47.4	65.5	74.1	91.7	106.8	145.2
Italy	10.2	12.6	17.1	24.9	32.8	42.4	46.4	54.6	68.6	114.5
United Kingdom	19.8	23.2	30.7	41.6	49.2	58.6	68.7	77.8	100.1	108.3
Spain	9.2	12.5	19.3	26.1	40.1	45.4	45.9	82.8	98.0	157.1
Other OECD Europe	40.8	51.9	70.6	96.6	122.4	152.2	170.7	225.4	270.4	381.8
United States	19.4	27.2	39.0	52.3	72.9	81.5	126.6	156.2	129.0	100.6
Other OECD countries	9.4	9.9	15.7	20.2	26.5	34.1	36.7	45.0	63.3	73.0
Non OECD countries	52.0	52.7	88.6	149.6	190.9	230.4	273.4	392.0	435.9	313.7
of which: OPEC	20.6	27.1	47.9	918.0	113.5	144.6	166.7	214.3	229.8	121.2
Previous Escudo Area	2.2	1.5	3.2	2.2	2.6	3.4	4.1	8.4	15.8	12.1

Source: INE, *Boletim mensal das estatisticas do comercio externo.*

Table L. **Balance of payments**

Million US dollars

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Exports, fob	2 001	2 379	3 550	4 575	4 088	4 108	4 569	5 177	5 673	7 202
Imports, fob	4 533	4 787	6 182	8 781	9 283	8 941	7 643	7 307	7 177	8 874
Trade balance	–2 532	–2 408	–2 632	–4 206	–5 195	–4 833	–3 074	–2 130	–1 504	–1 672
Services, net	–97	–53	104	–45	– 544	–1 092	– 742	– 674	– 361	–84
Travel	268	431	695	859	777	609	588	728	901	1 203
Transports	– 104	– 129	– 114	– 194	– 147	– 282	– 200	– 192	– 184	– 134
Investment income	– 179	– 329	– 437	– 612	– 975	–1 269	–1 066	–1 202	–1 152	–1 014
Government transactions	–38	–31	–1	–50	– 141	–65	–37	–40	–44	–56
Other services	–44	5	–39	–48	–58	–85	–27	32	118	–83
Transfers, net	1 134	1 635	2 476	3 000	2 887	2 680	2 171	2 179	2 251	2 915
Current balance	–1 495	– 826	–52	–1 251	–2 852	–3 245	–1 645	– 625	386	1 159
Medium and long-term capital	95	758	813	1 175	1 954	2 582	1 458	1 333	1 109	– 315
Private	19	249	462	770	1 433	1 946	858	835	729	– 215
Official	76	509	351	405	521	636	600	498	380	– 100
Short-term and unrecorded	–30	228	594	934	750	786	– 564	– 221	– 523	–1 068
Balance of non-monetary transactions	–1 430	160	1 355	858	– 148	123	– 751	487	972	– 224
Private monetary institutions short-term capital	567	– 201	– 995	– 498	42	–15	– 310	– 289	4	199
Balance on official settlements	– 863	–41	360	360	– 106	108	–1 061	198	976	–25
Use of IMF credit	83	–53	–41	– 102	–55	–43	366	221	– 288	0
Miscellaneous official accounts	419	201	– 253	– 335	–9	– 103	0	– 287	4	–82
Changes in reserves (increase = -)	361	– 107	–66	77	170	38	695	– 132	– 692	107

Source : Bank of Portugal.

BASIC STATISTICS :

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period[1]	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany
Population										
Total	Thousands	1986	15 974	7 565	9 858 (85)	25 675	5 116	4 919	55 379	61 048
Inhabitants per sq.km	Number		2	90	323	3	119	14	101	246
Net average annual increase over previous 10 years	%		1.3	0.0	0.1	1.1	0.1	0.4	0.5	–0.1
Employment										
Total civilian employment (TCE)[2]	Thousands	1986	6 946	3 235 (85)	3 607 (85)	11 634	2 522 (85)	2 420	20 695	25 257
of which: Agriculture	% of TCE		6.1	9.0	2.9	5.1	6.7	11.0	7.3	5.3
Industry	% of TCE		26.8	38.1	29.7	25.3	28.1	32.0	31.3	40.9
Services	% of TCE		67.1	52.9	67.4	69.6	65.2	57.0	61.3	53.8
Gross domestic product (GDP)										
At current prices and current exchange rates	Billion US$	1986	167.3	93.8	112.2	363.9	82.5	70.5	724.2	892.0
Per capita	US$		10 473	12 403	11 377	14 174	16 130	14 326	13 077	14 611
At current prices using current PPP's[3]	Billion US$	1986	193.0	85.1	111.2	413.5	66.7	59.3	676.6	777.8
Per capita	US$		12 084	11 254	11 276	16 105	13 030	12 050	12 218	12 741
Average annual volume growth over previous 5 years	%	1986	2.9	1.8	1.5	2.7	3.3	3.2	1.7	1.7
Gross fixed capital formation (GFCF)	% of GDP	1986	23.3	22.4	16.1	20.2	20.3	23.1	18.8	19.5
of which: Machinery and equipment	% of GDP		11.2 (85)	9.8	5.2 (85)	6.9	9.4	9.2	9.4 (85)	8.3
Residential construction	% of GDP		5.2 (85)	4.6 (85)	3.2 (85)	6.3	4.9	5.5	4.7 (85)	5.3
Average annual volume growth over previous 5 years	%		–0.1	0.5	0.7	0.4	9.5	1.6	–0.7	0.3
Gross saving ratio[4]	% of GDP	1986	18.6	24.3	18.4	18.0	16.4	22.2	19.7	23.4
General government										
Current expenditure on goods and services	% of GDP	1986	18.8	19.0	16.7	20.0	24.0	20.7	19.4	19.7
Current disbursements[5]	% of GDP	1986	35.3 (85)	45.7 (85)	52.0 (85)	43.0	53.3	38.7	49.4 (85)	42.9
Current receipts	% of GDP	1986	33.5 (85)	48.1 (85)	46.2 (85)	39.2	58.0	41.8	48.5 (85)	44.7
Net official development assistance	% of GNP	1986	0.47	0.21	0.49	0.48	0.89	0.45	0.72	0.43
Indicators of living standards										
Private consumption per capita using current PPP's[3]	US$	1986	7 199	6 299	7 172	9 389	7 129	6 571	7 389	7 116
Passenger cars, per 1 000 inhabitants	Number	1985	..	306 (81)	335 (84)	421 (82)	293	316	360 (83)	441 (86)
Telephones, per 1 000 inhabitants	Number	1985	540 (83)	460 (83)	414 (83)	664 (83)	783	615	541 (83)	641 (86)
Television sets, per 1 000 inhabitants	Number	1985	..	300 (81)	303 (84)	471 (80)	392	370 (86)	297 (80)	377 (86)
Doctors, per 1 000 inhabitants	Number	1985	..	1.7 (82)	2.8 (84)	1.8 (82)	2.5 (84)	2.1	2.1 (82)	2.5 (84)
Infant mortality per 1 000 live births	Number	1985	9.2 (84)	11.0	9.4	9.1 (83)	7.9	6.3	6.9	9.1
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1986	7.7	5.0	4.4	5.5	6.2	11.5	8.7	3.7
Consumer prices	%	1986	8.2	3.8	5.7	5.8	6.3	6.9	7.4	2.6
Foreign trade										
Exports of goods, fob*	Million US$	1986	22 536	22 428	68 652[7]	86 664	21 216	16 296	119 268	242 400
as % of GDP	%		13.5	23.9	61.2	23.8	25.7	23.1	16.5	27.2
average annual increase over previous 5 years	%		0.7	7.3	4.4	4.2	5.8	3.1	3.3	6.7
Imports of goods, cif*	Million US$	1986	23 916	26 724	68 544[7]	81 312	22 824	15 300	128 760	189 684
as % of GDP	%		14.3	28.5	61.1	22.3	27.7	21.7	17.8	21.3
average annual increase over previous 5 years	%		0.1	4.9	2.1	4.1	5.4	1.5	1.3	3.1
Total official reserves[6]	Million SDR's	1986	6 202	5 778	5 724[7]	3 348	4 116	1 528	28 579	45 626
As ratio of average monthly imports of goods	Ratio		3.7	3.0	1.2	0.6	2.5	1.4	3.1	3.4

	Greece	Iceland	Ireland	Italy	Japan	Luxembourg	Netherlands	New Zealand
Population								
Total	9 934 (85)	241 (85)	3 540 (85)	57 221	121 440	367 (85)	14 563	3 279 (85)
Inhabitants per sq.km	75	2	50	190	326	141	429	12
Net average annual increase over previous 10 years	0.9	1.0	1.1	0.3	0.7	0.2	0.6	0.6
Employment								
Total civilian employment (TCE)[2]	3 588 (85)	116 (85)	1 056 (85)	20 614	58 530	160 (85)	5 083 (85)	1 329 (85)
of which: Agriculture	28.9	10.5	16.0	10.9	8.5	4.2	4.9	11.1
Industry	27.3	36.8	28.9	33.1	34.5	33.4	28.1	32.4
Services	43.8	52.7	55.1	56.0	57.1	62.4	67.0	56.5
Gross domestic product (GDP)								
At current prices and current exchange rates	39.8	3.9	24.5	599.9	1 955.6	5.0	175.3	27.2
Per capita	3 987	15 984	6 914	10 484	16 109	13 574	12 040	8 300
At current prices using current PPP's[3]	62.1	..	24.5	652.7	1 497.9	5.2	172.0	33.8
Per capita	6 224	..	6 903	11 406	12 339	14 070	11 809	10 311
Average annual volume growth over previous 5 years	1.6	2.2	1.1	1.9	3.6	3.5	1.6	1.8
Gross fixed capital formation (GFCF)	18.5	18.3	18.7	20.1	27.8	20.7	19.6	21.5
of which: Machinery and equipment	7.7	5.2	11.5 (84)	7.9 (85)	10.6 (85)	9.0 (82)	10.1	13.1 (85)
Residential construction	4.6	3.5	4.4 (84)	4.7 (85)	4.9 (85)	4.7 (82)	4.7	4.0 (85)
Average annual volume growth over previous 5 years	–1.8	–1.3	–4.6	0.3	3.5	–0.5	3.1	0.3
Gross saving ratio[4]	15.4	17.3	17.1	22.0	32.1	65.8	23.5	19.5
General government								
Current expenditure on goods and services	19.4	17.1	19.3	16.1	9.9	15.9	15.9	16.2
Current disbursements[5]	42.8	26.1 (85)	49.7 (84)	51.9 (85)	26.9 (85)	44.6 (84)	54.0	..
Current receipts	36.4	30.8 (85)	43.7 (85)	44.1 (85)	31.2 (85)	53.3 (84)	52.8	..
Net official development assistance	..	0.09	0.28	0.40	0.29	..	1.01	0.30
Indicators of living standards								
Private consumption per capita using current PPP's[3]	4 130	9 849*	3 994	6 963	7 132	7 921	7 016	6 101
Passenger cars, per 1 000 inhabitants	108 (83)	431	206 (83)	355 (84)	221 (83)	414	341	455
Telephones, per 1 000 inhabitants	336 (83)	525 (83)	235 (83)	448 (84)	535 (83)	404 (84)	410 (86)	646
Television sets, per 1 000 inhabitants	158 (80)	303	181 (80)	244 (84)	250 (80)	336 (83)	317 (86)	291
Doctors, per 1 000 inhabitants	2.8 (83)	2.4 (84)	1.3 (82)	3.6 (82)	1.3 (82)	1.7 (84)	2.2 (84)	2.4
Infant mortality per 1 000 live births	14.1	5.7	8.9	10.9	5.9 (84)	9.0	9.6 (86)	10.8
Wages and prices (average annual increase over previous 5 years)								
Wages (earnings or rates according to availability)	–0.7	..	13.4	12.6	3.9	..	3.4	10.3 (85)
Consumer prices	20.4	42.4	9.0	11.3	1.8	5.3	2.9	11.6
Foreign trade								
Exports of goods, fob*	5 640	1 092	12 636	97 476	210 804	..[8]	80 580	5 837
as % of GDP	14.2	28.0	51.6	16.3	10.8	..	46.0	21.5
average annual increase over previous 5 years	5.6	3.9	10.0	5.2	6.8	..	3.3	0.7
Imports of goods, cif*	11 340	1 116	11 616	99 972	127 668	..	75 420	6 156
as % of GDP	28.5	28.6	47.4	16.7	6.5	..	43.0	22.6
average annual increase over previous 5 years	4.9	1.6	1.8	1.9	–2.2	..	2.7	1.3
Total official reserves[6]	1 357	255	2 658	18 674	35 394	..	10 687	4 752
As ratio of average monthly imports of goods	1.7	3.2	3.2	2.6	3.9	..	2.0	0.9

	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States	Yugoslavia
Population									
Total	4 167	10 185	38 688	8 369	6 533 (85)	49 841 (85)	56 618 (85)	239 283 (85)	23 120 (85)
Inhabitants per sq.km	13	111	77	19	158	64	231	26	89
Net average annual increase over previous 10 years	0.3	0.6	0.7	0.2	0.2	2.1	0.1	1.0	0.8
Employment									
Total civilian employment (TCE)[2]	2 086	4 029 (85)	10 959	4 269	3 196	15 290 (85)	24 239	109 597	..
of which: Agriculture	7.2	23.2	15.6	4.2	6.5	57.1	2.6	3.1	..
Industry	26.7	35.3	32.4	30.2	37.7	17.5	31.1	27.7	..
Services	65.9	41.5	52.1	65.6	55.8	25.4	66.4	69.3	..
Gross domestic product (GDP)									
At current prices and current exchange rates	69.8	29.0	229.1	131.1	135.1	58.0	547.8	4 185.5	44.2 (85)
Per capita	16 746	2 984	5 945	15 661	20 587	1 142	9 651	17 324	1 913 (85)
At current prices using current PPP's[3]	62.3	57.0	310.8	109.7	..	199.7	652.7	4 185.5	..
Per capita	14 956	5 868	8 065	13 111	..	3 927	11 498	17 324	..
Average annual volume growth over previous 5 years	4.1	1.6	2.1	2.1	1.6	5.5	2.6	2.9	..
Gross fixed capital formation (GFCF)	27.5	21.6	19.7	18.2	24.3	23.6	17.2	17.8	21.8 (85)
of which: Machinery and equipment	7.7	14.7 (81)	6.6 (85)	8.5	8.4	9.1 (82)	8.1	7.8	..
Residential construction	4.7	6.4 (81)	4.6 (84)	3.8	15.9 (9)	2.6 (82)	3.8	5.2	..
Average annual volume growth over previous 5 years	0.9	–3.7	1.4	2.1	4.0	7.6	4.4	4.4	..
Gross saving ratio[4]	23.0	26.5	22.2	18.3	31.1	22.2	18.3	15.0	..
General government									
Current expenditure on goods and services	19.8	14.0	13.8	27.2	12.9	8.8	21.3	18.6	13.8 (85)
Current disbursements[5]	47.6	37.6 (81)	36.7	59.9	30.4	..	44.9 (85)	35.6	..
Current receipts	56.3	33.3 (81)	35.8	61.5	35.0	..	43.7 (85)	31.3	..
Net official development assistance	1.20	0.08	0.09	0.85	0.30	..	0.32	0.23	..
Indicators of living standards									
Private consumption per capita using current PPP's[3]	8 109	3 857	5 113	6 804	12 326*	2 713	7 156	11 500	953 (85)*
Passenger cars, per 1 000 inhabitants	382 (86)	135 (82)	240	377	402	18 (82)	312 (83)	473 (84)	121 (83)
Telephones, per 1 000 inhabitants	622 (84)	166 (83)	369	890 (83)	1 334	55 (83)	521 (84)	650 (84)	122 (83)
Television sets, per 1 000 inhabitants	346 (86)	140 (80)	256 (82)	390	337	76 (79)	336 (84)	621 (80)	175 (83)
Doctors, per 1 000 inhabitants	2.2	1.8 (82)	3.3	2.5	1.4 (84)	1.5 (83)	0.5 (83)	2.3 (83)	1.6 (82)
Infant mortality per 1 000 live births	8.5 (86)	17.8	7.0 (84)	6.8	6.9	..	9.4	10.6 (84)	31.7 (83)
Wages and prices (average annual increase over previous 5 years)									
Wages (earnings or rates according to availability)	11.3	23.6	17.4	8.0	..	..	9.1	4.0	..
Consumer prices	7.8	21.5	11.1	7.4	3.1	37.2	5.5	3.8	56.3
Foreign trade									
Exports of goods, fob*	18 240	7 188	27 132	37 200	37 248	7 428	107 016	217 308	7 188
as % of GDP	26.1	24.8	11.8	28.4	27.6	12.8	19.5	5.2	16.3
average annual increase over previous 5 years	0.3	11.7	5.8	5.4	6.7	9.3	0.7	–1.4	–3.1
Imports of goods, cif*	20 292	9 444	34 920	32 484	40 860	11 124	126 156	369 960	8 196
as % of GDP	29.1	32.6	15.2	24.8	30.2	19.2	23.0	8.8	18.5
average annual increase over previous 5 years	5.4	–0.6	1:7	2.4	6.0	4.5	4.2	7.2	–7.5
Total official reserves[6]	10 541	1 896	12 581	5 568	20 726	1 332	15 726	39 790	1 259
As ratio of average monthly imports of goods	7.3	2.8	5.1	2.4	7.1	1.7	1.8	1.5	2.2

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour force Statistics*.
3. PPP's = Purchasing Power Parities.
4. Gross saving = Gross national disposable income *minus* Private and Government consumption.
5. Current disbursements = Current expenditure on goods and services *plus* current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDR's per ounce. End of year.
7. Including Luxembourg.
8. Included in Belgium.
9. Including non-residential construction.

Sources:
Population and Employment: OECD *Labour Force Statistics*.
GDP, GFCF, and General Government: OECD *National Accounts*, Vol. I and OECD *Economic Outlook, Historical Statistics*.
Indicators of living standards: Miscellaneous national publications.
Wages and Prices: OECD *Main Economic Indicators*.
Foreign trade: OECD *Monthly Foreign trade Statistics, series A*.
Total official reserves: IMF *International Financial Statistics*.

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