1990/1991

OECD ECONOMIC SURVEYS

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PORTUGAL

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BASIC STATISTICS OF PORTUGAL

THE LAND

Area (thousands sq. km)	91.8	Major cities, resident population in thousands (1981)	
		Lisbon	808
		Porto	327

THE PEOPLE

Population (1989, thousands)	10 340	Civilian employment (1989, thousands)	4 395
Number of inhabitants per sq. km	112	as a percentage of total	
Civilian labour force (1989, thousands)	4 676	Agriculture	18.9
		Industry	35.2
		Services	45.9

PRODUCTION

Gross domestic product in 1989		Gross domestic product at factor	
(million of US dollars)	47 608	cost by origin (1988, % of total)	
Gross domestic product per head in 1988		Agriculture	6.2
(US dollars)	4 604	Industry	38.1
Gross fixed asset formation in 1989: % of GDP	26.7	Services	55.7
per head (US dollars)	1 228		

THE GOVERNMENT

Public consumption (1989, % of GDP)	15.7	Composition of Parliament (number of seats)	
Public investment (1989, % of GDP)	3.7	Social Democrats (PSD)	148
(% of total investment)	14.0	Center Democrats (CDS)	4
General Government current revenue		Socialists (PS)	60
(in 1989, % of GDP)	38.5	Democratic Renewal (PRD)	7
		Communists, etc. (CDU)	31

FOREIGN TRADE

Exports of goods and services (1989, % of GDP)	37.2	Imports of goods and services (1989, % of GDP)	46.4
Main exports as a % of commodities exports, 1988		Main imports as a % of commodities imports, 1988	
SITC:		SITC:	
Food, beverages and tobacco (0, 1)	7.7	Food, beverages and tobacco	10.2
Basic and semi-finished materials (2, 3, 4)	12.8	Basic and semi-finished materials	15.9
Manufactured goods (5, 6, 7, 8)	79.3	Manufactured goods	73.8
of which: Chemicals (5)	6.0	*of which*: Chemicals	9.9
Machinery and transport equipment	16.7	Machinery and transport equipement	38.3

THE CURRENCY

Monetary unit: Escudo		Currency units per US $	
		average of daily figures:	
		Year 1989	157.10
		November 1990	130.59

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 20th November 1990.

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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 10th December 1990.

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The previous Survey of Portugal was issued in July 1989.

Introduction

In 1989, GDP growth accelerated to 5½ per cent, well above the average rate since 1985. While all components of domestic demand eased, exports were extremely buoyant and the current account deficit narrowed. This development, however, was temporary and, as demand pressures intensified in 1990, the deficit widened again. Unemployment fell below 5 per cent in the first half of 1990. Inflation picked up after mid-1988, and consumer prices rose by 13 per cent in 1989 and during most of 1990. As a result of the recent oil-price hike and the expected slowdown of world trade, GDP growth is projected to ease over the next two years to a 3 to 3½ per cent annual rate, and the reduction in inflation is expected to resume significantly in the second half of 1991.

Economic policy was tightened in 1989: the implementation of the tax reform and the associated overlapping of tax payments under two different tax regimes induced a marked reduction in the government deficit; and a string of restrictive monetary policy measures were introduced during the year. But in 1990, when exceptional factors behind the 1989 deficit contraction vanished, some of the gains achieved in fiscal consolidation were lost. Given the policy of pre-announced changes in the exchange rate, the effectiveness of monetary restraint was eroded further by large capital inflows. In July 1990, the authorities adopted a new medium-term programme, the QUANTUM, outlining the adjustment requirements for full participation in the EC economic and monetary union. In October, the regime of constant monthly depreciation of the Escudo was replaced by a more flexible exchange-rate policy. The authorities have continued to implement important structural reforms, as exemplified by the privatisation of public enterprises, the transition to indirect monetary control and the reform of the income tax system.

Part I of the Survey examines recent trends in the economy, while the medium-term strategy and progress in structural reform are analysed in Part II. Macroeconomic policy and short-term prospects are discussed in Part III, and relevant aspects of the recent tax reform measures are presented and discussed in Part IV. Part V summarises the major findings of the Survey and presents related policy conclusions.

I. Recent trends[1]

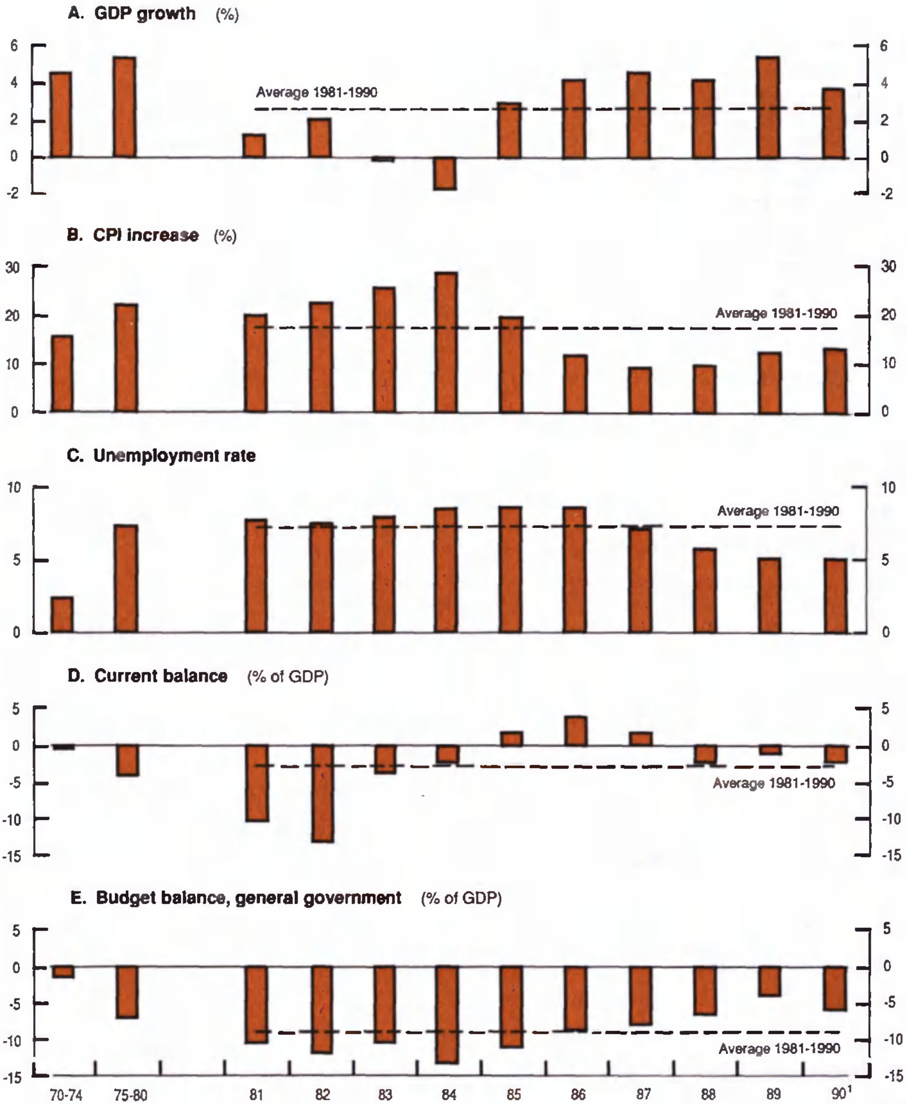
Overview

Portugal's macroeconomic performance during the past two years has been very satisfactory except for inflation (Diagram 1). The rate of output growth has remained above both the country's long-term average and the average growth rate of the OECD area. The unemployment rate has fallen to the lowest level since the late seventies and is significantly below the average for the OECD area. On the other hand, inflation, after declining sharply from its peak rate of close to 30 per cent in 1984, has reaccelerated to double-digit rates and the inflation differential with the EC average has widened to close to 9 percentage points. Likewise fiscal consolidation, which proceeded rapidly after 1984, has slowed down (especially when abstracting from special factors operating in 1989), and the budget deficit in relation to GDP is likely to have increased again in 1990.

Demand and output

The rate of growth of total domestic demand, which averaged more than 8 per cent per year over the period 1986-88, fell to 4¼ per cent in 1989. Notwithstanding this slowdown, which had been expected as a response to a tightening of macroeconomic policies, real GDP growth – at an unexpected 5½ per cent – was higher than in 1988 (Table 1). This was due to a strong improvement in the real foreign balance which added ½ percentage point to GDP growth, following large negative contributions in the three preceding years (more than 5 points in 1987 and again in 1988) (Diagram 2). But the improvement in the foreign balance was short-lived: in 1990, as domestic demand reaccelerated, import volumes expanded more rapidly than export volumes, entailing a negative contribution of perhaps 2¼ points to GDP growth, estimated to have eased to about 4 per cent.

Diagram 1. **MACROECONOMIC PERFORMANCE**



1. Secretariat estimates.
Source: OECD, *National Accounts;* Secretariat estimates.

Table 1. **Demand and output**
Percentage changes, volume (1977 prices)

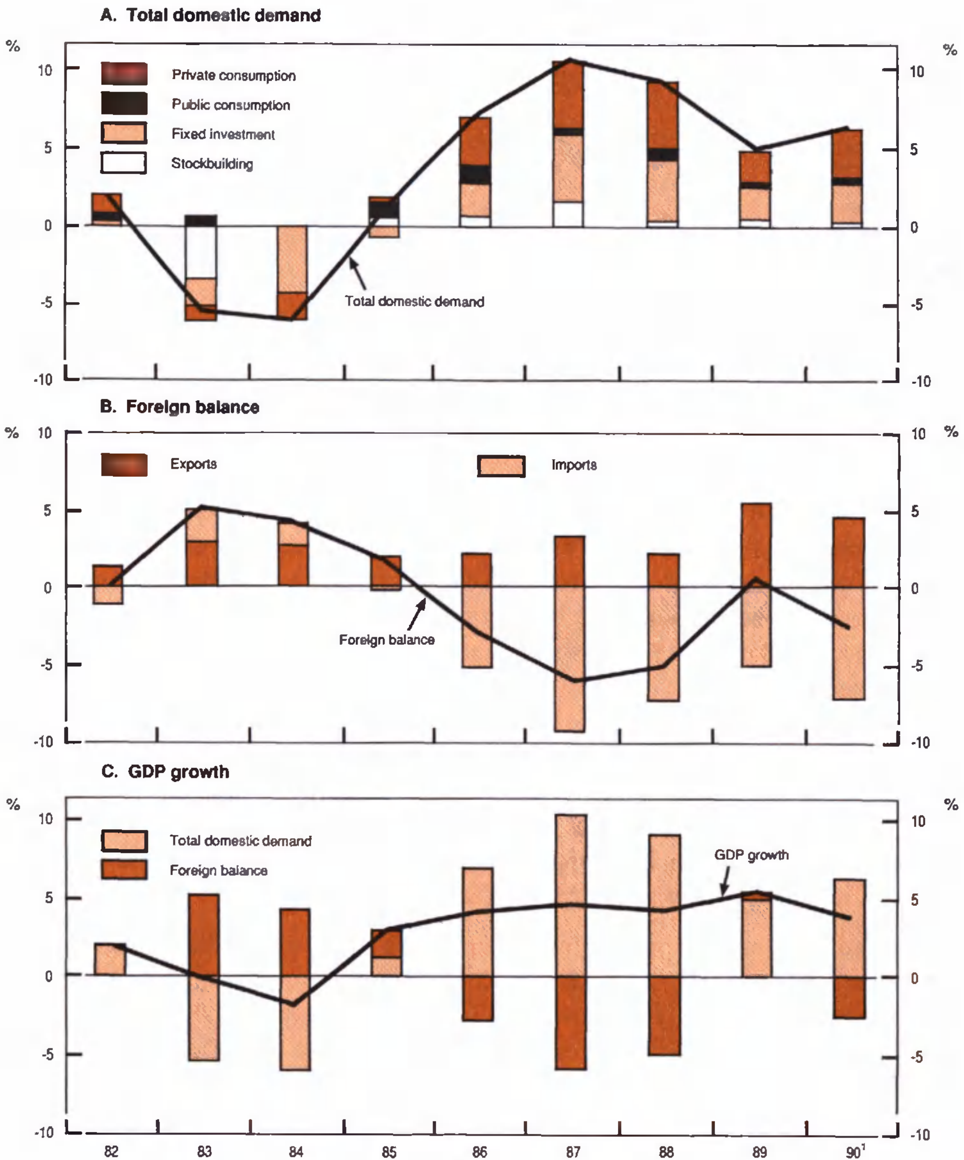
	1987 current prices Esc. billions	1989/1984	1986	1987	1988	1989	1990[2]
Private consumption	3 335.7	4.3	4.8	6.8	6.5	3.1	4.5
Government consumption	787.8	4.4	7.2	2.0	4.5	2.0	2.2
Gross fixed capital formation	1 250.8	9.9	10.9	20.2	16.0	7.5	9.0
Final domestic demand	5 374.3	5.6	6.4	8.8	8.4	4.0	5.3
Change in stockbuilding[1]	171.0	0.6	0.6	1.6	0.4	0.5	0.3
Total domestic demand	**5 445.3**	**6.2**	**6.9**	**10.1**	**8.4**	**4.3**	**5.4**
Exports of goods and services	1 774.7	9.8	7.7	10.8	7.1	16.5	12.0
Imports of goods and services	2 145.2	14.0	16.4	26.4	17.3	10.6	13.2
Change in foreign balance[1]	–370.6	–2.7	–2.9	–6.0	–5.0	0.5	–2.2
GDP at market prices	**5 174.7**	**4.3**	**4.1**	**4.6**	**4.2**	**5.4**	**3.9**
GDP by kind of activity							
Agriculture, forestry, fishing	379	2.2	3.1	4.1	–11.5	7.4	..
Industry[3]	1 436	3.4	6.2	3.0	2.0	5.0	..
Electricity, gas and water	188	6.3	–6.3	3.4	14.8	7.0	..
Construction	297	4.7	2.3	7.9	10.9	8.0	..
Services	2 769	4.7	4.1	7.5	4.4	5.0	..

1. As a percentage of GDP in the previous period.
2. Preliminary estimates.
3. Mining and manufacturing.
Sources: OECD, *National Accounts;* Ministry of Finance and Planning Dept.

All major demand components contributed to the slowdown in 1989. Private consumption grew by about 3 per cent in 1989, down from 6½ per cent on average over the three previous years. Per capita wages accelerated to 15 per cent under the influence of public pay scale adjustments, and income from property and other non-wage revenue expanded by 20 per cent (Table 2). On the other hand, the implementation of the income tax reform and the resulting overlapping of tax payments induced a 39 per cent increase in revenues from direct taxes (see Part III). As a result of increased tax collections and higher inflation, the growth of households' real disposable income decelerated to about 3 per cent in 1989. The saving ratio, which has been on a downward trend since Portugal's entry into the EC, fell only marginally in 1989.

Consumption growth was curtailed by credit restrictions implemented in March 1989; over the four quarters which followed, car sales fell sharply, in

Diagram 2. **CONTRIBUTIONS TO GDP GROWTH**
As a percentage of GDP in the previous year



1. Secretariat estimates.
Source: OECD, *National Accounts;* Secretariat estimates.

Table 2. **Household appropriation account**

Percentage changes

	1987 Esc.bill.	1986	1987	1988	1989	1990[1]
Compensation of employees	2 290.5	19.1	16.6	13.8	17.1	17.6
Income from property and others	1 833.9	12.5	9.1	13.8	20.0	18.2
Current transfers received	1 218.9	22.8	20.0	14.7	12.7	15.0
Total income	5 343.3	17.4	14.6	14.0	17.1	17.2
Less: Direct taxes	219.9	3.3	1.4	24.5	39.0	12.0
Current transfers paid	615.5	22.5	17.8	11.7	17.1	18.6
Disposable income	**4 507.9**	**17.6**	**14.9**	**13.8**	**15.9**	**17.4**
Consumers' expenditure	3 335.7	20.2	16.0	17.2	16.3	18.3
Saving ratio	**26.0**	**26.7**	**26.0**	**23.8**	**23.5**	**22.9**
Real disposable income		2.5	5.8	3.3	2.9	3.6

1. Preliminary estimates.
Sources: Bank of Portugal, *Annual Report;* OECD Secretariat.

contrast to their exceptional buoyancy since Portugal's entry into the EC in 1986. The reacceleration of inflation may also have contributed to the slowdown of consumption via its effect on the real value of household wealth, but also because it has historically been associated in Portugal with considerable uncertainty over future income. Both these effects seem to have offset the impact of declining real interest rates (which, net of taxes, turned negative in the case of six-month deposits) on the household saving ratio. Over the period 1985-87, higher consumer confidence associated with slowing inflation and EC membership had led to a significant decline in the household saving ratio, which came to a halt in 1989. On the basis of preliminary estimates, private consumption growth picked up again in 1990 as real disposable income growth accelerated from 1989, and the saving ratio resumed its previous downward trend (Diagram 3).

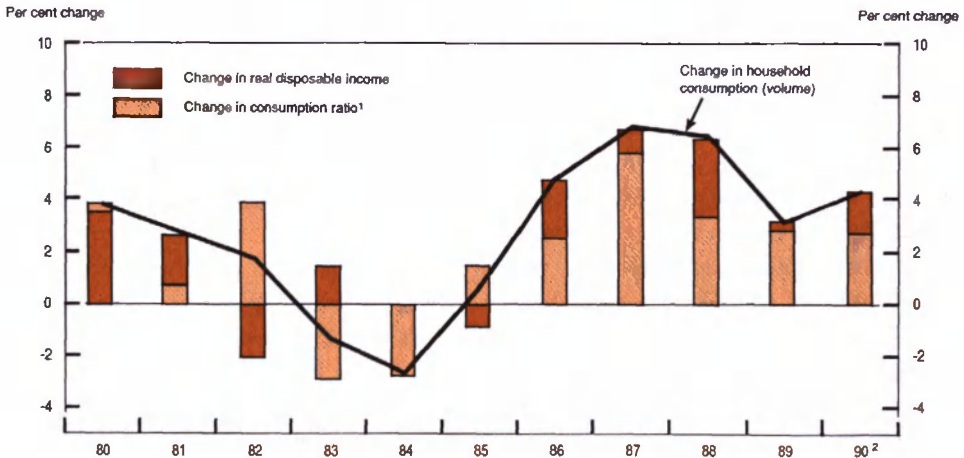
Fixed investment expanded by 7½ per cent in 1989, or half the average growth rate over the period 1985 to 1988. The contribution of investment to GDP growth fell from an average of 3½ percentage points per year between 1986 and 1988 to 2 in 1989, still a relatively large contribution, equivalent to that of private consumption. The deceleration in 1989 can be explained by the already sizeable amount of new capacity created over the preceding years, together with the slowdown of private consumption in 1989 and a tightening of credit rationing. According to survey results, about half of total investment was self-financed as in previous years, while the share of investment co-financed by the EC continued to increase. The

good profit situation of the corporate sector and availability of EC funds both for public and private enterprises facilitated a slight pick up of investment growth in 1990, as restrictions on domestic credit expansion were increasingly circumvented by capital imports.

In 1989, growth of construction investment was stronger than that of machinery and equipment. Non-residential construction was boosted by major public works (roads, schools and hospitals), while housing demand remained subdued. Rises in construction costs and increased difficulty in obtaining subsidised credit from the State, when mortgage rates were close to 17½ per cent, were some of the factors underlying the slowdown. No breakdown of fixed investment into its components was available for the year 1990 when this report was finalised.

The expansion of gross fixed capital formation was partly associated with a strong rise in foreign direct investment which almost doubled between 1988 and 1989, from 1.7 to 3.2 per cent of GDP (Annex Table A1). High profitability, increased confidence related to political stability, simplified administrative procedures and easier access to incentives (the same as for domestic investors) were

Diagram 3. **SOURCES OF HOUSEHOLD CONSUMPTION GROWTH**
Annual percentage change



1. 1 minus saving ratio.
2. Secretariat estimates.
Source: OECD, *National Accounts.*

among the main factors conducive to the accelerating inflow of foreign direct investment. The biggest rises in foreign investment occurred in the areas of retail trade, tourism, construction (especially for public works) and the banking and insurance sectors – the latter being partly related to the process of privatisation (see section in Part II). Close to one-third of the inflow went into the manufacturing sector as in previous years, with major investments in the motor-vehicle industry.

While all major demand components are estimated to have reaccelerated in 1990, the decline in the real foreign balance entailed a fall in output growth to about 4 per cent. On a sectoral basis, value added in agriculture, forestry and fishing increased by an exceptional 13½ per cent in 1989. Production of cereals surged after a bad 1988 crop to levels far above the last ten years' average. Industrial output increased by 5 per cent, a strong acceleration from 1988, largely reflecting expansion of mining capacity, but also of consumer goods industries for which foreign demand was buoyant. Value added in construction expanded by some 6 per cent, boosted by public works. Housing construction remained subdued, partly because of the unsold dwelling units accumulated over the previous years. The service sector was sustained by continued buoyancy in banking and insurance, tourism, transports and communication. No estimates for output by sector are available for 1990.

Labour market developments

Reflecting vigorous economic growth, labour market conditions tightened further in 1989. Labour supply, rising by 1.5 per cent in 1989, the largest increase since the mid-1980s, responded flexibly. Attracted by strong demand for labour induced by booming goods and service markets, rising numbers of men and women joined the labour force. At the same time, the outflow of labour from agriculture quickened, while part-time jobs were increasingly transformed into full-time employment (Table 3). Labour mobility between firms is likely to have increased as a result of changes in legislation on dismissals in early 1989[2]. Despite signs of increasing flexibility and supply responsiveness in the labour market, mismatches appeared in the Lisbon and central area of the country. Judging by the fall in the rate of unemployment, labour markets seem to have tightened further in 1990.

Employment gains in 1989 were strong. Increases in female employment continued to exceed those in male employment – albeit by a smaller margin than in 1988 – partly reflecting buoyant demand in the services sector. Here, the number of

Table 3. **Labour market indicators**

Percentage changes from previous period

	1987	1988	1989	1990[1]
Employment	2.6	2.7	2.2	2.3
Total full-time	2.3	2.5	2.3	..
part-time	7.4	5.5	0.7	..
Men full-time	0.9	1.6	2.1	..
part-time	3.0	5.9	–0.6	..
Women full-time	4.6	3.8	2.5	..
part-time	9.7	5.7	1.3	..
Agriculture	3.9	–4.4	–6.4	..
Industries	5.5	3.4	3.0	..
Services	–0.1	5.6	5.7	..
Labour force[2]	0.9	1.1	1.5	1.5
Men	–0.5	0.1	1.3	..
Women	3.1	2.5	1.6	..
Participation rate[2,3]	67.6	67.9	68.4	68.8
Men	80.9	80.1	80.4	..
Women	55.0	56.0	57.2	..
Unemployment rate[2]	7.1	5.8	5.0	4.1
Men	5.3	4.1	3.4	..
Women	9.5	8.0	7.2	..
Long-duration unemployment[4]	47.5	42.0	38.2	..
Vacancies[5]	0.2	0.2	0.2	..

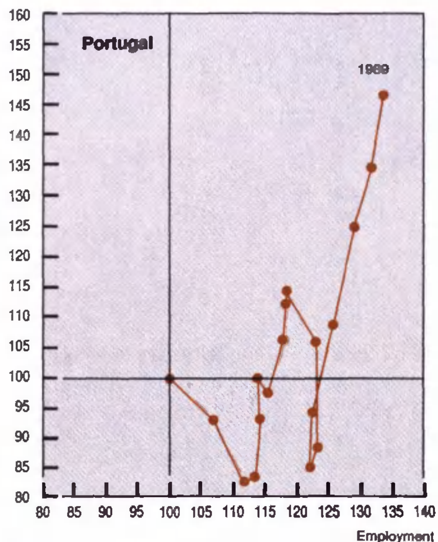
1. Data refer to June.
2. Data based on the narrowest definition, which includes in the labour force, as unemployed, only persons who have been actively seeking a job during the four weeks prior to the survey.
3. As a percentage of population aged 15-64 years.
4. Persons seeking a job for 12 months and over as a percentage of total unemployment.
5. As a percentage of labour force.

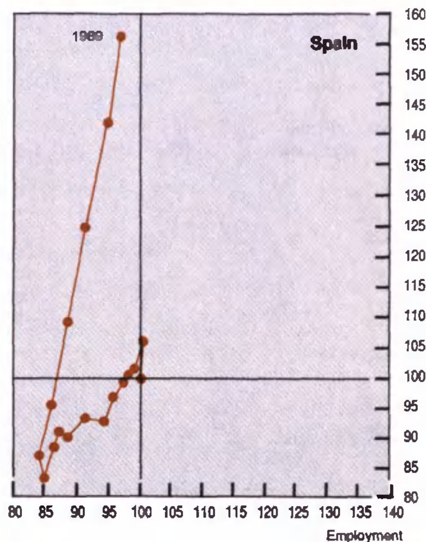
Sources: OECD *Labour Force Statistics; Employment Outlook*, July 1990; Bank of Portugal, *Monthly Bulletin*.

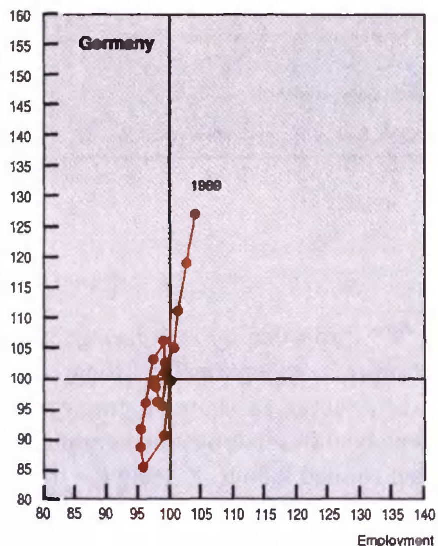
jobs increased by as much as 6 per cent in 1989, propelled by new hirings in the public sector (especially in health and education) and exceptionally strong labour demand in the banking, insurance and real estate sector. In contrast, employment growth weakened in industry, as many firms engaged in modernisation (in mining, chemicals and basic metal industries) continued to shed labour. Placing the overall employment trend into a longer-term perspective, i.e. its behaviour since the first oil price shock, reveals a comparatively favourable record for Portugal: assisted by a surge in capital-widening investment, employment gains far outstripped those

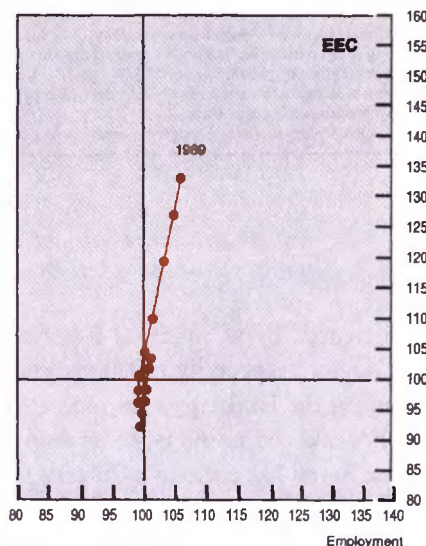
Diagram 4. **GROSS FIXED CAPITAL FORMATION AND EMPLOYMENT**

1973-1989, Total economy, volume indices, 1973 = 100









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

observed in other European countries (Diagram 4). This suggests that the positive employment impact of capital-widening investment in services, including infrastructure, outweighed employment losses in some industries, linked to capital-deepening investment.

The rate of unemployment fell to 5 per cent (average for 1989), the lowest level since the mid-1970s. This brought the cumulative decline since the unemployment peak of 1985 to around 3½ percentage points (Table 4). The extent of this improvement has only been surpassed by developments in the United Kingdom and Spain over the four years to 1989. Similarly, together with the United States, Finland and Sweden, Portugal belongs to a small group of countries where the rate of unemployment in 1989 has slipped below levels prevailing at the previous cyclical peak in the late 1970s. Such a fall points to reduced non-cyclical unemployment, confirming Portugal's record as a country with a high degree of labour market flexibility[3]. On the other hand, the current rate of unemployment may well be below levels consistent with stable wage inflation (NAWRU). In the first half of 1990, unemployment continued to drift downward, reaching 4.1 per cent in June. The gap between female and male unemployment rates narrowed further in 1989. Even so, while long-duration unemployment (twelve months and over) kept on drifting downward in line with the rate of unemployment, its level (just under 40 per cent of total unemployment) has remained relatively high. This underlines the scale of hard-core unemployment in Portugal, partly reflecting a lack of educational opportunities. Similarly, despite significant progress over the past five years, unemployment among young workers (11.3 per cent in 1989) has remained high.

Table 4. **Price deflators and labour costs**[1]

Percentage changes from previous year

	1986	1987	1988	1989	1990[2]
Private consumption	14.7	10.0	10.1	12.7	13.3
Total domestic demand	15.9	10.8	10.6	12.3	13.1
Export prices	3.5	9.2	12.0	6.9	6.5
Import prices	-6.3	6.7	10.2	7.7	7.5
GDP	20.4	12.0	11.3	12.8	13.6
Compensation per employee[3]	16.7	14.5	13.1	14.6	15.8
Unit labour cost[3]	14.4	11.4	9.2	11.1	13.2

1. Price deflators are calculated at 1977 relative prices.
2. Preliminary estimates.
3. Total economy.
Sources: OECD, *National Accounts;* Secretariat estimates.

Renewed wage and price inflation

After a steep decline from 28 per cent in 1984 to 10 per cent in 1987, inflation, as measured by the private consumption deflator, remained stable in 1988, but gathered speed in both 1989 and 1990 (Table 4). In 1988, a further fall in inflation was undercut by a rise in the basic VAT rate, accelerating import prices and emerging supply bottlenecks. At the same time, nominal wages continued to decelerate in 1988, even though actual wages rose faster than contractual wages in reaction to higher-than-expected inflation (Table 5). The gap between expected and actual inflation was large in 1988. In the context of incomes policies, the government had fixed the inflation target at 6 per cent as a benchmark for wage increases in 1988. Instead, inflation turned out 4 percentage points higher than expected. In 1989 and 1990, the rise in inflation owed much to high and rising demand pressures.

Table 5. **Wages and expected price inflation**

Percentage changes from previous year

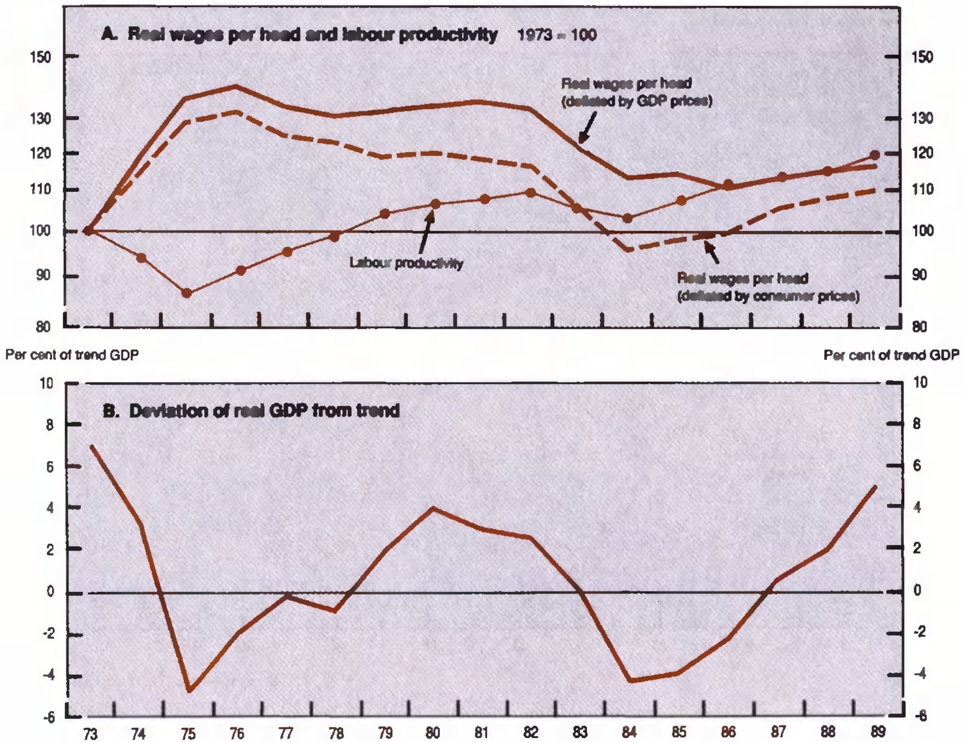
	1986	1987	1988	1989	1990[1]
a. Contractual wages[1]	17.1	12.0	8.6	10.0	13.7
b. Compensation per employee	16.7	14.5	13.1	14.6	15.8
c. Difference (b minus a)	-0.4	2.5	4.5	4.6	2.1
d. Expected inflation[2]	14	7-8	6	6	9 ½-10 ½
e. Private consumption deflator	14.7	10.0	10.1	12.7	13.3
f. Difference (e minus d)	0.7	2.5	4.1	6.7	3.3

1. OECD Secretariat estimates; for contractual wages, 1990 estimate based on first quarter data.
2. From 1986 to 1988, expected inflation is the government's target for consumer price increase on which was based incomes policy. For 1989 and 1990, it is the official inflation forecast on which the budget was based. The OECD projection (for the private consumption deflator, see December issues of the OECD *Economic Outlook*) was slightly higher in most of these years.

Sources: Bank of Portugal, *Monthly Bulletin*, OECD, *Economic Outlook* n. 38, 40, 42, 44 and 46.

Nominal wage growth began to rise in 1989, as unemployment declined to a record low. Buoyant labour demand, combined with a further straying of inflation from official targets, led to nominal wage growth far above rates agreed upon in collective wage settlements, as was the case in 1988. As it turned out, labour costs (compensation per employee) increased by nearly 15 per cent in 1989 as opposed to a rise of 10 per cent for contractual wages.

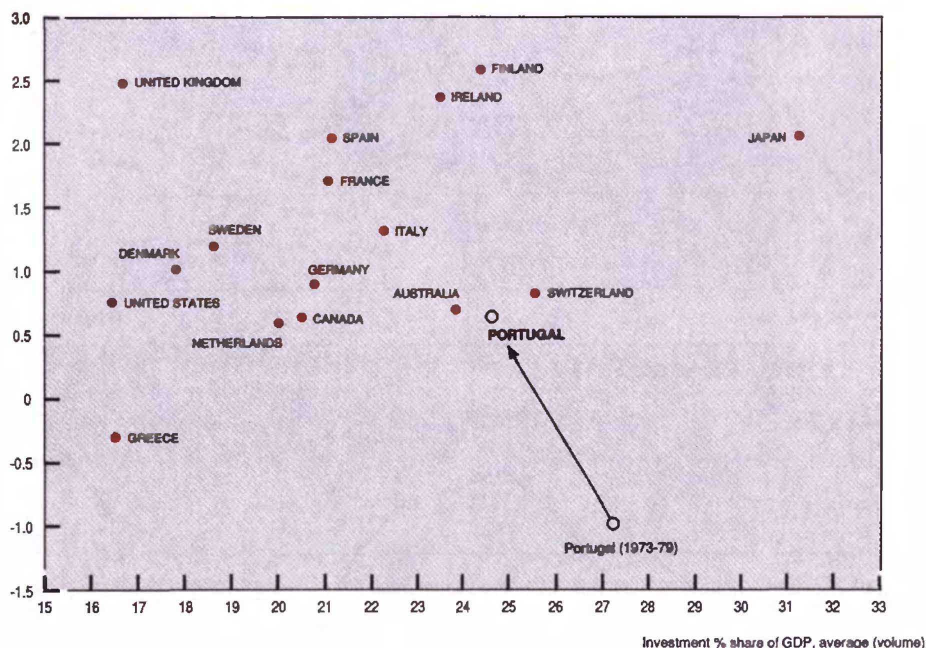
Diagram 5. **REAL WAGES, PRODUCTIVITY AND DEMAND PRESSURES**



Sources: Bank of Portugal; OECD Secretariat estimates.

High and rising profits made it easy for employers to accommodate extra wage claims, especially in the service sector. Part of the unexpectedly large pay rises also came from the introduction of new pay scales for civil servants. In addition, minimum wages were raised, with a view to allowing a catch-up for the lowest paid within the category of people receiving minimum wages, i.e. domestic services and agricultural employment. In January 1990, the share of persons in industry and services receiving the minimum wage stood at 6.4 per cent of employment in these sectors compared with 7 per cent a year earlier. All told, the amount by which the

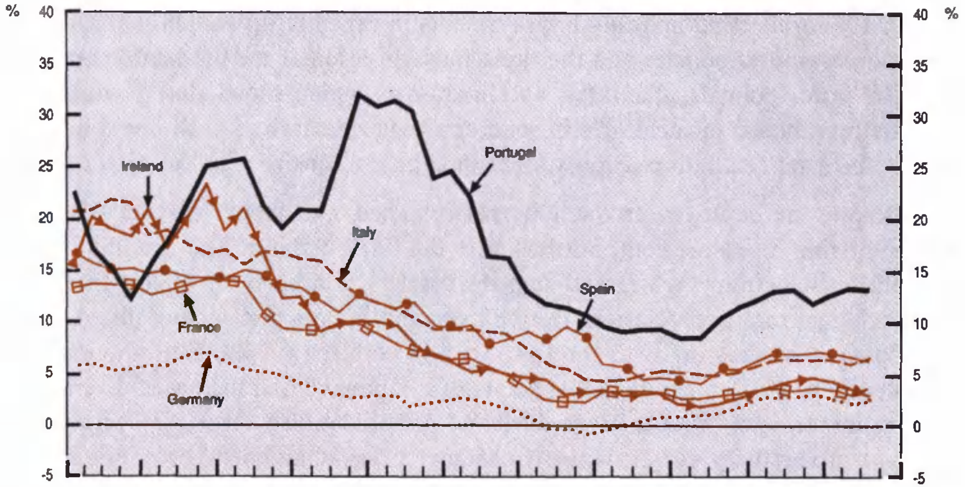
Diagram 6. **TOTAL FACTOR PRODUCTIVITY AND INVESTMENT SHARE**
1980-1988

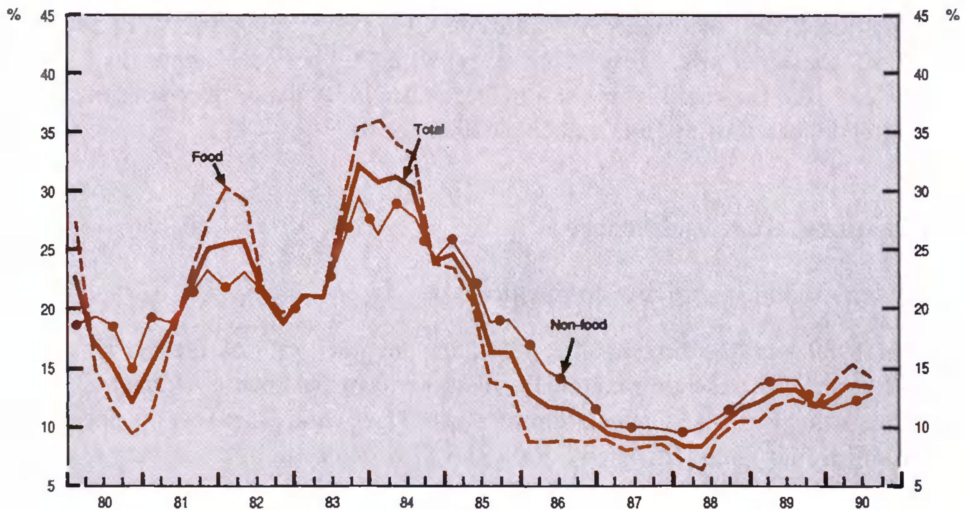


Source: OECD, *National Accounts;* Secretariat estimates.

overall rise in labour costs in 1989 exceeded the rise in contractual wages was still lower than the amount by which actual inflation, measured by the private consumption deflator, exceeded "expected" inflation (Table 5). Nominal wage growth is likely to have accelerated further in 1990, as labour markets remained tight and inflation kept on rising. In the non-agricultural sector (excluding public administration), nominal wages jumped by 18.2 per cent in the first six months over the same period of the previous year. A new incomes policy agreement (Economic and Social Agreement) was signed in October 1990 (see Part III).

Diagram 7. **CONSUMER PRICE INDEX**
Change over corresponding period of previous year





Source: OECD, *Main Economic Indicators.*

Wage increases were eroded by rising inflation in 1989 and 1990 and remained small (in real terms) relative to the level of demand pressure. Both the real product wage (deflated by GDP prices) and the real consumption wage (deflated by consumer prices) continued to rise less than labour productivity, allowing the profit share to rise further (Diagram 5). Overall labour productivity rose by over 3 per cent in 1989, reflecting not only improvements in capacity utilisation, but also the effects of structural policies and the rapid modernisation of the production apparatus. The latter point is illustrated by Diagram 6, which shows that productivity trends strengthened in the 1980s in spite of a reduced share of fixed investment in GDP, which reflects reduced investment in capital-intensive, "sunset" industries[4].

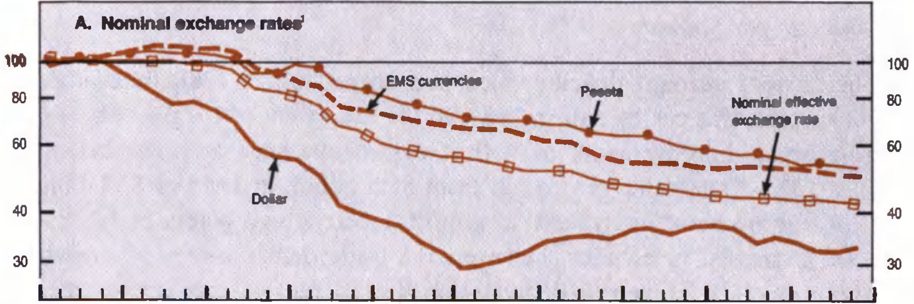
Despite the improved productivity performance, unit labour costs accelerated in 1989, rising by 11 per cent, but less than the GDP deflator. The resultant boost to profits, rising from high levels, helped exporters to absorb the effects from the real exchange rate appreciation. Both export and import prices decelerated. This development, contrasting with the faster rise in both the private consumption and the total domestic demand deflator, points to a continued and increased divergence of price movements between tradeables and non-tradeables, largely reflecting differential productivity performance. Consumer price inflation, after a fall in the second half of 1989, reaccelerated in the first half of 1990, led by supply shocks in the food sector, the simultaneous withdrawal of selective price controls for some food products[5], and increased VAT rates on some items (Diagram 7). In September 1990, consumer prices (excluding rents) were 13.7 per cent higher than a year earlier and 10.8 per cent higher than in December 1989. Fuel prices were raised by a total of 11 per cent in June and September 1990.

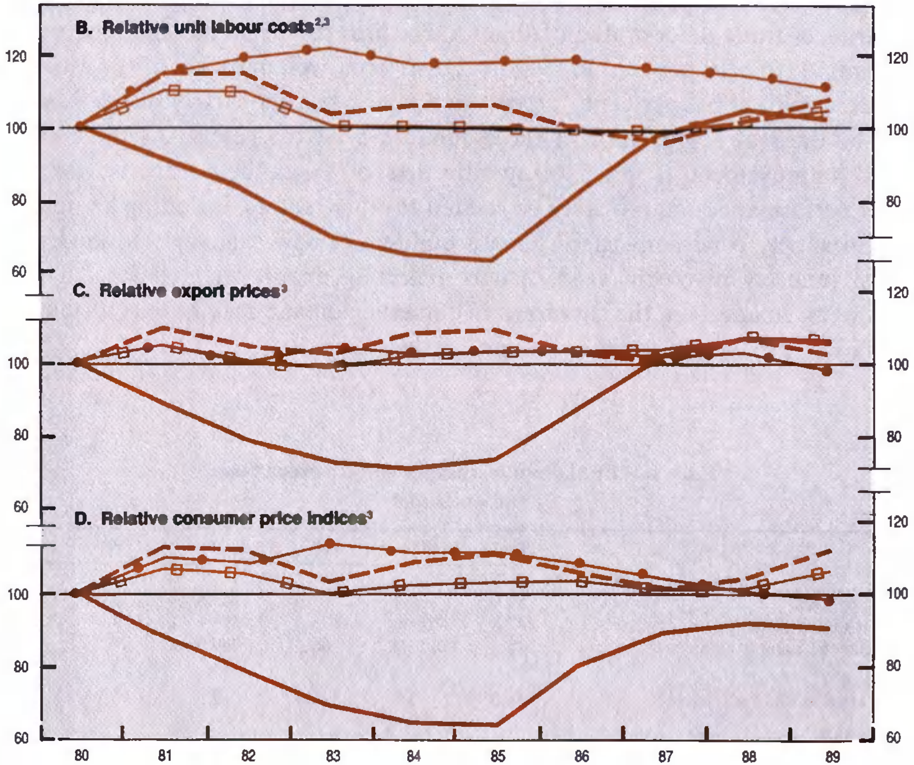
International trade and finance

The exchange rate and competitiveness

In 1989 and the first half of 1990, the monthly rate of the crawling peg depreciation of the escudo remained at 0.25 per cent per month, equivalent to an effective annual rate of depreciation of about 3 per cent. This was insufficient to maintain overall competitiveness, given the high domestic inflation rate over the last eighteen months. The various indicators of competitiveness show that, while depreciating in real terms with respect to the dollar and the peseta in 1989, the escudo appreciated against other EMS currencies (Diagram 8). However, the appreciation, which is suggested by the development of relative unit labour costs and consumer price indices *vis-à-vis* these countries, was not reflected in export

Diagram 8. **EXCHANGE RATE OF THE ESCUDO AND INDICATORS OF COMPETITIVENESS**





1. Units of currency per escudo.
2. Manufacturing.
3. In a common currency.

Source: OECD Secretariat.

prices: these remained stable in 1989, facilitated by rapid productivity growth in the export industries. Hence, the deterioration of price competitiveness *vis-à-vis* major European countries was limited in 1989 despite rapid domestic inflation.

The current balance

The current account deficit, which had opened up in 1988 following three years of surplus, was cut by half in 1989, to the equivalent of 1.2 per cent of GDP, reflecting small improvements in both the trade balance and the balance on invisibles[6]. The trade deficit narrowed from $5.5 billion in 1988 to $5.1 billion in 1989, an improvement equivalent to almost 1 percentage points of GDP (Diagram 9). Expressed in escudos, however, the trade deficit widened somewhat in 1989, because of exchange rate depreciation. The current balance improvement (in dollar terms), which contrasted with a worsening in both 1987 and 1988, was due to an unexpected large positive contribution from changes in trade volumes, while the terms of trade deteriorated (Table 6). The growth of real merchandise exports accelerated from 10 per cent in 1988 to 21 per cent, well in excess of the estimated market growth of 6½ per cent. Exports to Spain were particularly buoyant, stimulated by the real depreciation of the escudo *vis-à-vis* the peseta. As there was no overall improvement of price competitiveness of Portuguese exports, the good export performance can probably be related to other factors, including an improvement of supply conditions based upon a build-up of new capacity and modernisation of industry in recent years, partly reflecting export-oriented foreign direct investment. In addition, the slowdown in domestic demand may have contributed to the shift of production towards foreign markets.

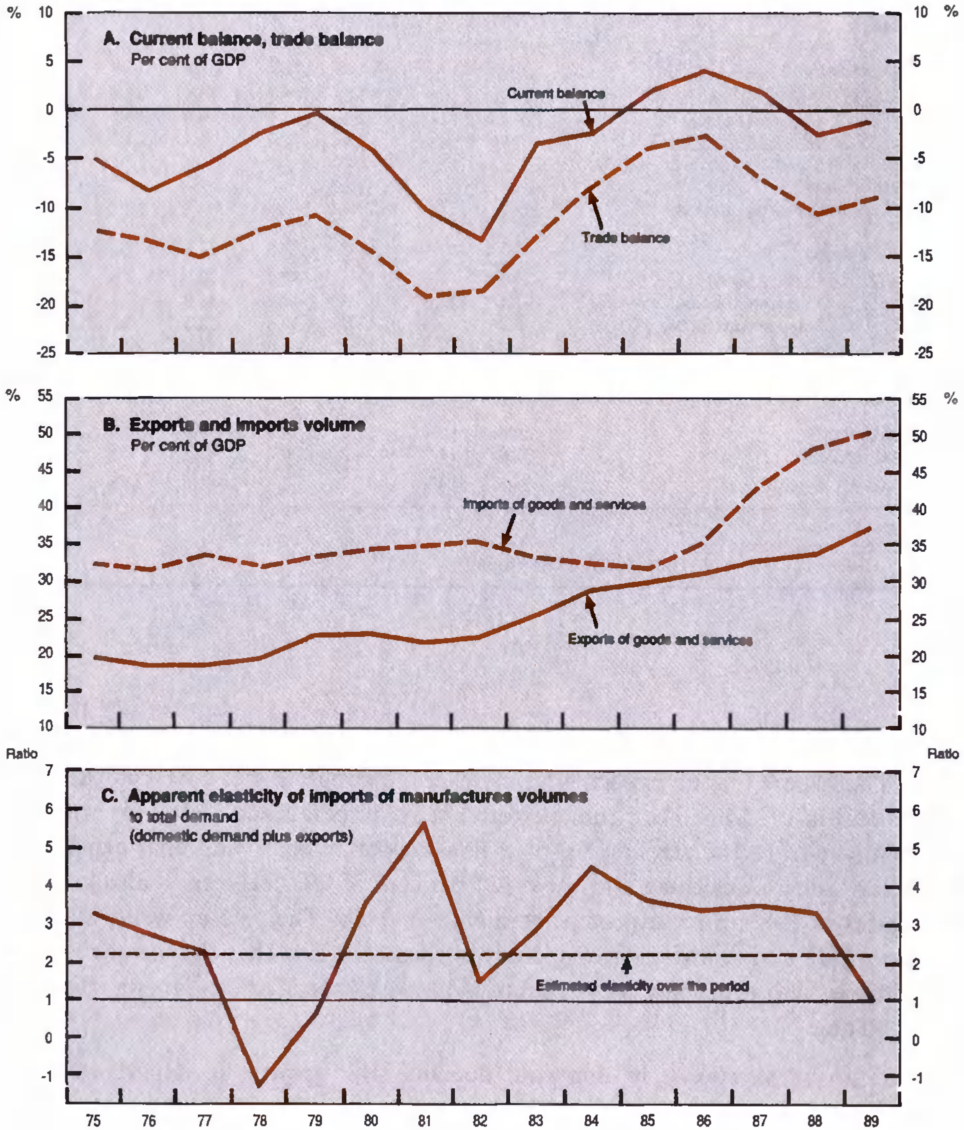
Table 6. **Breakdown of changes in the current balance**

Billion escudos

	1985	1986	1987	1988	1989	1990[1]
Current balance	59.9	171.7	63.5	–145.5	–86.0	–169.0
Trade balance (goods)	–247.8	–244.6	–475.5	–793.1	–809.4	–1 006.2
Change in the current balance	145.5	111.7	–108.2	–209.0	59.5	–83.0
of which:						
Change in the trade balance	44.0	3.2	–230.9	–317.5	–16.3	–196.8
of which:						
Due to terms of trade changes	50.0	162.1	–8.8	–8.7	–83.4	–72.6
Due to volume changes	–6.0	–158.9	–222.1	–308.8	67.1	–124.2

1. OECD Secretariat estimate.
Sources: Bank of Portugal, *Annual Reports;* OECD Secretariat.

Diagram 9. **TRENDS IN CURRENT BALANCE AND FOREIGN TRADE**



Source: OECD, *National Accounts.*

Table 7. **Foreign trade**
Percentage changes

		1984	1985	1986	1987	1988	1989[1]	1990[2]
A. Volumes								
Total exports		14.7	10.5	8.4	11.2	10.2	18.9	12.3
of which:	Capital goods	35.2	0.9	3.0	15.4	20.5	35.1	..
	Consumer goods	18.4	12.0	14.2	17.0	9.6	19.0	..
	Intermediate goods	12.9	8.4	4.4	5.6	4.7	10.7	..
Memorandum item:								
Growth in manufacturing markets[2]		9.5	7.0	10.2	8.3	10.0	10.1	6.9
Total imports		–2.1	2.8	18.5	27.6	22.1	7.3	15.2
of which:	Capital goods	–21.2	2.1	32.6	44.2	30.0	7.3	..
	Consumer goods	–2.1	28.6	17.9	43.7	41.9	6.1	..
	Intermediate goods	3.0	5.4	12.9	22.8	12.5	4.7	..
	Energy	6.9	–9.6	20.1	–1.0	7.8	22.1	..
B. Average values								
Total exports		30.4	15.7	2.8	8.9	9.5	6.1	8.1
Total imports		31.9	11.2	–8.3	6.7	7.1	7.8	8.0
of which:	Energy	28.6	14.6	–47.7	2.6	–11.6	23.8	..

1. Provisional data.
2. OECD Secretariat estimates.
Sources: Ministry of Trade and Tourism, OECD Secretariat.

Exports of motor vehicles and machinery grew by rates above 30 per cent in 1989. Their share in total exports thus increased to almost 20 per cent, compared to 15 per cent in 1985-86. The strong performance of minerals and metals exports was essentially due to the starting up of a new copper mine. Traditional exports of Portugal – such as clothing and shoes (28 per cent of total exports) – also grew at high rates in 1989, after a poor performance in 1988. The pick-up would suggest that the 1988 slowdown was a temporary phenomenon and that the sector remains competitive with other low wage countries likewise specialised in labour intensive goods (Table 7).

With the slowdown in domestic demand, the growth of import volumes (including services) decelerated to 10½ per cent in 1989, from an annual rate above 15 per cent in the three previous years. The elasticity of imports of manufactures with respect to total demand (total domestic demand plus exports) declined to unity, well below the average over the period 1975-89. Part of the deceleration

resulted from the running down of stocks of intermediate goods, which replaced imports – a development which can only be temporary and is likely to be followed by a reverse swing thereafter. However, the deceleration of imports was also significant in machinery and motor vehicles. Imports of motor vehicles, which had been expanding by about 40 per cent per year since Portugal's entry into the EC, were almost stagnant in 1989 (3.7 per cent), reflecting new restrictions on consumer credit. In 1990, as domestic demand picked up, import growth accelerated, with imports of machines for investment and consumption surging (+50 per cent in the first quarter, year on year, for home appliances and consumer electronics), while car imports continued to grow at a more moderate pace. The rebuilding of stocks run down in 1989 also contributed to the pick up.

Export and import prices, as measured by the deflators for goods and services, rose by 7 and 8 per cent, respectively, in 1989 against 13 per cent for the GDP deflator, indicating a fall in relative prices of foreign-traded goods and services compared to those of domestic goods, as in previous years and despite a rise in oil prices[7]. The small terms-of-trade deterioration had a significant negative effect on the trade deficit, reflecting the large weight of imports relative to that of exports, but did not offset the positive volume effect entirely.

The surplus on invisibles (services, investment income and transfers) was equivalent to 10 per cent of GDP in 1989, as in 1988. Net receipts from tourism grew by 17 per cent in escudos, about 4 per cent in real terms, a noteworthy performance in comparison with the fall in tourism receipts recorded in other Southern European countries. After a stabilisation in 1988, the number of foreigners entering the country increased again in 1989. In addition, the breakdown by country of origin reveals a shift towards tourists with a higher spending capacity in 1989, as in 1988: entry by German, French and Dutch tourists increased, while that by Spanish and U.K. tourists stagnated. Migrants' remittances grew by 9 per cent in escudos in 1989, a slightly higher rate than in 1988. These transfers were attracted by higher deposit interest rates and the reduction in the rate of periodic depreciation of the escudo. They have continued to expand in recent years despite the reduction of the number of migrants abroad. Their level remains significant: it amounted to 20 per cent of total exports of goods and services in 1989. With the continued inflow of EC funds, net official transfers continued to increase, amounting to 1.8 per cent of GDP in the year 1989.

All told, the current balance, originally expected to deteriorate in 1989, improved by $0.5 billion on 1988, showing a deficit of only $0.6 billion (about 1.2 per cent of GDP, Table 8). As both the trade balance in volume terms and the

Table 8. **Balance of payments**
US $ million

	1986	1987	1988	1989
Exports (Fob)	7 202	9 268	10 875	12 782
Imports (Fob)	8 874	12 849	16 393	17 934
Trade balance	**–1 672**	**–3 581**	**–5 518**	**–5 152**
Services, net	–84	250	137	219
Of which: Tourism	1 203	1 721	1 869	2 013
Investment income	–1 014	–932	–877	–802
Transfers, net	2 915	3 775	4 317	4 382
Private	2 651	3 401	3 598	3 558
Public	264	374	719	824
Current balance	**1 159**	**444**	**–1 064**	**–551**
(as per cent of GDP)	(4.0)	(1.2)	(-2.4)	(-1.2)
Medium and long-term capital	–315	194	843	2 560
Short-term capital and unrecorded transactions	–1 068	1 273	1 826	1 858
Balance on non-monetary transactions	**–224**	**1 911**	**1 605**	**3 867**
Short-term capital of private monetary institutions	199	–101	–671	614
Balance on official settlements	**–25**	**1 810**	**934**	**4 481**

Source: Bank of Portugal.

terms of trade deteriorated in early 1990, partly in response to the oil-price shock, the current deficit for 1990 is estimated to have widened again, perhaps to $1.2 billion or 2 per cent of GDP.

Capital movements and external debt

Net non-monetary capital inflows rose sharply in 1989, reaching a record of $4.4 billion, mostly consisting of foreign direct investment and short-term capital. The influx of long and medium-term capital exceeded the current account deficit by a wide margin, yielding an unprecedented surplus in the basic balance of around $2 billion, compared with a small deficit of around $200 million in 1988. Capital inflows continued to accelerate in 1990, reaching $3.6 billion in the first eight months, again including substantial amounts of short-term capital. Several factors combined to attract such private foreign capital: in a setting of small and predictable decreases in the exchange rate, high and rising nominal interest rates offered substantial, risk-free returns on financial investment in Portugal. At the same time,

they stimulated the demand for foreign credit. Finally, investors' confidence in the escudo was strengthened by the 1989 tax reform and the related sharp fall in the public sector deficit relative to GDP.

Total non-monetary external debt increased by $775 million in 1989 (net of exchange rate changes). However, the general government reduced its external debt, partly offsetting massive capital inflows. The non-monetary external debt continued to rise in the first quarter of 1990 (by $215 million), mainly reflecting a rise in the short-term debt of non-financial enterprises (both public and private), resorting to foreign credit as a result of comparatively low interest rates abroad. In contrast, the general government reduced its external debt further (both on the short and long-term end) through advance repayments. Official reserves increased by $3.9 billion in 1989 compared with $1.6 billion in 1988. A further gain in these holdings ($3.2 billion) was recorded in the first eight months of 1990. The share of short-term in total external debt kept mounting in 1989 and in the first five months of 1990, largely reflecting a build-up of short-term debt of non-financial private enterprises accompanied by a fall in the long-term debt of non-financial public enterprises.

II. Medium-term adjustment: strategies and problems

Historical background

Portugal entered the decade of the 1980s with an economy beset with severe structural problems. Many of the structural weaknesses of the economy pre-dating the 1974 revolution still persisted: an underdeveloped infrastructure, widespread illiteracy, a large inefficient agricultural sector and an archaic tax system. The 1974 revolution had added further important impediments to the rapid modernisation of the economy: large-scale public ownership of production, all-pervasive price regulation, heavy-handed intervention on factor markets, and greatly increased public sector indebtedness. The decision to join the EC in 1986, the subsequent acceleration of the integration of EC economies, and Portugal's commitment to participate fully in this process have reinforced the need for structural adjustment, both at the micro and macroeconomic level.

Since the turnaround in policy orientation, which occurred in the first half of the 1980s, successive governments have made determined efforts to rid the economy of its impediments to efficient resource utilisation and inflation-free growth. Among the major institutional changes implemented have been the decontrol of prices for goods and services (with few remaining exceptions), reform of regulation of financial markets, the transition to indirect monetary control, the disentanglement of accounts of public enterprises and the public administration, privatisation, and major reforms of both the direct and indirect tax system. As Diagram 1 shows, starting in 1985 – and helped by a favourable international environment – key macroeconomic indicators have responded favourably to the wide-ranging government initiatives to modernise the economy.

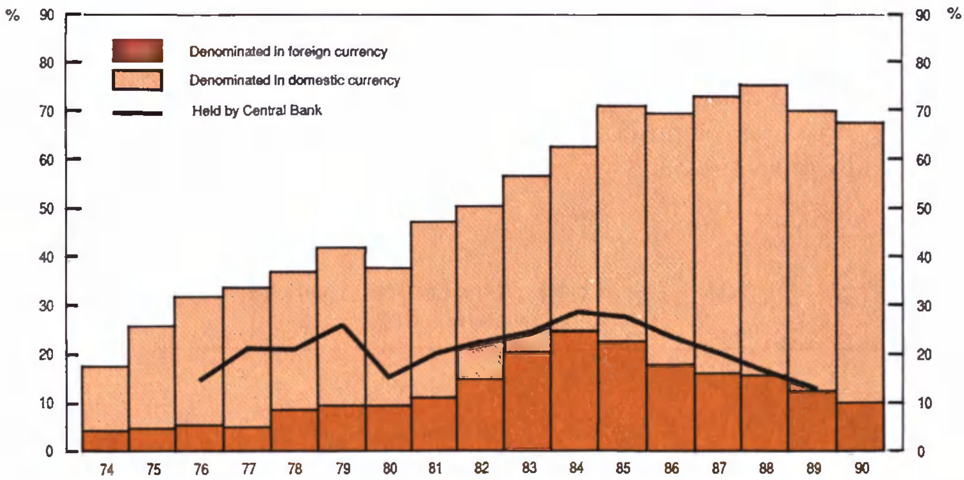
While impressive progress has been made in many areas over the last decade, not all results have been satisfactory. Arguably the most serious shortcoming has been the failure to contain inflationary pressure after the rapid initial reductions of

inflation rates between 1984 and 1988. Linked to the deteriorating inflation performance since 1988 are the continuing difficulties of bringing the public sector deficit under control and the way in which these deficits are financed. The following section looks at some of the problems created by high public sector indebtedness and the related issues of debt financing and privatisation of public enterprises.

Fiscal consolidation and debt financing

Between 1974, the year of the revolution, and 1988, the public debt/GDP ratio quadrupled, reaching a peak of 74 per cent in 1988 (Diagram 10). This rapid increase in absolute and relative public debt is only partly due to the accumulation of deficits by the general government. It also reflects the reorganisation of various public funds and enterprises, the separation of their accounts from those of the government, and their fiscal consolidation. In the process, the central government took over large amounts of debt incurred by these entities[8]. In addition, the government also paid arrears to banks to cover payments associated with interest subsidies

Diagram 10. **PUBLIC DEBT**
Per cent of GDP



Note: Data for 1990 are estimates, for 1991 projections.
Sources: Bank of Portugal, *Annual Report;* Ministry of Finance.

for housing. Cumulated over the period from 1985 to the end of 1988, the combined effects of these operations amounted to as much as 11 per cent of GDP (1988 value). Combined with a rise in effective interest rates on public debt, the increased stock of public debt led to higher interest payments, reaching 8 per cent of GDP in 1987-88, compared with 1 per cent in 1976.

The rising trend of the public debt /GDP ratio was reversed in 1989, as a surge in tax revenues, linked to the income tax reform, reduced the public sector borrowing requirement relative to GDP. At the same time, both the share of foreign currency denominated debt and the share of public debt held by the central bank have declined from well over 20 per cent in 1984 to less than 15 per cent of GDP in 1989. Much of the reduction in the external debt in recent years has been due to advance repayments made to prevent massive capital inflows from leading to an excessive build-up of foreign reserves. Compared with other EC members, Portugal's public debt burden in 1989 was slightly below the (unweighted) EC average (Table 9). After a further fall in 1990, the public debt/GDP ratio is expected to decline to 64 per cent in 1991, reflecting fiscal restraint and increased proceeds from privatisation.

The high level of debt adds to efficiency losses in the economy: financing the debt requires the imposition of taxes, which distort relative prices of both inputs and outputs and thus entail an inefficient allocation of resources[9]. At the same time the tax-financed interest payments on the public debt imply a redistribution of income from taxpayers to bond holders, likely to decrease horizontal equity. Financing the public debt will create distortions irrespective of whether the debt is financed by explicit taxes or extracting resources from the private sector by monetary financing or other forms of implicit taxation. One of the major objectives of the ongoing structural reform in Portugal is the replacement of "implicit" forms of taxation by explicit taxes.

Table 9. **Gross public debt in European countries, 1989**

As a percentage of GDP

Belgium	131	Denmark	55
Ireland	124	France	47
Italy	98	Germany	43
Greece	80	Spain	43
Netherlands	79	United Kingdom	39
Portugal	**70**	Unweighted average	74

Source: OECD Secretariat.

Disguised taxation

The public sector, the dominant borrower, has long enjoyed privileged treatment in financial markets[10]. By restricting the flow of bank credit to the private sector via credit ceilings and forcing banks to buy public debt, the public sector secured easy access to loanable funds until 1985, both in terms of credit availability and interest costs. These privileges were gradually phased out thereafter. In the face of foreign exchange controls, lenders were unable to invest abroad at more attractive market-determined rates. Requirements to purchase low-yield public debt combined with minimum deposit rates and ceilings placed on lending rates put a squeeze on bank profitability. Easing this profit squeeze became possible only from September 1988, when most lending rates were deregulated[11].

Given artificially low returns on financial assets issued by the general government, lenders (the banks) were forced to charge artificially high interest rates to private borrowers or to pay low interest on bank deposits in order to remain economically viable. This implied disguised or "implicit" taxation, with the hidden tax falling upon lenders (banks and/or deposit holders) and private borrowers. The importance of this implicit tax can be gauged by measuring the spread between loan rates and deposit rates net of an assumed "normal" intermediation margin. According to the latter criterion, the hidden tax revenue in 1986-88 has been estimated to amount to close to 4 per cent of GDP per annum, down from a peak of 8 per cent in 1983-85 (Table 10)[12]. Concealed revenues of this kind are bound to disappear with the deregulation of financial markets, intended by the government to meet the conditions for full participation in the Economic and Monetary Union of the EC. A number of policy measures have been taken in 1989-90 to reduce the "implicit" taxation as described above. Among these were the inclusion in July 1989 of medium and long-term treasury bonds in banks' credit ceiling, putting an end to credit availability at low cost as a source of Treasury finance. Moreover, since 1989 the Central Bank is no longer required to purchase government debt, and a new Central Bank Law has been passed, granting a higher degree of autonomy to the Central Bank. In March 1990, credit ceilings on individual bank credit were suspended altogether, and the Central Bank announced "recommended" growth rates for net credits to the total economy. Interest rates paid on existing public debt were adjusted upwards in 1989 and 1990. Even so, the effective real interest rate on public debt in 1989 was negative, reflecting both the unexpected rise in inflation and the particular time pattern of interest payments (see Part III).

It is the government's intention to allow interest rates on public debt to gravitate towards market levels over the whole range of debt instruments, and, as

Table 10. **Estimated revenue from "implicit intermediation tax"**

	Deposit rate	Private loan rate	"Tax" rate[1]	Hidden tax revenue/GDP[2]
1978-79	9	20	8	5
1980-82	12	24	9	6
1983-85	18	34	13	8
1986-88	11	21	7	4
1986	13.7	22.6	5.9	3.0
1987	10.1	21.3	8.2	4.0
1988	8.9	19.3	7.4	3.7

1. The "implicit intermediation tax" rate is equal to the difference between the private loan rate and the deposit rate, allowing for a "normal" intermediation margin of 3 per cent.
2. The hidden tax revenue/GDP ratio is calculated as the "tax rate" (column 3) times the ratio bank credit to the private sector/GDP.

Source: J.B. de Macedo, "External liberalisation with ambiguous public response: the experience of Portugal", Centre for Economic Policy Research, Discussion Paper Series No. 378, February 1990.

noted above, several steps have recently been taken to this effect. As a result, borrowing requirements will, all other things remaining equal, tend to increase, requiring a higher primary surplus (i.e. the financial balance excluding interest payments) to stabilise the debt/GDP ratio. Indicators of sustainability show that in 1988 and 1989 the cyclically-adjusted primary surplus was above the level needed to stabilise the debt/GDP ratio. Moreover, debt repayment from revenues obtained from privatisation are expected to play an important role in the gradual reduction in the public debt/GDP ratio after 1990, thereby reducing the efficiency losses entailed by high public sector indebtedness referred to above.

Successive adjustment programmes

The PCEDED: overtaken by events

While the ultimate objective of economic policy is to narrow the large per capita real income differential with the average of EC member countries through steady non-inflationary growth, the adjustment requirements implied by the process towards economic and monetary union are widely seen as the appropriate policy environment to achieve this objective. This conviction has found expression in various adjustment programmes, setting out intermediate economic goals and

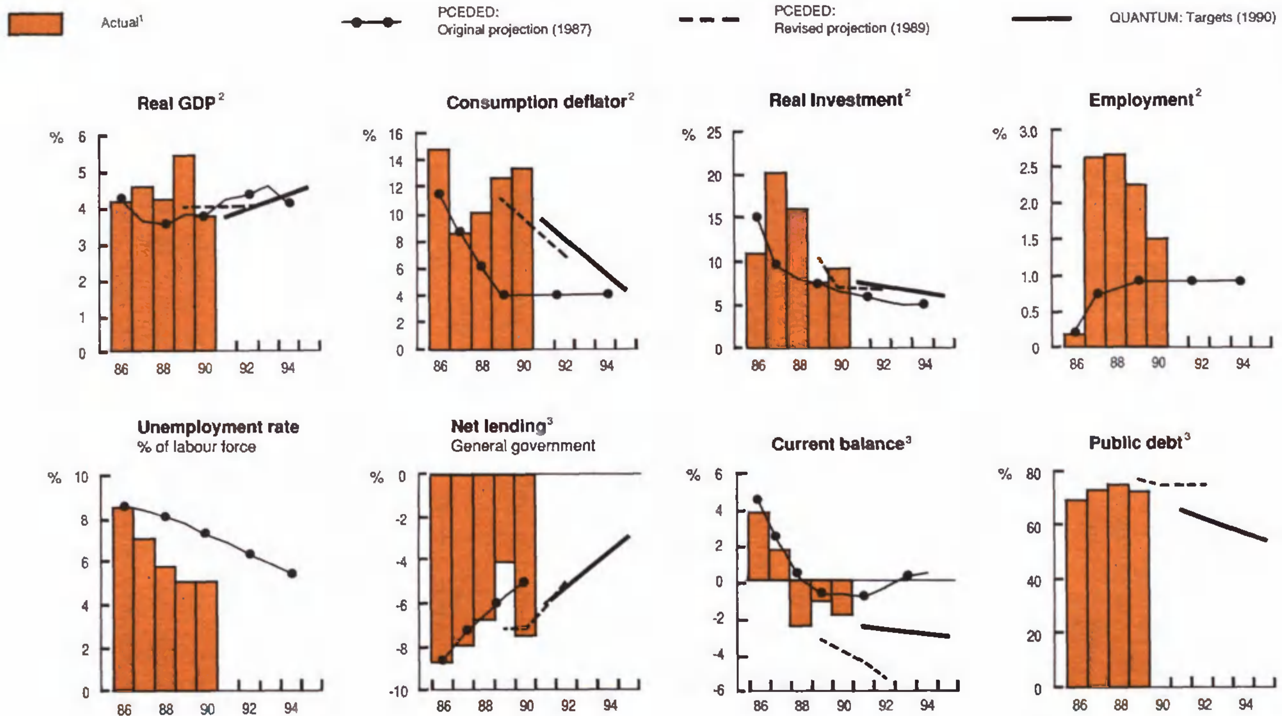
related adjustment requirements over a medium-term time horizon. In March 1987 the government adopted the "Programme for the structural adjustment of the foreign deficit and unemployment" (PCEDED), a programme to be implemented in two stages. A first stage would cover the period 1987-90 and a second one the period 1991-94 when the main imbalances (public sector deficit, unemployment and current account deficit) would be rectified as a consequence of policies applied in stage one. Inflation, then expected to be reduced to 4 per cent by 1989, was not singled out as a separate imbalance[13].

The PCEDED was quickly overtaken by events. Inflation stopped falling at a level of 10 per cent in 1988, rising thereafter, as gains in output, employment and investment all displayed unexpected buoyancy (Diagram 11). The slippage of inflation owed much to difficulties in controlling credit growth. Credit controls were undermined by a surge in credit not subject to ceilings, partly stimulated by recourse to foreign credit. Foreign borrowing was made possible by the progressive liberalisation of exchange controls since 1986. On the other hand, both government net lending and the current-account deficit shrank, evolving as projected. Faced with a large gap between inflation outcomes and initial targets, the authorities revised the structural adjustment programme in July 1989. Under the new version, the public debt/GDP ratio would stabilise before 1992, helped by tax increases, cuts in public consumption and proceeds from privatisation. New targets were set for inflation, the public-sector deficit and the current-account position, all considerably less ambitious than those laid out in the original programme (Diagram 11). Yet the revised version of PCEDED was short-lived as well: again it was the underestimation of inflation which made the projections obsolete within a year.

The current approach: QUANTUM

In July 1990, the authorities adopted a new adjustment plan (Quadro de Ajustamento Nacional para a Transição para a União Económica e Monetária, QUANTUM) motivated by a series of sudden and far-reaching changes in the domestic and international environment since autumn 1989. These included unanticipated food price shocks, massive capital inflows and, perhaps most importantly, the new schedule for achieving economic and monetary union within the EC. For this reason, QUANTUM pays particular attention to policy changes which would be needed to create the conditions for membership in the exchange rate mechanism of the EMS. Joining the "narrow-band option" of the exchange rate mechanism of the EMS is required for full participation in the second stage of the EC integration process, which is due to start in 1994. Portugal has committed itself to this process.

Diagram 11. **MEDIUM TERM PROJECTIONS AND OUTTURNS**



1. Data for 1990 are preliminary estimates.
2. Annual rate of growth.
3. Per cent of GDP.

Sources: Ministry of Finance; OECD, *National Accounts*.

To highlight adjustment requirements for economic policy, QUANTUM distinguishes between two scenarios, one being called "scenario without convergence", the other "scenario with convergence". The term "convergence" stands for the elimination of the inflation differential *vis-à-vis* EC countries by 1995. The assumed average import price of oil is $22½ over the 1992-95 period. The first ("no-convergence") scenario assumes the continuation of present policies, including what is described as "accommodating monetary policy", expansionary fiscal policy and steady exchange rate depreciation (3 per cent a year in effective terms). Under this scenario, inflation falls only slightly, remaining in the double-digit range. The public debt/GDP ratio increases and the current-account deficit widens sharply, as the real exchange rate appreciates strongly. In the authorities' view, this scenario is unacceptable (Table 11)[14].

Under the second scenario, both public borrowing requirements and the public debt fall sharply relative to GDP. This derives from increases in revenues from both direct and indirect taxes coupled with stringent expenditure restraint (Table 11 and Diagram 11). Over the period 1992-95, public expenditures on goods and services are frozen in real terms at a level which is 4 per cent lower than that in 1990, an

Table 11. **"Quantum" scenarios**[1]

	Scenario showing no convergence towards EC inflation[2]			Scenario showing convergence towards EC inflation		
	1991	1995	1992-95	1991	1995	1992-95
Percentage change at annual rate						
Private consumption deflator	12 1/2	11 3/4	13 1/4	9 1/2	4 1/4	6 1/4
Gross fixed capital formation	7 1/2	4 1/2	5 1/4	7 1/2	6	6
Volume exports	9	7 3/4	7 3/4	7 1/2	8 1/2	7 3/4
Volume imports	9	7 3/4	8 1/2	7 1/2	6 3/4	7 1/4
Real GDP	4 1/2	3 1/4	3 1/4	3 3/4	4 1/2	3 3/4
Depreciation of the effective exchange rate	3	3	3	1 1/2	0	0
Per cent of GDP						
Current account balance	–2 1/2	–5 3/4	–4 3/4	–2 1/2	–3	–3 1/4
General Government borrowing requirement	–10 1/2	–11 3/4	–10 3/4	–6	–3	–4
Primary budget balance	–1/4	–1 1/2	–3/4	2 3/4	3 1/2	3
Public debt	68	69 1/2	67	65 3/4	54 1/2	57 3/4
External debt	26 1/4	20	21 1/4	25 1/2	15	18 1/2

1. "Quantum" is the new structural adjustment programme adopted in July 1990.
2. This scenario is based on the assumption of unchanged policies.
Source: Submission of Portuguese authorities.

ambitious target. At the same time, the effective exchange rate is assumed to show no change in 1992-95 after a small fall in 1991, while the real exchange rate rises by much smaller amounts than under the first scenario. Given increased tax revenues, reduced expenditure and nominal exchange rate stability, inflation falls to 4¼ per cent by 1995. The critical year in the "convergence" scenario is 1991 when fiscal policy is assumed to be severely tightened, producing a swing in the primary budget balance from deficit to surplus of around 3 per cent of GDP compared with the "no-convergence scenario". This coincides with a sharp rise in the real exchange rate, reflecting a large inflation differential, which narrows subsequently[15].

On the basis of assumptions underlying the QUANTUM, the adjustment requirements in the "convergence" scenario seem consistent with the aim of removing the inflation differential *vis-à-vis* the EC by 1995. But the starting position for pursuing this aim has worsened appreciably, due to the oil price shock coming on top of high inflation in the first half of 1990. The required pace of disinflation has therefore quickened, and economic policies may need to be tightened more severely than specified by QUANTUM. Since interest payments on public debt are set to rise in relation to GDP, expenditure restraint necessarily falls on public wages, subsidies and transfers. Some of these expenditures, health and education, are not to be cut, while others, e.g. wages, are hard to rein back because inflation strongly strayed from targets over the past three years.

Progress in structural reform

The authorities have made further progress in structural adjustment, relying on internal reforms encompassing public sector financing, land reform, labour and financial markets and the fostering of competition. In 1986, the government began to close down some public entities and to settle the State's payment arrears to public enterprises, whose financial results have shown considerable improvement. A land reform law was passed in 1988, opening the way for the privatisation of some of the collective farms. A new labour market law, introduced in 1989, eases conditions for individual and collective dismissals and improves support for the unemployed (reduction of the age limit for early retirement of the unemployed from 62 to 60 years, easing of eligibility provisions for unemployment benefits). Development of capital markets has been rapid, leading to the creation of new financial institutions and instruments. The banking and insurance sectors have been opened up to private initiative and to foreign competition. More recently, a

privatisation programme has been started: it is seen as a crucial element in stimulating productivity gains in a number of key sectors and, as noted above, in reducing the public debt/GDP ratio over the medium term. Portugal has continued to receive substantial amounts of funds from the EC, which have contributed to the modernisation of the economy, and will continue to do so in the future provided that they are spent on the basis of economic criteria.

Privatisation

The government has recently embarked upon a programme of privatising enterprises nationalised after 1974, a process long stalled because the 1976 Constitution explicitly ruled out privatisation. In April 1990, legislation concerning privatisation was passed following a Constitutional Amendment in June 1989 which provided the basis for a complete (100 per cent) privatisation of public enterprises. This amendment was preceded by a law in March 1988, allowing the transformation of public enterprises into corporations in which the State would retain 51 per cent of total equity (for details of the privatisation process, see Annex III). For the first phase of "*partial*" privatisation, the government selected profitable enterprises: a brewery company (Unicer), a medium-sized bank (Banco Totta & Açores) and two insurance companies (Aliança and Tranquilidade). Share issues for these companies were substantially over-subscribed in 1989. The envisaged participation of workers and small shareholders was not fully achieved, while major groups, including foreign companies were able to acquire larger amounts of shares than had been intended.

The new Privatisation Law, passed in April 1990, allows full privatisation of public enterprises. The sale of the remaining 51 per cent of State-owned shares of Unicer and Tranquilidade took place in June and October 1990, respectively. The sale of the remaining 51 per cent equity capital of the bank Banco Totta & Açores is to be made in two instalments, the first one of which took place in July. The 51 per cent state-owned shares in the sea transports company Transinsular were sold in August. The full privatisation of the other state-owned brewery (Centralcer) was made in November 1990.

Even though there is no well defined timetable, other privatisations envisaged for 1991 include the Banco Português Do Atlântico, the largest commercial bank, and the remaining shares of Aliança. Next may come other companies from the financial sector and the cement companies (Secil and Cimpor). Despite important investments, the largest industrial enterprises still need financial, organisational and physical restructuring, ruling out privatisation in the near future. The same

applies to State-owned banks. In the financial sector, the State intends to maintain an important position, through the establishment of two major financial groups. The first one would include the largest financial institution (Caixa Geral De Depósitos – a saving bank), a commercial bank (Banco Nacional Ultramarino) and an insurance company (Fidelidade). The second financial conglomerate would deal with international trade and export promotion. It consists of an investment bank (Banco De Fomento Exterior), a commercial bank (Banco Borges & Irmão) and an external credit insurance company (Cosec). Together, these two groups account for some 40 per cent of banking transactions.

Assessment of the privatisation process

Privatisation of public enterprises tends to improve economic performance in several ways. Nationalised enterprises are often plagued by inefficiencies, including overmanning and misguided investments. Accompanied by changes in management practices, rules and legislation favouring greater competition, privatisation can therefore raise overall efficiency of production. While recent research suggests that changes in competitive conditions and regulations have often had larger effects on incentives, and hence on performance, than the change in ownership *per se*, privatisation is nonetheless seen as an important step in making greater competition possible and indeed more likely[16]. Moreover, proceeds from privatisation are used to reduce public debt, and to the extent that profits rise after privatisation, tax revenues will expand. Some positive spillover from the privatisation process to the development of capital markets is also expected. In this regard, the privatisation of individual companies in stages is viewed as helping the creation of a wider secondary market for privatised stock, thereby improving proceeds to the government. Projecting revenues over the medium run is difficult since there is no firmly scheduled order in which enterprises will be privatised. In 1991, proceeds from privatisation are nevertheless expected to be equal to 2.5 per cent of GDP.

Funds for structural adjustment

The bulk of funds transferred from the EC are the "structural" funds, which amounted to 2.4 per cent of GDP in 1988 and in 1989, rising to 2.7 per cent in 1990. They are used for infrastructure developments (financed through transfers from the regional fund, ERDF) and professional training (supported by transfers from the European social fund, ESF). Additional EC funds are allocated specifically to the development of the agricultural sector and the industrial sector[17].

Budgetary contributions of Portugal to the EC also increased, but remained below 1 per cent of GDP.

The programme for industrial adjustment: the PEDIP

The PEDIP is an envelope programme designed to co-ordinate financial aid to industry, channelling funds from various Community and domestic sources (EC funds, Portuguese government, bank finance) to specific projects. Its objective is to modernise and diversify industry through infrastructure development as well as targeted financial aid and/or technical assistance. PEDIP is aimed at enhancing competitiveness of plants in "mature sectors" via process and product innovation.

After one year of implementation, a preliminary review of some of the actions undertaken is possible. Of the total 4 000 or so projects submitted, more than half were assessed and 40 per cent approved by the end of 1989. The two main areas of action undertaken in 1989 were:

i) Incentives to productive investment for modernising and restructuring, which absorbed the largest share of public funds appropriated to the PEDIP: Esc.28 billion or three-quarters of total direct public transfers to industry, with an important contribution from the EC. These incentives represent, however, only a small share of the overall cost of investment projects. They are primarily applied in the form of capital grants;

ii) Occupational training in industry, for which public contribution amounted to Esc.6.5 billion over the year and which involved 57 000 persons.

The main beneficiary of these two types of support was the manufacturing sector: machinery and transport vehicles, textile and clothing in particular.

Programmes in support of the labour market

Government expenditure on active and passive support of the labour market amounted to 1 per cent of GDP in 1989, a ratio unchanged from the previous two years. The share of public expenditure channelled into measures targeted on youth increased, while the share on income support for the jobless decreased, in accordance with the fall in unemployment. In addition, transfers from the European Social Fund (ESF) serving to finance training in private enterprises continued on a large scale. The total ESF contribution to the Portuguese labour market amounted to 0.7 per cent of GDP in 1989 and 1990, close to the average over the previous years.

A survey taken in 1987 and 1988 gives some indication of the scale of private training programmes co-financed by the ESF. On average, 100 000 people, about 2 per cent of the labour force, were involved in the programmes each year. More than 40 per cent of them were unemployed before entering the training programme, and 30 per cent were unemployed after the completion of training. In the youth category, 70 per cent were unemployed before the training, compared to 45 per cent after the completion of training.

III. Economic policies and short-term outlook

Budgetary developments

The 1989 budget outturn

The public debt/GDP ratio dropped substantially in 1989, as the general government borrowing total requirement (i.e. including financial transactions) fell from 8.2 per cent of GDP in 1988 to 4.8 per cent. Excluding financial transactions, the balance also narrowed – though to a lesser extent – falling from 6.8 per cent of GDP in 1988 to 4.2 per cent in 1989[18]. This outcome was far better than expected, reflecting a surge in revenues linked to buoyant economic growth, higher-than-expected inflation, the broadening of the tax base under the 1989 income tax reform and the overlapping of tax payments under two different tax regimes. Revenue increases resulting from the implementation of the income tax reform in 1989 had been largely underestimated. Despite buoyant revenues, public-expenditure growth remained under control. Projections made at the start of 1989, based on the assumption of a significant slowdown in nominal GDP, had anticipated a fall in general government borrowing requirements of only 0.4 per cent of GDP.

Direct taxes and social-security contributions increased by as much as 29 per cent in 1989 (Table 12). As a result, the ratio of these revenues to GDP approached 18 per cent in 1989, more than 3 points above the ratio recorded two years earlier. A major cause for the surge in direct tax revenues was the implementation of the 1989 tax reform. This reform implied a widening of the tax base as civil servants' salaries and interest paid on public securities were brought into the tax base[19]. Moreover, tax collection was accelerated as tax payments on 1988 incomes to be paid in 1989 overlapped with tax payments on 1989 incomes which – as a result of the reform – were due in the same year. Part of the rise in government revenues in 1989 was therefore temporary. Revenues from indirect taxes, which had been rising since the introduction of VAT in 1986, eased in 1989, as consumption shifted away from goods and services subject to high VAT rates,

such as cars. This shift also lowered the receipts from the car sales tax. All in all, the current revenue/GDP ratio increased by 1½ percentage points between 1988 and 1989.

General government current expenditure in 1989 was broadly in line with initial projections despite an unexpected acceleration in inflation. Together with faster-than-expected real growth, this reduced the ratio of expenditure to GDP by a full percentage point. Originally, a rise in this ratio had been foreseen in the budget. Individual expenditure components, however, developed differently from what had been projected. Interest payments were lower because of changes in debt management operations and the timing of the rise in interest rates[20]. Offsetting these "savings" (equal to more than 1 per cent of actual GDP in 1989) were spending overruns in the domain of health, education and government wages. As regards the public wage bill, the expenditure overrun is explained by three factors:

i) The general reform of the civil servants' salary scale had not been incorporated in the initial budget because the timing was then uncertain. As it turned out, the reform took effect as from October 1989;

ii) Because of strong unanticipated inflation, the normal annual rise in public wages, originally planned for January 1990, was advanced to October 1989;

iii) Finally, the amount initially budgeted for compensation for the new income tax on civil servants' incomes had been underestimated.

Capital expenditure continued to grow in line with nominal GDP, reflecting the co-financing of projects supported by EC funds.

All levels of government contributed to the surprisingly good budget outcome in 1989. Instead of a projected deficit, autonomous funds showed a small surplus, mainly reflecting improved control of expenditure, a result of administrative reforms. The effects of these reforms, which should continue in 1990, were underestimated in the initial 1989 budget[21].

The 1990 budget

When preparing the budget for 1990, the authorities aimed at achieving further progress in fiscal consolidation without increasing the overall tax burden. The budget was essentially aimed at providing sufficient resources for areas viewed as "priority areas" such as health, education and infrastructure investment co-financed by the EC. The underlying assumptions were that GDP would keep growing by 4 per cent and that inflation would slow to 9.5 to 10.5 per cent. It was

recognised that some of the special influences explaining the favourable budget outturn in 1989 would vanish, while others might even be reversed. On the revenue side, the positive impact on revenue from the overlapping of tax payments would disappear, while expenditure would be swollen by the full effect of the new pay scale for civil servants, combined with a steep rise in interest payments on the public debt. Initial budget projections for 1990 implied a rise in the general government total borrowing requirement (including financial transactions), to about 9 per cent of GDP. However the outturn estimated at present is slightly below this projection: about 8½ per cent of GDP, i.e. 3½ points larger than the 1989 outcome and close to the 1988 outturn (Table 12).

Current revenue was initially projected to rise by 12.3 per cent in 1990, but its increase is now estimated to be close to 13½ per cent, mainly reflecting unexpectedly high inflation. This increase implies a revenue/GDP ratio slightly above the level recorded two years ago. The revenue-enhancing effects of the tax reform are still exceeding initial projections, while some former taxes, such as remnants of the industrial tax and the supplementary tax, are still being collected in 1990. On the other hand, tax revenue was set to shrink on account of tax relief introduced in February 1990, in an *ad hoc* inflation adjustment of personal income tax brackets and tax deductions which exceeded the actual inflation rate. Indirect taxes were projected to accelerate in line with nominal income, leaving their ratio to GDP unchanged.

Current expenditure is estimated to have grown by 24 per cent in 1990. There has been no upward adjustment of expenditure growth despite the unanticipated acceleration of inflation, but some inflation compensation within components of expenditure will be implemented. Interest payments are likely to have increased from 7.3 per cent to about 9 per cent of GDP. Main reasons for this rise were:

- The issue of public securities at gross interest rates[22];
- The timing of debt management operations which, after being favourable in 1989, will augment the budgetary burden in 1990 by an estimated 0.5 per cent of GDP;
- Higher effective interest rates on the public debt, as new debt is increasingly financed at market rates.

Other current expenditure is estimated to have grown by about 20 per cent, due in large part to the salary-scale reform. Expenditures on education and health as well as capital expenditures have risen sharply. The increase in capital spending was, however, entirely offset by incremental capital receipts.

Table 12. **Consolidated General Government account**

	Billion Escudos	Percentage changes on previous year			
	1988	1988 Outturn	1989 Outturn	1990[1] Estimate	1991[1] Projections
Current revenue	**2 262.2**	**20.9**	**23.5**	**13.5**	**21.8**
of which:					
Direct taxes and social ins. contr.	983.8	29.1	28.7	19.3	22.4
Indirect taxes	967.2	22.9	12.6	13.9	13.0
Current expenditure	**2 399.2**	**16.8**	**15.5**	**24.1**	**19.0**
Expenditure on goods and services	1 121.8	23.8	18.1	20.2	19.2
Subsidies to enterprises	128.6	–11.6	32.2	–11.9	38.7
Interest on public debt	504.8	14.7	3.5	42.5	17.0
Current transfers	644.0	14.4	17.0	26.4	15.5
Capital receipts	**63.8**	**31.5**	**16.8**	**80.3**	**41.5**
Capital expenditure	**337.3**	**16.1**	**19.4**	**25.0**	**18.1**
of which:					
Investment	229.5	27.6	13.6	14.8	13.4
Capital transfers	107.8	–2.5	31.0	54.3	17.7
Overall balance[2]		**–6.8**	**–4.2**	**–7.5**	**–6.5**
Total borrowing requirement[3]		**–8.2**	**–4.8**	**–8.5**	**–7.2**
Overall balance *less* interest on public debt[2]		1.5	3.0	1.3	2.5

1. Draft budget estimates for 1990 and projections for 1991.
2. Excluding financial transactions, as a percentage of GDP.
3. Including financial transactions, as a percentage of GDP.

Source: Ministry of Finance.

The overall general government balance (excluding financial transactions) may increase from 4.2 per cent of GDP in 1989 to 7½ per cent in 1990. The deterioration is due both to increased interest payments and other current expenditure. The primary surplus, which widened from 1½ per cent of GDP in 1988 to 3 per cent in 1989, is expected to have fallen back to 1.3 per cent of GDP in 1990. As financial transactions are expected to increase relative to GDP, the total borrowing requirement may rise to 8½ per cent of GDP. These estimates are still provisional. Great uncertainty attaches to both the expenditure and the revenue side, given the recent reforms of the tax system, of the pay scale for civil servants and of public accounting procedures. Budgets of autonomous funds and services were included for the first time in the central government budget in 1990 for approval by Parliament.

The incorporation into public debt of liabilities previously incurred by autonomous funds and public enterprises continued in 1990, albeit at a slower pace. It will cease thereafter, the process being completed. As a result, the rise in public debt in 1990 has once again exceeded the projected budget deficit. Even so, a further reduction (by 2½ percentage points) in the public debt/GDP ratio is foreseen for 1990.

The 1991 budget proposals

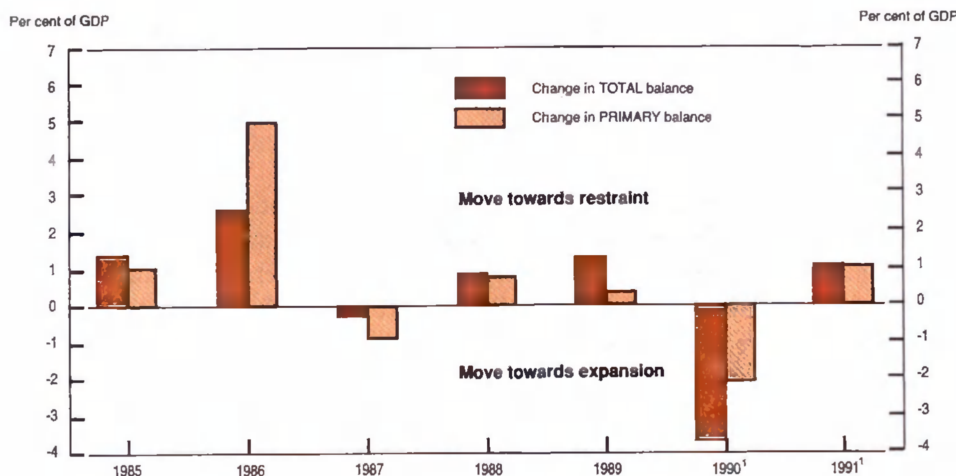
The budget proposals for 1991 are based on the assumption that real GDP will rise by nearly 3½ per cent, with consumer price inflation slowing to 10¾ per cent. The prime objective of the 1991 budget is to cut the general government deficit relative to GDP by way of raising indirect taxation, combating tax evasion and reducing the share of some components of current expenditure in GDP. Despite increased tax concessions for low and high incomes, direct tax revenues are projected to expand by some 22 per cent, helped by more efficient ways of tax collection. Expenditures are planned to rise less strongly than tax revenues: interest payments would increase by 17 per cent only, returning to a normal pattern after their exceptional expansion in 1990, while further advances in spending on public works, education and health are partly offset by zero growth for most ministerial administrative budgets. Total current expenditure in 1991 seem set to rise in real terms.

All in all, on these proposals, the general government balance (excluding financial transactions) would be put back on a downward track, falling to 6.5 per cent of GDP from an estimated 7.5 per cent in 1990. The primary surplus is expected to widen to 2.5 per cent (compared to a projected 2¾ per cent in the QUANTUM). As financial transactions fall slightly relative to GDP, the total borrowing requirement is projected to drop to 7.2 per cent of GDP, 1.3 percentage point below the estimated outturn for 1990.

The stance of fiscal policy

To assess the stance of fiscal policy, it is useful to look at the annual changes in the budget balances from 1988 to 1990 on a cyclically adjusted basis. Exceptional factors, which played an important role in 1989 have been reversed in 1990, i.e. the overlapping of tax revenues and the timing of interest payments. These effects partly cancel out when the cumulative change over the two years 1989-90 is considered. The surplus in the cyclically adjusted *primary balance* (i.e. excluding

Diagram 12. **THE STANCE OF FISCAL POLICY**
Change in the cyclically adjusted budget balance, % of GDP
(General Government account)



1. Secretariat estimates.
Source: OECD Secretariat.

net interest payments) increased by ½ per cent of GDP in 1989, followed by a reduction of 2 percentage points in 1990. Hence, discretionary policy action overall implied a move towards expansion (Diagram 12). On the other hand, the cyclically adjusted *total budget deficit*, which fell by slightly more than 1 per cent of GDP in 1989, increased by over 3½ per cent of GDP in 1990, as debt service costs escalated (the impact of the timing of debt management operations cancels out). This move of the budget towards greater ease came at a time of low unemployment and booming goods and services markets. As inflation remained broadly unchanged in 1989 and 1990, the inflation adjustment does not modify this assessment significantly. Budget proposals for 1991 imply a move towards fiscal restraint. Although it is useful – for the purpose of policy appraisal – to separate automatic changes in the budget position (the cyclical component) from discretionary actions, and within discretionary measures to isolate temporary distortions not related to normal activity of the government, it is the *total deficit,* including debt service, which must be financed.

Monetary and exchange-rate policies

The tightening of monetary policy in 1989-90

Monetary policy was repeatedly tightened in 1989 and 1990, as inflation reaccelerated in the wake of food price shocks and an overheating of goods and labour markets. At the same time, rapid capital inflows boosted domestic liquidity, prompting the authorities to make advance repayments on the external public debt. To curtail the liquidity effects of private capital inflows the authorities also speeded up the easing of exchange controls for residents, and made foreign borrowing by companies more costly. Special measures were taken to reduce the government's automatic access to bank credit. The policy of moving towards an indirect control of monetary aggregates was maintained, notwithstanding the difficulties to liquidity management posed by rapid capital inflows, encouraged by high domestic interest rates and pre-announced changes in the exchange rate.

In March 1989, a set of restrictive measures was introduced aimed at making credit ceilings more effective, absorbing bank liquidity and raising lending and deposit rates[23]. Thereafter, monetary policy was tightened further several times in rapid succession. In May 1989 it was announced that banks' holdings of medium and long-term Treasury Bonds were to be included in credit aggregates subject to credit ceilings as from July 1989. Credit to the public sector had been outside the ceilings since June 1987, fuelling credit expansion[24]. In June 1989, steps were taken to reduce banks' and non-monetary institutions' ability to borrow abroad. Banks' external medium and long-term borrowing not subject to ceilings was confined to the existing balances at the end of June 1989 and to credits with a duration of more than five years. The external borrowing by the main non-bank financial institutions was limited to the amount of their own capital. In Spring 1990, as part of the continued efforts to facilitate the transition to indirect monetary control, formal credit ceilings were suspended[25], while minimum reserve requirements were extended to non-monetary financial institutions. Under the new regime, the definition of liabilities subject to reserve requirements may be broadened further.

In June 1990, the minimum interest rate on time deposits of more than six months was raised from 13 to 14 per cent. The deposit rate on saving for house purchase was increased to 14.5 per cent. In July 1990, to discourage foreign borrowing, the authorities introduced a compulsory deposit at no interest with the Central Bank equal to 40 per cent of new loans from abroad taken up by companies. Exempt from this requirement are trade credits. At the same time, residents were allowed to buy stocks and bonds in OECD countries, but restrictions on

opening a foreign checking account remain. Advance repayments of the foreign debt were continued, and the Central Bank bought large amounts of foreign exchange in a bid to stabilise the exchange rate.

Given tighter credit controls and increased interest rates, all monetary aggregates decelerated strongly in 1989, while velocity of circulation surged in the second half of the year. The growth of liquid assets (L-) fell to 7.5 per cent in December 1989 from 15.0 per cent a year earlier (Table 13 and Diagram 13)[26]. At 11.7 per cent, the average growth of L- in 1989 remained within the target range set in the revised monetary programme for 1989[27]. Unsterilised net purchases of foreign exchange by the central bank were responsible for a major part of the growth in L- in 1989. At the same time, total growth of bank credit subsided, falling to 6 per cent in December 1989 compared with a rise of 11 per cent a year earlier. Both massive sales of Treasury bonds directly to the non-bank sector and the sharply reduced borrowing requirement of the public sector contributed to this result. At the same time, private foreign borrowing expanded rapidly, induced by comparatively low interest rates abroad combined with the smallness of the exchange rate risk. In the first eight months of 1990, monetary aggregates accelerated in reaction to capital inflows and stronger credit growth. Monitoring changes in monetary aggregates as well as their interpretation have become more difficult, given structural changes in the financial sector and attempts by banks to circumvent credit ceilings.

Reflecting the string of restrictive measures described above, nominal interest rates moved up in 1989 and early 1990 (Diagram 14). In real terms, though, short-term rates declined. At the same time, the interest differential *vis-à-vis* foreign

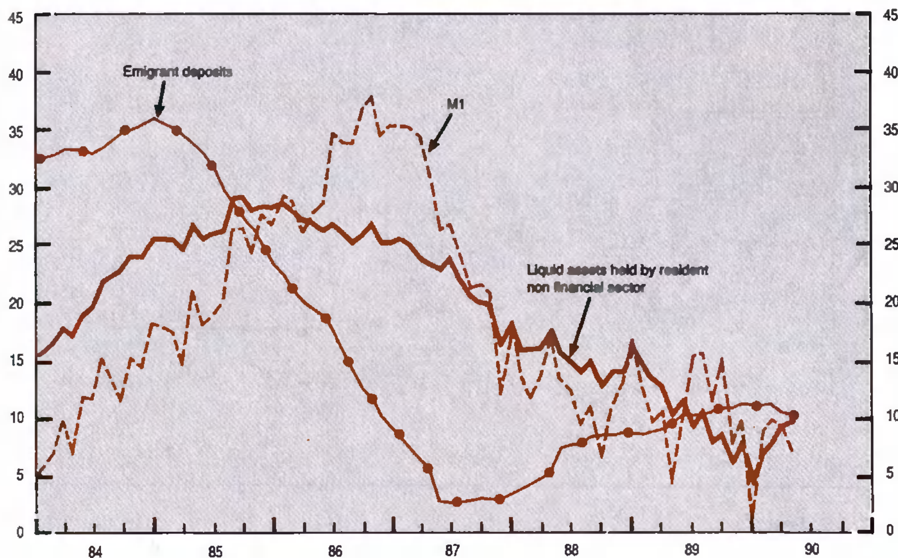
Table 13. **Monetary aggregates**

Percentage changes over same period of previous year

	Esc. bn. 31/12/88	1987	1988		1989		1990	
		December	June	December	June	December	June	August
M1-	1 722.1	14.4	14.5	12.8	10.5	6.1	10.0	18.6
Time deposits[1]	2 832.1	13.2	13.0	12.3	11.6	14.3	10.3	10.1
Treasury bills[1,2]	566.7	47.1	24.7	15.8	3.0	2.6	38.7	68.4
L-	5 389.8	17.5	16.2	15.0	13.2	7.5	10.8	16.5
Migrants' deposits	1 420.3	3.7	8.2	9.7	11.3	11.8	12.2	10.7
L	6 892.6	14.2	14.0	14.5	13.8	9.4	12.3	16.0

1. Residents, excluding financial institutions.
2. Including auctioned credit for public investment (CLIP) since December 1988.
Source: Bank of Portugal, *Monthly Bulletin.*

Diagram 13. **MONEY AND CREDIT**
Per cent change over 12 months

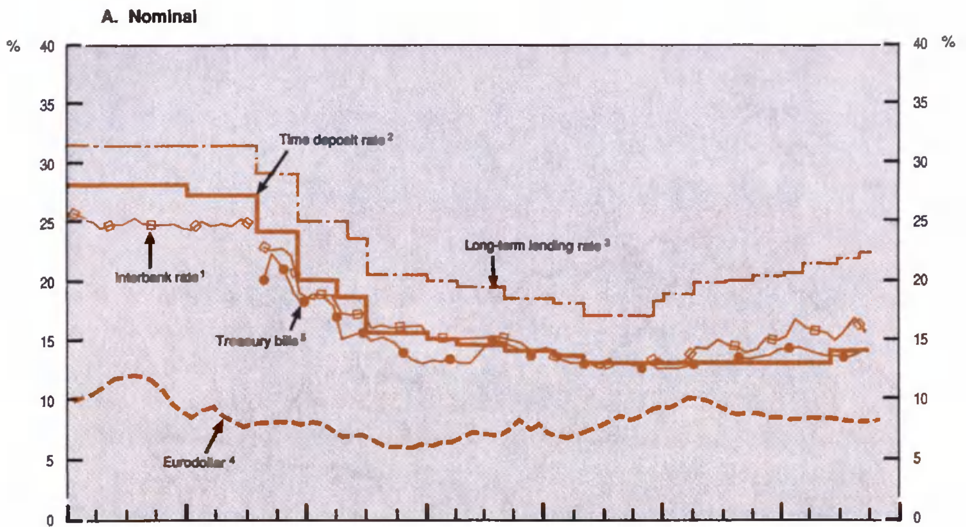


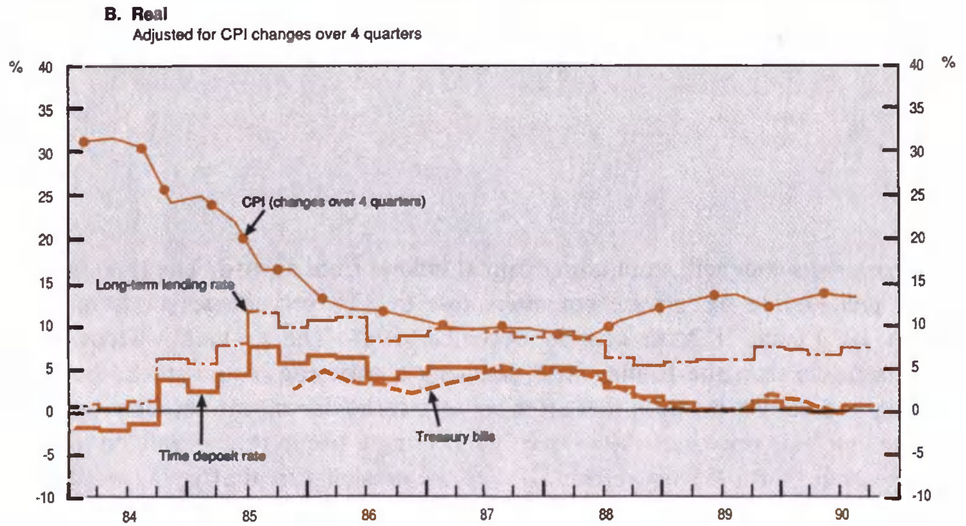
Source: Bank of Portugal.

credit markets widened, stimulating capital inflows from abroad. The three-month bank lending rate for private borrowers rose to 22.8 percentage points in November 1990 from 18.2 per cent in December 1988. The six-month deposit rate increased less than the lending rate, implying a widening of the spread between lending and deposit rates. In real after-tax terms, the deposit rate became negative for the first time since early 1985, partly reflecting a rise in the tax rate on interest income under the 1989 tax reform. Due to the erosion of real after-tax returns on deposits, non-bank financial institutions were able to attract savings via the issue of competitive debt instruments.

The monetary programme for 1990 envisaged a maximum rise in L- of 12 per cent from December 1989 to December 1990, i.e. an 8.2 per cent year-on-year rise. Guidelines for public debt management policy included in the 1990 budget also foresaw a further substantial rise in sales of medium and long-term debt by the

Diagram 14. **INTEREST RATES**





1. Average 60-90 day rate until July 1985; 31-90 day rate thereafter.
2. Six months to one year.
3. Over two years, less than five years.
4. 3-months rate.
5. 182 days; as from July 1989, gross rate.

Source: Bank of Portugal, *Monthly Bulletin.*

banks to the public. As in 1989, this was coupled with further reductions in external debt through advance repayments. The authorities intend gradually to replace low-yield public debt held by the banking sector by debt remunerated at market rates. This would help siphon off excess liquidity in the banking system, a legacy of credit ceilings and high private sector saving in the form of bank deposits. At present, interest rates on large portions of medium and long-term public debt are still indexed to administratively fixed interest rates, i.e. until 1989 the official discount rate and the reference rate for capital markets[28]. Changes in indexation procedures have brought returns on public debt to market levels.

In order to absorb excess liquidity, the authorities envisage selling an estimated Esc 1 060 billion (13 per cent of GDP) of public debt to the banking system. The greater part of proceeds from this sale (an estimated Esc 850 billion) will be used to repay old public debt held by the Bank of Portugal. The remainder will serve to make further advance repayments of general government external debt. The authorities also announced that the present system of "recommended" credit expansion will be discontinued.

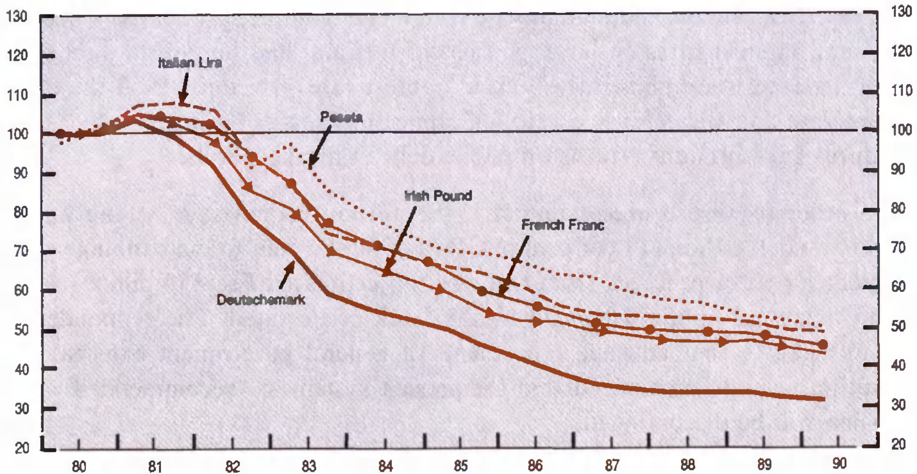
Exchange rate policy

Under the policy of pre-announced, small devaluations, the effective exchange rate continued to fall during 1989, the cumulative decline amounting to 3 per cent between December 1988 and December 1989 or 0.25 per cent per month. Against the ECU, the cumulative devaluation was 3.5 per cent in 1989 (year-on-year). However, as in 1988, the real exchange rate appreciated as the fall in the effective exchange rate was less than the inflation differential (Diagram 15). With inflation reaccelerating, the rise in the real exchange rate picked up in 1989, reaching 3.8 per cent compared with 2.7 per cent in 1988 (December-on-December).

In September 1990, amid massive net capital inflows, the authorities announced a more flexible exchange rate regime[29]. Beginning in October, the escudo has been allowed to fluctuate more freely, ending the policy of small pre-announced exchange-rate depreciations. Under the new regime, exchange-rate changes are evaluated against a basket of the five main currencies included in the exchange rate mechanism of the EMS, i.e. Deutschemark, Spanish peseta, French franc, Pound Sterling and Italian lira. Excluded from the currency basket are the U.S. dollar and the yen. On the basis of this currency basket, the authorities appear to have maintained a 3 per cent effective annual devaluation as a broad guideline.

Diagram 15. **EXCHANGE RATE OF THE ESCUDO VIS-À-VIS SELECTED CURRENCIES**[1]

Index, 1980 = 100



1. Unit of currency per escudo.
Source: OECD Secretariat.

Under the new exchange rate policy, this trend devaluation is to be implemented in a flexible way, so that the nominal exchange rate may well appreciate over the short run, raising the real exchange rate and attenuating inflation. Immediately following the new approach, the escudo actually appreciated in nominal terms in October and November 1990.

In June 1990, the government announced its intention to take the escudo into the Exchange Rate Mechanism (ERM) of the EMS, reviving expectations of an imminent entry. This announcement came as no surprise, since the authorities are known to seek full participation in the second stage of the economic and monetary union in the EC. Such participation requires adherence to the ERM for exchange-rate changes. Joining the ERM requires, in turn, a substantial drop in the rate of inflation if large increases in the real exchange rate and corresponding losses in competitiveness are to be avoided.

Prospects for 1991 and 1992

In mid-1990 the economy was still characterised by high levels of capacity utilisation, tight labour markets and persistent buoyancy of gross fixed capital formation. Economic policies aimed at reducing inflation are the major forces behind the projected slowdown of output over the forecast horizon.

The projections by the OECD Secretariat presented below are based on the following technical and policy assumptions and assessment of international developments:

- The nominal exchange rate remains unchanged relative to the level prevailing on 5th November 1990, namely Esc.130.7 to the dollar;
- The fob import price per barrel of oil, estimated at $27 on average in the second half of 1990 and remains constant in real terms thereafter;
- World trade growth is estimated at 5.2 per cent in 1991 and 6.3 per cent in 1992, while market growth for Portuguese manufactures is estimated at 6½ and 7, respectively, in 1991 and 1992;
- The 1991 budget implies a move towards fiscal restraint;
- Monetary policy is assumed to entail a rise in both nominal and real interest rates in 1991;
- Under the new incomes policy agreement signed in October 1990, contractual wage increases in the private sector are limited to 13.5 per cent in the first quarter of 1991.

After rising by an annual average of 4½ per cent over the two-year period 1989/1990, real GDP growth is expected to weaken in 1991, recovering thereafter. All components of domestic demand are projected to contribute to the deceleration in 1991. Private consumption spending may slow, reflecting lower employment gains, higher effective taxation and higher real interest rates. Gross fixed investment is likely to lose some strength, given accelerator effects from the slowing of private consumption and exports (Table 14).

Due to weaker output trends, employment gains are likely to diminish in 1991. This may lead to an upward drift in the rate of unemployment by perhaps ¼ percentage point between 1990 and 1991. Since real wages have traditionally been quite responsive to growing labour market slack, the rise in unemployment may lower nominal wage growth by amounts large enough to curb the rise in unit labour costs. However, given the recent increase in the price of oil and the sensitivity of the

Table 14. **Short-term prospects**

	1989	1990	1991	1992
	Percentage changes			
Demand and output volumes (1977 prices)				
Private consumption	3.1	4.5	3.2	3.5
Government consumption	2.0	2.2	1.8	1.8
Gross fixed inestment	7.5	9.0	7.0	7.5
Final domestic demand	4.0	5.3	4.0	4.4
Stockbuilding[1,2]	0.5	0.3	0.3	0
Total domestic demand	**4.3**	**5.4**	**4.1**	**4.2**
Exports of goods and services	16.5	12.0	8.0	8.6
Imports of goods and services	10.6	13.2	8.5	8.7
Foreign balance[1]	0.5	–2.2	–1.4	–1.4
GDP at market prices	**5.4**	**3.9**	**3.3**	**3.5**
Inflation				
GDP price deflator	12.8	13.6	12.6	11.0
Private consumption deflator	12.7	13.3	12.0	10.5
Labour market				
Total employment	2.2	1.2	0.7	1.2
Unemployment rate	5.1	5.1	5.4	5.2
	$ billion			
Balance of payments				
Trade balance	–5.1	–7.0	–8.7	–10.0
Current balance	–0.6	–1.2	–1.9	–2.7
(as a percentage of GDP)	(-1.2)	(-2.0)	(-2.6)	(-3.1)

1. Changes as a percentage of GDP in the previous period.
2. Including statistical discrepancy.
Source: OECD Secretariat.

economy to energy price increases, inflation, as measured by the private consumption deflator, is projected to remain high at 12 per cent in 1991, falling to 10½ per cent in 1992. The government expects inflation to ease to 10¾ per cent in 1991, assisted by a new incomes policy initiative. The Economic and Social Agreement of October 1990, signed by the government, the Employers' Association and the Socialist Trade Union (UGT), aims at moderating the rise in wages and prices in 1991, taking into account an inflation target of 10.75 per cent. The new incomes policy agreement contains no catch-up clause, but provides for a re-evaluation every three months of inflation prospects for 1991. Changes in inflation relative to target, attributable to the oil shock, are not taken into account[30].

On the external side, exports of goods and services seem set to decelerate in 1991 as market growth weakens and the real exchange rate continues to appreciate. At the same time, import growth is projected to slacken in response to the expected slowing of domestic demand. As terms of trade deteriorate under the influence of the oil-price hike, the trade deficit is projected to widen strongly in both 1991 and 1992. Accompanied by a smaller surplus in the invisible balance, partly a consequence of lower workers' remittances, this deterioration may lead the current account deficit to widen in 1991 and 1992, reaching 3 per cent of GDP in 1992.

Strong exposure to oil-price shocks

Like many other OECD countries, Portugal is highly dependent upon energy imports, predominantly oil, which accounted for 85 per cent of total primary energy requirements in 1989. What sets Portugal aside from other countries is an unusually high degree of oil and energy intensity of production, making the economy particularly vulnerable to oil-price shocks (Table 15). In 1989, the nominal value of oil consumption was 3.3 per cent of GDP, 2½ times as high as the European average.

Despite the oil-price shocks in the 1970s, energy intensity of production rose sharply in the 1970s, slowing thereafter. This contrasts with developments in most other countries where energy use declined relative to output. Portugal uses large amounts of energy per unit of industrial output, partly reflecting subsidies which stimulated energy-intensive activities. Indeed, until 1987, the use of heavy fuel oil in industry and electricity generation was heavily subsidised. As a result in the early 1980s, real energy prices to final users increased much less than elsewhere. By the end of the 1980s, they were even lower than at the time before the second oil-price shock (Diagram 16).

Experience in various countries during the preceding oil-price shocks suggests that the inflation and employment consequences of a given oil-price shock depend predominantly on the policy response and wage behaviour rather than on the oil dependency of an economy. On this account, the repercussions of the current oil-price shock are likely to be limited in Portugal. Under the Economic and Social agreement concluded in October 1990, the oil-price induced rise in the price level will not be transmitted to nominal wages. Moreover, the potential for wage and

Table 15. **Primary energy requirements**

	1973	1979	1988
Portugal			
TPER/GDP[1]	0.52	0.61	0.67
TPER/Population	0.92	1.16	1.53
TPER (1973=100)	100	140	190
United States			
TPER/GDP[1]	0.59	0.55	0.44
TPER/Population	8.34	8.46	7.83
TPER (1973=100)	100	108	110
Italy			
TPER/GDP[1]	0.42	0.39	0.32
TPER/Population	2.46	2.61	2.64
TPER (1973=100)	100	109	113
Greece			
TPER/GDP[1]	0.51	0.54	0.58
TPER/Population	1.42	1.73	2.04
TPER (1973=100)	100	131	152
Spain			
TPER/GDP[1]	0.42	0.48	0.45
TPER/Population	1.62	1.98	2.17
TPER (1973=100)	100	130	150
Ireland			
TPER/GDP[1]	0.59	0.56	0.48
TPER/Population	2.37	2.70	2.75
TPER (1973=100)	100	123	133
OECD Europe[2]			
TPER/GDP[1]	0.51	0.48	0.42
TPER/Population	3.13	3.29	3.11
TPER (1973=100)	100	109	111
OECD[2]			
TPER/GDP[1]	0.54	0.51	0.41
TPER/Population	4.79	4.99	4.92
TPER (1973=100)	100	109	114

1. Total primary energy requirements (TPER), million ton oil equivalent, divided by GDP (billion 1985 US dollar).
2. IEA countries for 1988.

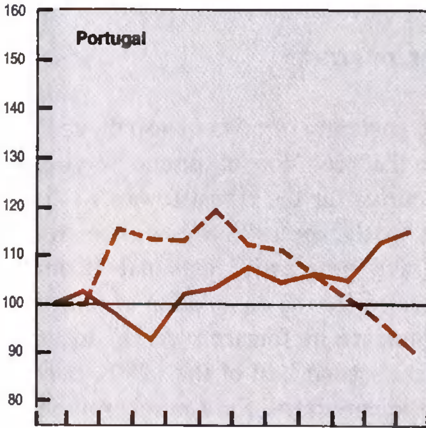
Source: International Energy Agency, *Policies and Programmes of IEA countries,* 1990.

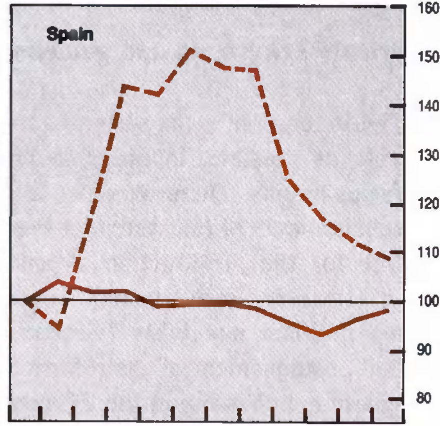
price spillovers is constrained by tighter economic policies. Finally, the authorities decided to allow higher oil prices to be fully reflected in higher energy prices to final users, while reducing oil subsidies further. This should help to reverse the rising trend in the energy intensity of production.

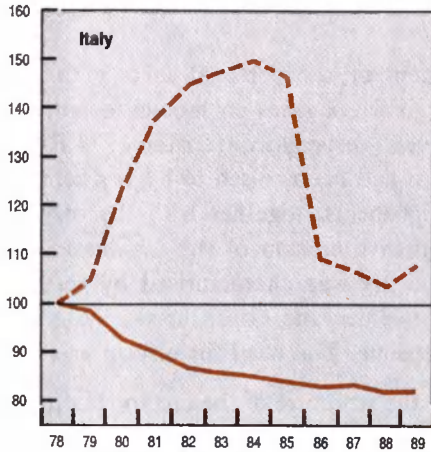
Diagram 16. **ENERGY INTENSITY OF OUTPUT AND REAL ENERGY PRICE TO FINAL USERS**

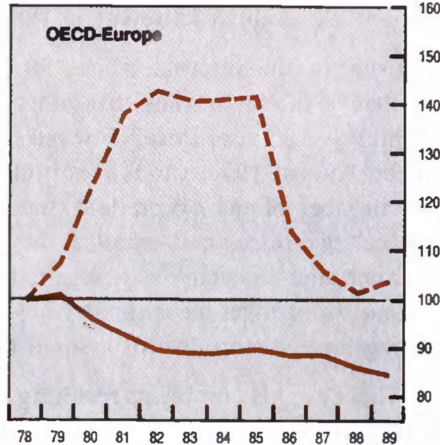
Primary energy requirements per unit of output

Real energy prices to final users[1]









1. Energy prices deflated by a weighted average of producer and consumer prices.
Source: IEA/OECD, *Energy Balances of OECD Countries; Energy Prices and Taxes.*

IV. Tax reform: reducing disincentives and inequities

Historical background and guidelines for reform

The function of a tax system is to raise government revenue as efficiently and equitably as possible, in order to finance the provision of public services and transfer payments. There were two major sources for the thrust towards reform of the archaic pre-1974 tax system of Portugal: firstly, the 1976 constitution created a mandate for the introduction of a single and progressive personal income tax system. However, since no deadline was specified for the completion of this reform, ongoing political instability (eleven governments in fourteen years) led to the repeated postponement of the reform until the second half of the 1980s. Secondly, Portuguese membership in the EC created the imperative for a number of changes in the tax system, especially the introduction of the Value Added Tax (VAT). A Tax Reform Commission was nominated in 1984 to study the reform of income taxation; it presented its report in 1987.

Prior to the reforms, about 90 per cent of the personal income tax base consisted of labour income. Statutory marginal tax rates on labour income were very high – even at relatively low income levels – especially after the 1974 Revolution: by August 1974, the top marginal rate had been raised to 84 per cent. The great number of tax exemptions and fiscal benefits, together with the very high marginal tax rates, had entailed the progressive erosion of the tax base by tax avoidance and evasion. As a result, income tax was characterised by very high marginal rates together with very low effective average rates: the tax system was creating large distortions for a small tax revenue. The need for reform was clear.

There are also problems resulting from the structure of the income tax prior to the reform. Since tax rates on different sources of income could vary significantly, two individuals with the same income level and identical in all other relevant aspects could be subject to quite different tax burdens, depending on the distribution of their income across the various categories distinguished in the tax code. Their marginal tax rates could differ significantly as well.

Portugal has had, in most years since the 1974 revolution, large budget deficits. They have been financed with recourse to both monetary financing by the Central Bank and compulsory financing at below market rates using the largely state-held financial institutions. As a consequence there has been a persistent increase in prices and a greatly inefficient financial intermediation system. An important aim of the tax reform – necessitated by Portuguese integration in the EC – has been to substitute explicit tax revenues for "implicit taxes" (seigniorage and implicit intermediation taxes) as well as creating a broader tax base that would lead to greater tax revenue without raising marginal tax rates. Thus, during the EC membership negotiations, Portugal made a clear commitment to reform its indirect tax system and introduce the VAT.

The tax reform – comprising both direct and indirect taxation – was a major element in a more comprehensive campaign to modernise the economy embarked on in the second half of the 1980s. The key objective of these overall reforms was to promote more efficient and market oriented economic performance, and to reduce government intervention in the economy[31].

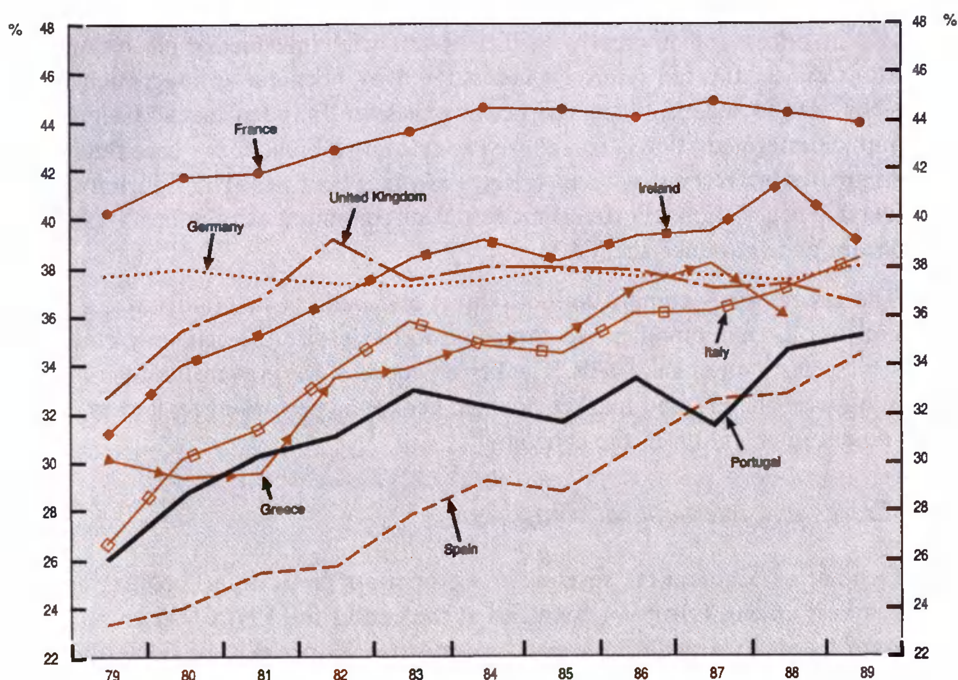
Trends and international comparison

General government tax revenue as a proportion of GDP in Portugal was one of the lowest among European countries at the end of the 1970s (Diagram 17). It increased by about 4 percentage points overall (to 33 per cent of GDP) between 1980 and 1983, mainly reflecting discretionary budgetary measures to consolidate the country's deteriorating fiscal position. The tax/GDP ratio remained broadly stable from 1983 to 1986, turning slightly upwards thereafter as major tax reform measures were implemented. By 1988, tax revenue (including social security contributions) as a percentage of GDP was close to those in Spain and Greece, but 4 points below the average in major European countries.

In 1988, a year before the reform of direct taxation, income tax accounted for only 20 per cent of Portuguese tax revenue, one of the lowest shares among OECD countries (Diagram 18)[32]. European Member countries typically raise about one-third of their tax revenue from income tax, while the ratio is above 40 per cent in non-European Member countries. With the new direct tax system the share of direct taxes is expected to increase, but to what extent remains uncertain, because taxes under the old system are still being collected in 1989 and 1990, thus distorting the statistics collected for those years. Revenue from taxes on goods and services (i.e. indirect taxes) account currently for 50 per cent of tax revenue in Portugal, far above the corresponding shares in most other OECD countries, except

Diagram 17. **TAX/GDP RATIOS IN SELECTED OECD COUNTRIES**[1]

Per cent



1. Including social security contributions.

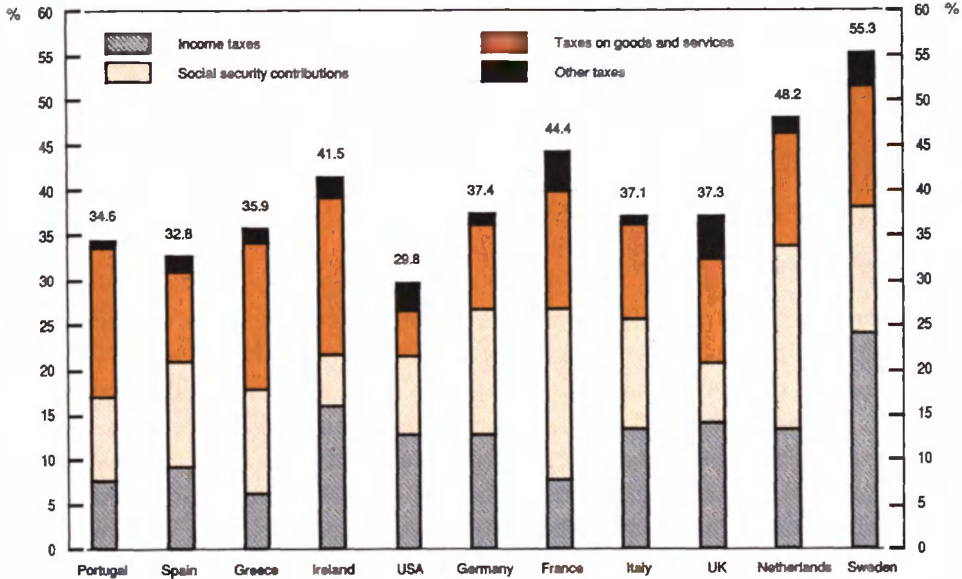
Source: OECD, *Revenue Statistics of OECD Member Countries.*

for Greece and Ireland. As in these two countries, the share of indirect taxes rose during the late 1980s, after the introduction of the VAT. Excises also represent a sizeable source of revenue in Portugal.

General guidelines for tax reform

There is no consensus on what constitutes the optimum level or composition of taxation, and hence no "ideal" tax system can be identified in practice. Reform is

Diagram 18. **TAX STRUCTURE IN SELECTED OECD COUNTRIES: Composition and share in GDP**
1988, per cent of GDP



Note: Figures above columns represent total tax shares in GDP.
Source: OECD, *Revenue Statistics of OECD Member Countries.*

thus the art of the possible – i.e. how to improve on existing imperfect tax systems, often the historical result of unco-ordinated decisions in response to specific economic objectives and/or pressure by special interest groups. However, it is generally agreed that tax reform should strive to improve efficiency, simplicity, fairness, and transparency[33]. These concepts are defined as follows:

i) *Efficiency*: virtually all taxes alter relative prices and decision making, and impose "deadweight" costs, (i.e. real income losses due to taxation exceeding the revenue collected)[34]. An efficient system seeks to minimise "deadweight" losses;

ii) *Simplicity*: tax systems should be simple, to reduce administrative and compliance costs and to curtail avoidance opportunities[35];

iii) *Fairness*: individuals with the same ability to pay and in comparable circumstances should be taxed identically. This principle is generally referred to as horizontal equity;

To the extent that individuals are unequal in terms of income, family situation etc., the tax system (in combination with public expenditure) should aim at reducing after-tax income differentials. This principle is generally referred to as improving vertical equity;

iv) *Transparency*: taxes should be transparent. The public should know what tax is being paid and who pays it.

There are clear tradeoffs between several of the four principles defined above, especially with respect to (vertical) equity and efficiency considerations[36]. Nonetheless, given the shortcomings of existing systems in many countries it is frequently possible to improve both efficiency and equity while maintaining, or even improving, simplicity. Tax systems are frequently the result of cumulative *ad hoc* changes in response to particular problems with little regard to overall coherence and permanent effects on efficiency. The resulting base erosion may be detrimental to horizontal equity. *Ad hoc* exemptions and special provisions reduce transparency and simplicity of the system, often permitting high-income individuals to avoid or evade tax.

In the case of Portuguese tax reform the following principles were emphasised:

i) Reform was to be based on the design of a global system and not on isolated changes which do not take account of relations between different parts of the system;

ii) The tax base was to be significantly broadened, thus permitting lower marginal tax rates for a given level of tax revenue. In particular, the reduction of marginal tax rates on labour income was considered a major objective;

iii) The system was to be simplified through the substitution of a single income tax for the different tax regimes applicable to different income sources;

iv) The fight against fiscal fraud and tax evasion, an important step toward improving equity (and efficiency) of the tax system, was to be enhanced by lower statutory tax rates and an increase in the efficiency of the tax collection process.

The implementation of tax reform

Tax reform proceeded in two major instalments: the VAT was introduced in 1986, the year of Portugal's entry into the European Community. The income tax reform, for both personal and corporate income, became effective in 1989. Direct and indirect tax reform were not linked, and there was no apriori intention to shift the tax burden between the major three components of tax revenue in the process of reform. Within the broad objective of fiscal consolidation, the reform of both direct and indirect taxation was designed so as to keep revenue (out of a given tax base) constant, but the increase in the tax base due to the efficiency gains resulting from the reforms was expected to lead to increased revenues (relative to a no-reform scenario) over time[37].

Personal income tax reform

Before the reform, income tax consisted of different taxes according to the source of income (labour, real estate, industrial and agricultural activity, capital income), as well as a general surtax levied on global income ("Imposto complementar"). No distinction was made with respect to the type of taxpayer, with the exception of the global surtax, under which individuals and legal entities were treated differently. The concept of income used was closer to that of income source than to that of income-recipient (financial capital gains, for example, were not systematically taxed). Concerning territorial coverage, all personal income taxes with the exception of the global surtax were paid on incomes resulting from domestic economic activity. The global surtax, on the other hand, was paid on residents' income regardless of its geographical origin.

Changing the structure of the income tax was one of the central aims of tax reform. The various existing tax regimes on different income sources were replaced by two new tax schedules: the personal income tax for individuals ("Imposto sobre o rendimento das pessoas singulares", IRS), and the corporate income tax ("Imposto sobre o rendimento das pessoas colectivoas", IRC) for legal entities. The concept of income-accretion was adopted, with some exceptions. In order to improve the fairness and transparency of the system, the range of situations in which a default revenue level is presumed by the tax authority was reduced, becoming an exceptional circumstance, rather than being as widespread as it was before the reform[38].

The IRS tax base includes all residents' income regardless of its source. As for non-residents, only the income originating from domestic economic activity is

Table 16. **Personal income tax: rate spread and number of brackets in selected OECD countries**

Per cent

	Central government taxes			Number of brackets[1]
	1975	1983	1989	
	Lowest and highest marginal rates			
Portugal	**4-80**	**4-80**	**16-40**	**5**
Spain	15-62	16-65	25-56	16
Greece	3-66	11-63	18-50	9
Ireland	26-77	25-60	35-58	3
Germany	22-56	22-56	19-53[2]	Formula[3]
France	5-60	5-65	5-57	12
Italy	10-72	18-65	10-50	7
United Kingdom	35-83	30-60	25-40	2

1. In 1989, not including zero-rate band.
2. From 1990.
3. The tax rate increases by linear progresssion.

Source: OECD, *Economies in Transition.*

included. The number of tax brackets was reduced from eleven to five and the difference between the minimum and the maximum rates is now 24 percentage points, against 76 percentage points in the previous system (Table 16 and Annex Table A2). Taxable income is computed by aggregating the income in each of the nine income categories distinguished in the tax code. Several deductions to the taxable income are allowed: social security payments; professional expenses; some personal expenditures (e.g. health and education). Couples are taxed based on the splitting method: the applicable tax rate can be found in Table A2, based on one-half the couple's aggregate taxable income. If one of the family members earns more than 95 per cent of the family's income, then the "splitting coefficient" is 1.85 rather than 2.

While the principle of a unified income tax was a central theme of the tax reform, a structure with different schedules was maintained in the IRS: as already mentioned, nine income categories are distinguished, each with its own specific rules. For some of these income categories, especially for capital income, there is a separate (flat) rate ("taxa liberatoria"). The main reason for this is the great mobility of capital and fiscal competition between countries, and the need to harmonise Portuguese capital income tax rates with those of other EC countries. It

is widely recognised that Portugal needs to raise its capital/labour ratio to achieve convergence of its real per capita income with that of other EC members – and therefore should not tax capital at higher rates than other European countries, since this would create incentives for net capital outflows.

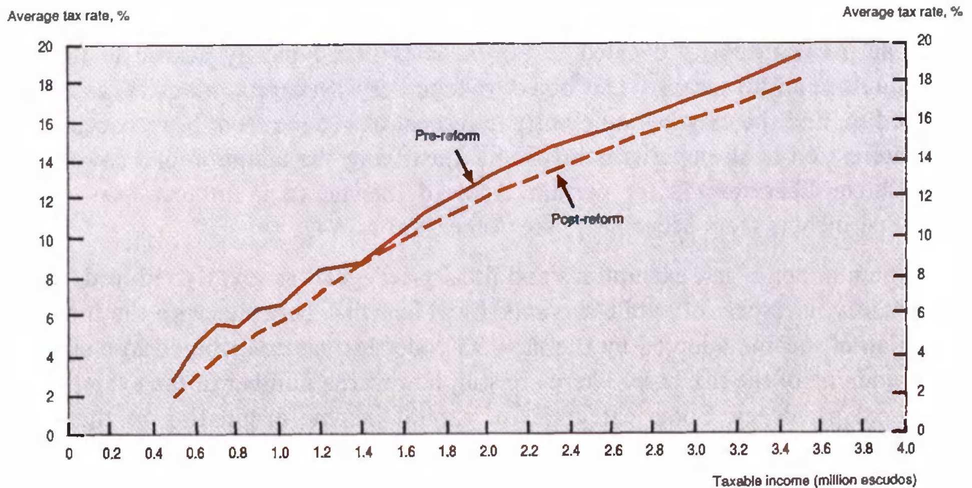
The fiscal authority decided to tax incomes that typically accrue to retired individuals more favourably. This objective together with capital mobility, as above referred to, and the existing anonymity in respect of income from bearer securities and interest on bank deposits is invoked as justifying the adoption of a lower flat rate ("taxa liberatoria") for certain types of income (e.g. interest from bank accounts, income from securities) (see Annex Table A4).

The number of tax exemptions and fiscal privileges was greatly reduced, most importantly in respect of public servants' fiscal benefits. Together with the broader definition of income adopted by the new tax code this has contributed to a significant widening of the tax base. There are still, however, a number of tax exemptions and fiscal privileges. Some categories of capital income originating in the "tax havens" of Madeira and Santa Maria (Azores) are tax exempt (see below). Pensions income of up to Esc.500 000 ($3 800) is exempt, and only half the pension income in excess of Esc.500 000 and up to Esc.1 250 000 is taxable. To promote home ownership and private pensions, various deductions are allowed for personal income invested in home purchase saving accounts, retirement plans and retirees' savings accounts. Also, capital gains resulting from the sale of owner-occupied housing are tax exempt if they are reinvested into owner-occupied housing within two years. Capital gains from the sale of bonds and shares, if the latter are held for a period of at least twelve months, are exempt from tax. Gains from the sale of certificates of participation in investment funds are exempt as well.

It is too early to measure precisely the extent to which the personal income tax reform has led to a change in average tax rates on personal income. As illustrated by Diagram 19, the income tax reform has resulted in a small reduction in average tax rates for labour income. Even so, the government's ability to raise tax revenues appears to have increased, owing to the broadening of the tax base (i.e. reduction in tax deductions and tax incentives) and, as well, to a decrease in tax evasion regarding non-labour incomes.

From the point of view of horizontal equity, income tax should be levied on life cycle or permanent income. However, difficulties arising in administering such a system have led governments to tax income accrued in specific periods, normally a year. Nevertheless, in some special cases the Portuguese tax code provides several *ad hoc* provisions in order to mitigate the problems arising from the interaction of

Diagram 19. **AVERAGE PERSONAL TAX RATES**[1]
Pre- and post-reform



1. Labour income only.
Source: Ministry of Finance.

uneven distribution of income over the life cycle and income-related marginal tax rates. Incomes earned by professionals subject to rapid human capital depreciation, and capital gains from real property transactions constitute two examples of such provisions. In the first case some deductions are allowed, and in the latter case only 50 per cent of the capital gain is subject to tax. The acquisition value used in determining the capital gain is subject to an inflation correction.

As a general rule, income tax is now retained at source to a much larger extent than before tax reform. When tax withholding is not feasible (e.g. in the case of the self-employed), taxpayers are required to make payments based on self-assessed tax liabilities during the year, rather than a year after income accrual (as was the case before reform). The process has implied a reduction in the lag between income accrual and tax payments for many taxpayers, thus improving the functioning of built-in stabilisers. It also generated a once-and-for-all increase in tax revenue in 1989 from the overlap of revenue collected under the "old" and the "new" system.

Social security contributions were not part of the reform programme. In fact, they have not been changed since 1986. Under current law, each worker pays 11 per cent of his gross pay in social security contributions. Employers pay 24 per cent on the same base. Self-employed workers are subject to monthly payments equal to 15 per cent of one-twelfth of their previous year's income. These social security contributions increase the marginal tax rate on labour income. The effective marginal tax rate on labour income (including social security contributions) varies between 28 per cent and 56.9 per cent for regular employees, and between 15 per cent and 49 per cent for the self-employed.

Corporate income tax reform

Since 1989, income from corporations has been subject to a single income tax, the IRC. Before the reform, corporate income was subject to an Industry Tax ("Contribuição Industrial") which varied between 30 per cent and 35 per cent, and the global surtax on retained profits ("Imposto Complementar-Secção B"), which varied between 6 per cent and 12 per cent. In addition there existed a local tax "Derrama" of up to 10 per cent of the value of the industry tax. Marginal tax rates on distributed profits could vary between 30 and 38.5 per cent, and on retained profits the tax range was 34.2 to 46.3 per cent.

The new IRC taxes income of legal entities with headquarters in Portuguese territory, regardless of where the income originates. Concerning other legal entities, only the income generated on Portuguese territory is taxed. The IRC tax rate is 36.5 per cent, with the following exceptions:

i) For legal entities with headquarters outside Portugal, whose income is not attributable to a permanent establishment situated in Portugal, the tax rate is 25 per cent, except for: income from intellectual property (15 per cent), income from leasing equipment (15 per cent), and capital income other than from securities or other distributed profits (20 per cent);

ii) If the legal entity's main activity is neither agricultural, industrial nor commercial, the tax rate is 20 per cent.

Corporations may be subject to local taxes as well. Rates are fixed by local authorities, with a ceiling of 10 per cent of the amount paid as IRC.

Before the implementation of the income tax reform, there were a large number of investment incentives in the form of fiscal benefits (investment tax credits, deductions for reinvested profits, and deductions for corporations entering the Stock Market listings). Most of these provisions were eliminated with the

Table 17. **Marginal effective tax rates on capital income**[1]
Per cent

Mode of financing	Industrial machinery (domestically produced)	Industrial machinery (imported)	Commercial buildings
A. Pre-reform			
Debt	–161	–59	44
New share issues	71	76	81
Retained earnings	51	60	73
B. After reform			
Debt	–12	16	19
New share issues	70	74	73
Retained earnings	50	59	59

1. Calculations assume a real interest rate of 6 per cent and 10 per cent annual inflation.
Sources: Bureau of Economic Studies of the Ministry of Finance; Bureau of Economic Studies of the Faculty of Economics of the New University of Lisbon.

introduction of the IRC. However, the new system allows for alternative methods of computing capital depreciation for tax purposes. In principle, the method used is straight line depreciation. The taxpayer may also use the declining balance depreciation method for tangible assets. Other methods require authorisation by the tax authority. No change was made to the provision that firms can carry business losses for five years and offset them against subsequent earnings.

Capital gains from the sale of a firm's real assets are not included in the tax base if the sales revenue is reinvested within two years after realisation. The acquisition value used in determining the capital gain is subject to a inflation correction. In the case of a resident company which owns other resident companies, this group of firms can opt for computing profits based on their consolidated balance sheet. In order to avoid double taxation of dividends, deductions and tax credits are provided according to the extent of cross ownership[39]. Tax credits are also allowed to avoid double taxation of profits in two countries when there exists a tax treaty between Portugal and the second country. The tax credit corresponds to the lowest amount payable in either country.

The effective marginal tax rate on capital is the net result of the interaction of several taxes, investment subsidies and other investment incentives. It will therefore vary according to the geographical location, type of asset, sector of activity and the

way in which the investment has been financed. Fiscal reform does not seem to have achieved a major reduction in the dispersion of effective marginal tax rates on income from different investments, implying that efficiency improvements are more modest than would have been possible.

Corporate income tax reform changed the relative attractiveness of different forms of financing of business investment. The calculations presented in Table 17 illustrate this point for investment in industrial machinery and commercial buildings. It appears that debt financing has become relatively more attractive after fiscal reform. However, it is too early to say whether this change has been important enough to change significantly the pattern of investment financing of Portuguese corporations. Simulation results for a restricted number of sectors (for which data were available) suggest that average pre-tax rates of return on marginal investment have slightly increased with fiscal reform.

Indirect taxation reform

Since the introduction of a general value-added tax on goods and services (VAT) in 1986, there has been no further reform in indirect taxation. Presently there are two types of indirect taxes in Portugal: the VAT, and excise taxes on some specific goods (the most relevant ones being on petroleum products, tobacco, alcoholic beverages and cars) as well as stamp duties.

Value added tax introduction

The VAT was introduced in 1986 when Portugal joined the EC, replacing the old sales tax ("imposto de transacçoes") on transactions between wholesalers and retailers. One of the major advantages of the VAT is that it provides a built-in control on tax evasion – lack of which was one of the main shortcomings of the old turnover tax. In addition, the tax base was substantially widened by the introduction of the VAT, mainly due to the inclusion of services. There are three different VAT rates according to the category of goods or services taxed: a "reduced" (8 per cent), a "normal" (17 per cent) and a "high" rate (30 per cent). Prepared food (restaurant meals), some school materials, fuel, and some services (e.g. electricity, telephone services) are taxed at the reduced rate. Luxury goods, liqueurs and other alcoholic beverages are taxed at the 30 per cent rate. In addition, some goods (e.g. non-processed foods, cultural goods such as books, intermediate goods used in agriculture) are zero rated. Several specific activities (e.g. medical services, services provided by non-profit institutions) and legal entities (e.g. non-profit museums and

Table 18. **VAT rates and structure in Portugal and selected OECD countries**

A. International comparison

	VAT structure (1989)				Effective rate[2] 1987 (per cent)
	Number of rates[1]	Rates (per cent)			
		Standard	Low	High	
Portugal	**3**	**17**	**8**	**30**	**8.3**
Spain	3	12	6	33	12.4
Greece	3	18	9	36	19.2
Ireland	3	25	2	2	10.6
Germany	2	14	7	–	7.9
France	4	18.2	5.5	22	11.0
Italy	4	18	2	38	11.5
United Kingdom	2	15	0	–	7.3

B. Relative importance of different VAT rates in Portugal (1989)

VAT rate (per cent)	Percentage of total consumption
0	30.9
8	33.7
17	35.0
30	0.4
Weighted average	8.8

1. Excluding zero rate.
2. Receipts of general consumption taxes (item 5 100 from *Revenue Statistics of OECD Member Countries*) as percentage of private *plus* public consumption.

Source: OECD, *Economies in Transition*, and Secretariat updates.

art galleries) are exempted[40]. Table 18 compares the various VAT rates in Portugal with those in other OECD countries and presents the share in total consumption of goods and services subject to the different VAT rates.

Other indirect taxes

Taxes on goods with price-inelastic demand can yield sizeable revenues with small excess burden. If, in addition, the consumption of such goods generates negative externalities, taxation may lead to a net welfare gain – it suffices that the social benefit as a result of reduced consumption exceeds the distortions caused by the tax and that the benefits of the increase in public consumption (or investment)

financed by the tax is at least as high as the welfare loss from reduced private consumption. This reasoning applies to taxes on tobacco and spirits, which can result in important tax revenues for the government at a comparatively small efficiency cost. In addition, the stamp duty (levied, in particular, on insurance and bank operations), the tax on the consumption of gasoline and other petroleum products, and the tax on motor vehicles are also important sources of tax revenue.

Some special issues

Local taxes on real estate property

In the context of the direct taxation reform discussed earlier, the government has also modified local taxation of real estate property to generate revenue for municipalities. All city dwellings with an assessed value below Esc.15 000 000 and which are owners' residences or are rented for housing purposes for a period of time in accordance with the information provided in Table 19 are exempt from taxation. Also, city dwellings rented under a regime of controlled rents are exempted for a period of fifteen years from the time of completion. For property not exempt from taxation the rates are 0.8 per cent for rural dwellings and vary between 1.1 per cent and 1.3 per cent for city dwellings. The assessed value of each building is revised annually.

Table 19. **Local tax on buildings: tax holidays for residential property**

Assessed value (10^6 Esc.)	Own residence	Rented for housing purposes
	(tax exempt for.. years after completion/acquisition)	
Up to 5	10	10
5 to 7.5	10	8
7.5 to 10	10	6
10 to 12.5	7	4
12.5 to 15	4	2

Source: Data provided by Portuguese authorities.

Tax havens (Azores and Madeira)

Tax-free areas in both the Azores and Madeira were enacted in 1985 as a regional policy measure. Interest payments and other capital revenues of entities participating in the financing of firms installed in these areas are exempt from both IRS and IRC, as well as interest payments on loans directed to investment in these areas. Revenues resulting from patent awards, brand names and technical assistance contracts in these areas are exempted from either IRS or IRC. Other income derived by firms in these areas is also exempt from IRC and IRS taxation until the year 2011.

The tax system and inflation

The interaction of inflation and the tax system can cause significant changes in both the level of the tax burden and its distribution between individuals and different income sources. Concerning the personal income tax, characterised by rising marginal tax rates, inflation leads to a steady rise in the tax burden through "bracket creep" and the erosion of the real value of tax deductions. Concerning the corporate income tax, inflation greatly complicates the computation of true income by driving a wedge between the acquisition cost and market value of real assets, and by adding an inflation premium to the "real" interest rate. Furthermore capital gains will be partly fictitious (i.e. a pure inflation adjustment), and the real value of volume based commodity taxes will be eroded.

In Portugal, where the inflation rate remains high, the potential distortions caused are likely to be significant. They can in principle be reduced (if not avoided) by "indexing" the tax system. Though the Portuguese tax code explicitly acknowledges the problem arising from the interaction of inflation with nominal taxation, no provisions for automatic indexation are made in the code. It is expected that some inflation correction will be made periodically by the government. This is, however, much easier in the case of labour income taxation than in the case of taxation of capital income. Concerning the latter, a system of comprehensive inflation accounting would be very complex and no OECD country has yet adopted such a system despite extensive research in the area.

Fiscal harmonisation or fiscal competition

The creation of a single European market by 1993 will, among other aspects, eliminate most administrative obstacles to free factor mobility within the EC. This

removal of barriers may exacerbate the detrimental effects arising from existing distortions due to non-harmonised tax systems. In order to limit such undesirable repercussions, economic authorities in both Portugal and the rest of the EC aim to implement some degree of fiscal harmonisation. This tax harmonisation does not necessarily imply centrally co-ordinated policies by national governments. In fact, the competition among tax systems may also – through iterative adjustments – bring about the necessary harmonisation.

General assessment of tax reform

Direct taxation reform has increased the government's ability to collect revenues from both individuals and corporations. Although it is too early to measure precisely the impact of the new system (IRS and IRC) on tax revenue, preliminary estimates would suggest that part of the observed increase in direct tax revenue in 1989-90 is of a permanent nature (Table 20). This is the result of a redefinition of taxable income, a reduction in allowed deductions, and the termination of most fiscal benefits for corporations. The resulting broadening of the income tax base has permitted a lowering of marginal tax rates, greatly reducing the disincentive effects to labour supply and saving. The reduction of lags between income accrual and corresponding tax payments is also a significant improvement compared to the previous system, because it enhances the functioning of built-in stabilisers. Finally, reduced tax avoidance and tax evasion will increase revenues and improve equity.

Table 20. **Direct tax revenue of the Central Government**

As a percentage of GDP

	1987	1988	1989	1990
Direct tax revenue	5.6	6.9	8.5	8.4
Of which:				
IRS-IRC	0	0	6.1	7.7
Various taxes on income[1]	5.6	6.9	2.4	0.7

1. The sum of proceeds from: industrial tax, professional tax, global surtax, capital tax, agricultural industry tax, capital gains tax and other income taxes.

Source: Ministry of Finance.

While tax reform has significantly improved both the equity and efficiency of the tax system, there remain various areas where further changes may be worth considering:

- Under a personal income tax regime with rising marginal tax rates, the real value of tax deductions is greater for high than for low income earners. Transforming the deductions into tax credits increases vertical equity and could be used to raise additional tax revenue, without additional efficiency losses;
- Preferential VAT rating of "essentials" (e.g. food) is a blunt instrument for protecting the poor, since it benefits high income earners as much (or more) than low income earners. In addition, multiple VAT rates complicate tax collection procedures and create relative price distortions and opportunities for tax evasion. Thus both the equity and efficiency of indirect taxation can in principle be improved by introducing a single VAT rate and combining it with appropriate tax credits for low income earners; however, future changes will be affected by decisions in this area at EC level;
- Saving incentives in the form of tax deductibility of contributions to pension schemes etc. are of dubious merit: they are likely to affect the composition rather then the level of household saving, and may actually reduce national saving, if the marginal propensity to save in the public sector exceeds that in the private sector. Such schemes also tend to benefit high income earners more than low income earners;
- Differential taxation of labour and capital income received by households violates the postulate of horizontal equity. The full integration of the personal and corporate income tax schemes would therefore be desirable. If this were to entail a level of capital taxation considered as conducive to capital flight, this problem should be addressed by a shift from income to consumption taxes rather than by preferential treatment of capital income of households.

V. Conclusions

The rapid expansion of output, under way since 1985, has continued in 1989 and 1990, and as a result the unemployment rate has fallen to its lowest level since the 1970s. At the same time, the current account deficit remained far smaller than that observed at the previous cyclical peak in the early 1980s, reflecting both strong export performance and large capital transfers from the EC. With both goods and labour markets showing signs of overheating, inflation – which had fallen rapidly since 1984 – reaccelerated from 1988 onwards and has exceeded 13 per cent in 1990. The fiscal deficit, which had declined steadily from around 13 per cent of GDP in 1984 to below 5 per cent in 1989, widened again in 1990.

Economic developments to the end of 1992 will be influenced by restrictive monetary and fiscal policies necessary to restore macroeconomic balance and to create conditions required to facilitate Portugal's entry in the EMS. The recent oil-price shock will likewise affect the outlook, given the economy's high energy intensity of production and the heavy dependence on oil imports. Under these conditions output is expected to slow to an annual rate of around 3½ per cent in 1991 and 1992, while inflation will start to decline significantly in the second half of 1991, coming down further in 1992, although remaining well above the projected EC average for that year. The current external deficit is expected to increase – perhaps to 3 per cent of GDP in 1992 – reflecting a widening of the trade deficit.

The reacceleration of inflation since 1988 from an already high rate has been the major disappointment in Portugal's economic performance in recent years. It has cast serious doubts on the government's ability to achieve its goal of reducing inflation rates to the average of the EC, and has thereby made entry into the EMS – a declared goal of the government – more difficult. While the progressive deregulation of the financial markets – in itself a desirable development – has certainly made monetary management more difficult in the transition period, there is little doubt that the increase in the inflation rate has been possible only because the attempts at tightening monetary policy were not effective.

One of the reasons for the failure to contain inflation has been the attempt by monetary authorities to curtail domestic demand through an increase in interest rates and at the same time keep the exchange rate on a predetermined path, with an implied rate of depreciation which was well below the interest rate differential *vis-à-vis* major trading partners. Given the gradual and progressive removal of controls on international capital movements, this led to huge capital inflows, which undermined the authorities' efforts to curtail domestic demand and thus price pressure.

Monetary authorities thus continue to face a dilemma: they cannot control interest rates and the exchange rate at the same time, without maintaining comprehensive controls on international capital movements. Given that the liberalisation of international capital movements is an important element in the process of European economic integration – in which Portugal is determined to participate fully – controlling the latter is politically difficult and would anyway be undesirable for efficiency reasons. Similarly, quantitative controls on domestic credit expansion contradict the government's declared objective of shifting towards indirect methods of monetary control. This implies that the remaining option of effective anti-inflation monetary policy will have to rely – at least temporarily – on high real interest and real exchange rates. The more mobile international capital, the greater the reliance on the real exchange rate in the transmission mechanism of monetary policy has to be. The recent changes in Portugal's exchange rate policy, which allow greater exchange rate flexibility and have already led to some effective appreciation, take due account of this situation. The stronger the effective exchange rate to obtain the real appreciation needed to eliminate excess demand, the easier it will be to reach the government's inflation target of 10¾ per cent in 1991 and continued disinflation thereafter. In fact, a strengthening of the effective exchange rate is also desirable since it would enable the authorities to set more ambitious inflation targets and speed up convergence with average inflation in the EC.

How tight monetary conditions – measured by both real interest and exchange rate levels – have to be in order to achieve a given inflation target will depend on many factors, including the stance of fiscal policy as measured by the general government borrowing requirement. Since further fiscal consolidation is an important government objective in its own right, determined action to achieve this objective can help to avoid the necessary monetary restraint causing unduly tight monetary conditions, putting a disproportionate adjustment burden on interest-sensitive demand components (e.g. fixed investment) and the tradable goods sector. From this perspective the fiscal easing in 1990, manifest in "inflation adjustments"

of tax brackets and tax deductions far in excess of the actual inflation rate, was inappropriate. The 1991 budget implies a resumption of the process of fiscal consolidation, with a 1 percentage point decline in the deficit to 6.5 per cent of GDP, which leads to a further fall in the debt-to-GDP ratio. Continued reductions in this ratio will require further deficit contraction as the inflation rate declines.

Whether the necessary fiscal consolidation should be achieved primarily by tax increases or by expenditure restraint is a decision that should in principle be made only after a careful cost-benefit analysis of existing and potential public expenditure programmes. In this context it is, however, relevant to note that the virtual elimination of "implicit taxation" by financing public debt at market interest rates has lowered the effective tax burden, even if the ratio of explicit taxes to GDP remains unchanged. The elimination of inflation over the long run would further reduce the effective tax burden. It is also true that the state of Portugal's infrastructure and public education are such that additional public expenditure in these areas may have very high social rates of return, possibly outweighing the social cost created by an increase in the tax burden.

Aware of the urgent adjustments required to participate fully in – and benefit from – the accelerating integration process under way in the EC, the authorities in July 1990 adopted a medium-term adjustment plan ("QUANTUM"). This plan, designed just before the outbreak of the Gulf crisis, outlines the strategy for bringing inflation down to EC levels over a five-year period. It duly emphasises the need for a severe tightening of fiscal policy in 1991, to be accompanied by tight monetary policy. Implementing the latter has been greatly facilitated by the decision to abandon the commitment to a predetermined exchange rate path, taken in October 1990. Recent institutional changes, strengthening the Central Bank's independence and cutting off the government's automatic access to Central Bank credit, should likewise make anti-inflation policy more credible and effective. The Economic and Social Agreement concluded in October 1990 is an important step in this direction. Policies of this kind improve prospects that inflation will be put once again on a downward track, damping inflation expectations and strengthening the credibility of medium-term policies. The recent oil-price surge underlines the urgency of following such a course of action.

High rates of inflation and manipulation of capital markets has traditionally enabled the government to extract substantial resources from the private sector (via the "inflation tax" and preferential borrowing rates) without levying explicit taxes. The social cost of this "implicit taxation" has been inefficient resource allocation due to distorted interest rates and increased uncertainty entailed by lack

of price stability. Furthermore, the lack of transparency of such implicit taxation is likely to hide important inequities. Recent decisions by the government to eliminate "implicit taxation" by moving to market-determined interest rates on government debt can be expected to improve the efficiency of capital markets and the transparency and fairness of overall taxation.

The replacement of the wholesale turnover tax by a value added tax in 1986 and the comprehensive reform of the archaic income-tax system in 1989, as well as administrative changes in tax collection procedures, have no doubt increased the efficiency, transparency and fairness of the tax system. These results were obtained by broadening the tax base, reducing effective marginal tax rates and greatly curtailing opportunities for tax avoidance and evasion. Nevertheless, further possible improvements in the reformed tax system can be identified and should be considered. Some of these improvements, which are presented in more detail at the end of Part IV, can raise overall revenue without increasing marginal tax rates; they are thus capable of contributing to fiscal consolidation without adding to the deadweight loss from taxation.

Privatisation of public enterprises, ruled out by the Constitution of 1976, has recently become feasible, following a constitutional amendment adopted in 1989. Full use of the newly acquired opportunities could confer important benefits on the Portuguese economy, facilitating:

- Increased efficiency of privatised enterprises, which – given efficient market regulation – will be subject to competitive discipline following privatisation;
- The freeing of limited administrative capacity in the public sector to concentrate on public administration proper, rather than running commercial enterprises;
- A reduction in government indebtedness, thereby reducing the tax burden – and resulting distortions – on the private sector.

To reap the full possible efficiency gains from privatisation, it is important that the newly privatised enterprises operate under competitive conditions, and that privatisation does not merely transform public companies into private monopolies.

In addition to the privatisation programme which has just started, significant progress has been made in recent years in various areas of structural reform. Labour market legislation has been modified to allow greater employment responsiveness to changes in the economic position of enterprises; financial markets have been progressively deregulated and their efficiency is set to rise. Public finances have improved and become much more transparent. Yet there is scope for further

action: concerning the labour market, low recorded unemployment coexists with hidden unemployment; it is necessary to further increase the supply of skilled labour, a process started in recent years with the help of EC funds. Additional steps to deregulate the housing market could improve resource allocation and enhance regional labour mobility. Further liberalisation and deepening of financial markets is desirable: the creation of new instruments could help promote long-term saving and parallel efforts should be made to lengthen the maturity of the public debt. More generally, the drive towards market-oriented policies should continue, with a view to enhancing the supply side responsiveness of the economy. Also, the allocation of EC funds and the effectiveness of their use must be closely monitored on the basis of economic criteria, so that potential rewards of integration are not wasted.

All in all, Portugal has in recent years combined an impressive performance in output growth and job creation with remarkable progress in structural adjustment and institutional reform, greatly facilitating the country's progressive integration into the EC. Major remaining obstacles to the completion of this process are the still-large inflation differential *vis-à-vis* other EC economies and the excessive public sector deficit. These issues imply clear priorities for the authorities' future policy agenda: both monetary and fiscal policy will need to be tight until macroeconomic balance has been firmly established. Considerable real-wage flexibility, rapid productivity advances that strengthen international competitiveness, and the autonomous strength of business investment related to bright prospects from European economic integration should make the necessary adjustment possible without excessive transitory losses in output and employment.

Notes and references

1. Developments in 1990 are discussed on the basis of preliminary estimates, based on information available up to November 1990.
2. See OECD *Economic Survey of Portugal,* 1988/89, p.70.
3. OECD, *Economic Survey of Portugal,* 1988/89, p.65-68.
4. There is a close statistical association between productivity trends in the private sector and changes in the ratio of gross investment to the capital stock, sometimes referred to as the "capital replacement rate". On the basis of this finding, efficiency gains may be expected to strengthen further in the light of the recent investment boom. S. Englander and A. Mittelstadt, "Total factor productivity: Macroeconomic and structural aspects of the slowdown", OECD Economic Studies, No.10, spring 1988, pp.8-56.
5. The weight of food and beverages in the consumer price index is currently 57 per cent compared with less than 20 per cent in high income Member countries.
6. The deficit of the current balance for 1988 which in last year's Survey was estimated to amount to $654 million or 1.5 per cent of GDP, has since been revised up to $1 064 million or 2.4 per cent of GDP.
7. The changes in unit values of exports and imports are respectively 6.4 and 8.5; they differ from changes in implicit price deflators because of differences in coverage.
8. Phased out funds are the Supply Fund, Special Fund for Overland Transportation, Fund for the Renovation of the Fishing Industry, Fund for the Renovation of the Merchant Marine and the Housing Fund. Large segments of the industrial and financial sectors were nationalised after the revolution in 1974. The autonomous funds were set up in the 1970s to collect revenues from specific taxes designed to compensate public enterprises for selling goods and services below production cost. When tax receipts fell short of "compensation payments", the autonomous funds borrowed from both domestic and foreign sources.
9. Ultimately it is the underlying public expenditure rather than its debt-financing that causes the distortions: the choice between debt and tax financing "only" influences the incidence of distortions over time.
10. By the end of the 1980s, public bonds accounted for about 95 per cent of gross issues in the bond market.
11. For a detailed calendar of measures aimed at decontrolling interest rates see Annex II.

12. J.B. de Macedo and M. Sebastião, "Public debt and implicit taxes: the Portuguese experience", *European Economic Review,* 33, 1989, pp.773-779.
13. The original PCEDED was described and discussed in detail in *OECD Economic Survey on Portugal,* 1987/88, pp.46-49.
14. See Ministério das Finanças: QUANTUM, 1990.
15. Because the Portuguese labour market is flexible, a rise in the real exchange rate is likely to be absorbed with no or only small increases in unemployment. See *OECD Economic Survey on Portugal,* 1988/89; OECD, "The role of indicators in structural surveillance", OECD/ESD Working Paper Series, No. 72, June 1990, p.92.
16. J. Vickers and G. Yarrow, *Privatisation: an Economic Analysis,* Cambridge, MIT Press, 1988.
17. A detailed review of actions undertaken with the EC contributions was presented in *OECD Economic Survey on Portugal,* July 1989, Part IV, "*Improved functioning of markets* ". The following section merely presents new information that has become available since the publication of the last Survey.
18. The narrow definition of the general government financial balance (called "overall balance" by the Portuguese authorities) measures the borrowing requirement that results exclusively from the activity of the general government. It does not take into account financial transactions, also called "active Treasury operations", which are for the larger part loans to public enterprises to help finance their borrowing requirement. These operations have been falling in the last three years, from close to 2 per cent of GDP in 1987 to 1.4 per cent in 1988 and 0.6 per cent in 1989. They are included in the general government total borrowing requirement.
19. Additional revenue from the taxation of civil servant's income has a counterpart on the expenditure side, in the government wage bill, which is increased by the compensation for this change. Similarly, revenue from taxation of interest paid on public securities has a counterpart in the "interest paid" item, since public securities have been issued at gross interest rates as of May 1989.
20. The increase in short-term interest rates which occurred after mid-1989 will have an impact on interest payments only in 1990. At the same time, 1989 saw a fall in the share of short-term debt (Treasury bills and CLIP which are new public investment credit instruments) in total domestic debt, while the share of medium-term debt (on which interest is paid on a half-yearly basis) rose. The combination of these two factors will automatically induce higher interest payments in 1990.
21. A reform of administrative procedure has been implemented progressively since 1987 (see *Economic Survey,* July 1989). Autonomous services and funds, in particular, are now required to present quarterly accounts and their borrowing requirement is submitted to a ceiling fixed in the preparation of the budget. They are financed by transfers from the State and are not allowed to raise funds on credit markets, nor to use deposit accumulated in banks. In the future, they will enjoy financial autonomy if their own revenue amounts to two-thirds or more of their total revenue.
22. This is the counterpart to the taxation of government securities effective as of May 1989. The full impact is to be felt in 1990; corresponding additional receipts are

estimated at about 0.7 per cent of GDP. The rise in interest payments net of the tax component is still 35 per cent.

23. *Credit ceilings* were tightened, thereby improving the control over the flow of credit to the private sector. In addition, consumer credit was severely restricted through the regulation of the general hire-purchase system. To absorb *bank liquidity*, the authorities broadened the definition of bank liabilities subject to reserve requirements and raised compulsory reserves to a standard ratio of 17 per cent. Before March 1989, the reserve requirements were applicable only to "traditional types of deposits", with reserve ratios ranging from 1 per cent for deposits over one year to 15 per cent for demand deposits. As regards *interest rates*, the discount and the reference rate for the capital market were both increased, while the ceiling on mortgage interest rates was suspended, thereby continuing the process of liberalising lending rates, which had begun in September 1988. In addition, the maximum interest rate on old mortgages was raised by ½ percentage point to 17.5 per cent. Finally, banks began to receive interest payments on their compulsory reserves for time deposits over six months. See *OECD Economic Survey Portugal*, 1988/89.
24. Treasury bonds issued in the period from June 1987 to July 1989 would remain outside the credit ceiling. These bonds had been subject to the credit ceiling until June 1987. For details see *OECD Country Survey Portugal*, 1988/89, p.36.
25. Even so, the authorities conveyed to the banks what they considered an upper limit for the growth of domestic bank credit in 1990.
26. L- is equal to total liquidity minus migrants' deposits and other liquid assets held by non-bank financial institutions.
27. Total liquidity (L), which includes migrants' deposits, decelerated less than L-, reflecting a pick up in these deposits combined with a sharp rise in holdings of Treasury bills and bank deposits by non-bank financial institutions.
28. The reference rate for the bond market, created in 1985, is an administratively fixed interest rate, which served as a benchmark for indexing the yield of bonds. Part of the public debt securities as well as of some enterprise bonds were indexed to this rate.
29. The restrictions on financial transactions in the forward exchange market introduced for three months in June 1990 were extended from October onwards.
30. Wage contracts concluded in the first quarter of 1991 are premised on a rate of inflation of 11 per cent. In the second quarter, contractual agreements reflect whatever revisions to the projected inflation rate for 1991 may be in order, excluding the effect of the oil-price shock.
31. See the detailed discussion of wide-ranging structural reform in last year's economic Survey.
32. Only two other countries in the OECD area raise a smaller share of total revenue from income tax: Greece and France.
33. For a review of general principles of tax reform in OECD countries, see R. Hagemann, B. Jones and B. Montador, "Tax reform in OECD Countries, Motives, Constraints and Practises", *OECD Economic Studies* No. 10, 1988, and J.A. Kay, "Tax Policy: A Survey", *The Economic Journal*, March 1990, pp.18-75.

34. The extent of deadweight loss will depend on a number of factors. The higher are marginal tax rates, the more they alter relative prices and economic decisions. The importance of these distortions depends *inter alia* on the responsiveness of consumers and producers to changes in prices, i.e. on the relevant elasticities of supply and demand:
    - For taxes on labour, the compensated elasticity of labour supply with respect to net real wages is relevant, as it affects the choice between labour and leisure;
    - Taxes on capital income affect saving/consumption decisions, depending on the elasticity of savings with respect to real net rates of return. Deadweight losses are aggravated by wide dispersion of effective tax rates across alternative investments by asset type and the way they are financed;
    - Taxes on commodities affect labour/leisure choices, but do not distort the saving/consumption decision. Deadweight losses are aggravated by narrow coverage and wide dispersion of tax rates. An efficient indirect tax would apply tax rates that are inversely related to the price elasticity of demand for the product taxed, as this would minimise distortions. But it would increase administrative complexity and probably affect equity adversely (by taxing mainly necessities). Therefore a broadly-based single rate indirect tax is generally preferred.
35. Some complications in tax systems are inevitable to ensure that the tax base is well and clearly defined. When the tax-transfer system is used to "target" specific groups this leads frequently (though not necessarily) to special exemptions, allowances and deductions.
36. For example, a comprehensive income tax is strong on equity grounds, but may be inefficient because some income recipients have high labour supply elasticities. In contrast, a comprehensive expenditure tax would be less distortionary, but is generally considered as impinging excessively on low income groups and hence inequitable.
37. Since the income tax reform also implied a shortening in the lag between income accrual and taxation, the overlap of "old" and "new" tax revenues in 1989 implied a one-off increase in revenues for that year.
38. An alternative reform proposal was also presented to the Reform Commission: that a linear tax system with equal marginal tax rates for personal and corporate income be established, along with the exemption of dividends and financial capital gains. This proposal was rejected namely because the Reform Commission interpreted the constitutional imperative of a progressive tax system as implying a tax system with increasing marginal tax rates.
39. A fraction of 95 per cent of the dividends paid by, say firm A to firm B, can be deducted if firm B owns at least 25 per cent of firm A's capital. If firm B's ownership is less than 25 per cent the method used is the tax credit which is equal to 20 per cent. In the case of venture capital or regional development corporations, the above deduction of 95 per cent is applicable regardless of the ownership relations.
40. The distinction between zero-rated, and exempted goods is that the seller of zero-rated goods can claim a tax credit for tax paid on all purchases of taxable goods and services, while sellers of exempted goods cannot claim such a tax credit.

Annex I

Technical note

Table A1. **Indicators of foreign direct investment**

	1985	1986	1987	1988	1989
Level (million $)	218	166	367	692	1 446
Share in gross fixed investment	4.8	2.7	4.9	8.2	18.9
Origin (per cent of total)					
United Kingdom	30.5	38.8	21.9	25.1	22.2
France	6.2	9.9	9.8	10.2	16.5
Germany	4.3	10.7	7.2	7.2	7.6
Spain	4.3	8.1	15.6	9.3	..
Total EEC	56.9	76.2	65.8	68.5	72.3
Switzerland	4.6	9.1	8.6	6.9	6.4
United States	27.2	8.6	14.3	11.8	4.6
Japan	0.0	0.7	2.2	0.6	0.7
Total OECD	90.9	96.0	93.0	92.6	88.0
Rest of the world	9.1	4.0	7.0	7.4	12.0
Destination (per cent of total)					
Agriculture	1.4	1.8	3.8	3.7	1.5
Mining	7.8	4.2	3.3	2.1	1.6
Manufacturing	46.8	45.8	29.4	33.4	21.0
Construction, public works	0.5	1.2	1.1	4.3	7.1
Services	43.5	47.0	62.4	56.5	68.7
Of which:					
Trade, hotels	14.2	28.9	18.8	18.0	18.4
Financial sector, insurance	27.1	17.5	39.2	35.7	46.8
Type of operation (per cent of total)					
Creation of new enterprises	30.5	21.3	28.1	47.1	31.8
Participation in existing enterprises	60.6	74.9	67.7	43.3	54.4
Other, (e.g. acquisition of enterprises)	8.9	3.8	4.2	9.6	13.8

Source: Bank of Portugal.

Table A2. **IRS tax rates – 1990**

Taxable income annual (Esc.1 000)	Marginal tax rate (per cent)
Up to 540	16
540 to 1 020	20
1 020 to 1 500	27.5
1 500 to 3 600	35
Over 3 600	40

Note: The following deductions from income are allowed across the board (1990 values):
Esc.23 000 for single taxpayers;
Esc.17 000 for each married taxpayer;
Esc.12 000 for each dependant.
Source: IRS Tax Code, 1990.

Table A3. **Personal income tax (IRS)**
Main tax schedules by income categories, per cent

	Income Categories	Before Tax Reform	After Tax Reform
A	Dependent Services	0 – 20[a]	0 – 40[d](withholding at source: different rates)
B	Independent Services	0 – 20[a]	0 – 40[d](withholding at source: 16 and prepayments)
C	Commercial and Industrial Activity	30 – 35[a, b]	0-40 (with prepayments)
D	Agricultural Activity	10[a]	0-40[e](with prepayments)
E	Capital		
	. Deposits	15 (withholding at source)	20[f] (withholding at source)
	. Debentures	12[c] (withholding at source)	25[f] (withholding at source)
	. Shares	12[c] (withholding at source)	25[f] (withholding at source)
	. Industrial property	15[a] (withholding at source)	16[g] (withholding at source)
	. Technical Assistance	–	16[g] (withholding at source)
F	Real Estate	14 – 18[a]	0 – 40 (withholding at source: 16)

a) Add "Complementary tax" : rate from 0 – 60%.
b) Local tax up to 10% (total rate: 33-38.5%). Reduced rate of 20% with regard to some agricultural activities and cattle-breeding.
c) Add "complementary tax": rate of 24%; possibility of aggregation in complementary tax (rates from 0-60%) for registered shares and debentures.
d) Non-residents: 25%.
e) Transitory scheme: during 5 years (to 1993) exemption up to 3 million escudos; 40% only of revenues over are taken into account.
f) Aggregation possible in personal tax: rate from 0-40% (see also "Statute of Tax Benefits").
g) Aggregation compulsory in personal tax: rate 0-40%. Non-residents: 15% (see also "Statute of Tax Benefits").
Source: IRS Tax Code, 1990.

Table A4. **IRS-Income categories subject to flat rate**

Per cent

	Income category	Flat rate
i)	Interest rate from bank accounts	20
ii)	Income from securities	25
iii)	Income from lottery prizes and similar sources	25
iv)	Pension and labour income for non-residents	25
v)	Capital gains in equity transactions	10
vi)	Other capital income for non-residents	20

Note: To protect low income families, they can opt for including categories *i), ii)* and *v)* in the calculation of their global income, thus benefiting from the lower marginal rate of 16 or 20 per cent.

Source: IRS Tax Code.

Annex II

Chronology of economic events

Fiscal policy

1988

December

Approval of a law widening the scope of the Public Debt Management Fund (Fundo de Regularização da Dívida Pública) in order to include receipts from privatisation and expenditures related to the privatisation process and to the financial reform of public enterprises. Receipts from privatisation will be used mainly for public-debt redemption. Up to a maximum of 20 per cent of the total may be used in the financial restructuring of public enterprises.

1989

January

New income tax system (IRS – Personal Income Tax – and IRC – Corporation Profit Tax) comes into force.

March

In order to equalise fiscal treatment of different saving instruments, public debt will be issued at gross interest rates and interest received on new public debt securities will be taxed.

Some incentives will remain, as only 80 per cent of interest income from domestic public debt is subject to IRS and IRC.

June

Changes were introduced in the VAT system, in order to adjust it both to EC legislation and to the new income tax system. Changes concern:

i) Transactions with non-EC countries;
ii) "Zero rate" on some items that were not negotiated in the Treaty of Adhesion (normal wine and cinema tickets) is suppressed;
iii) "Zero rate" on other items that were not included in the Treaty is maintained (prescription drugs, books and newspapers).

July

Approval of the Statute of Tax Incentives related to the new income tax laws, gathering all tax incentives in a coherent set.

August

Revision of the PCEDED; assumptions and projections as well as the economic policy guidelines are updated. Main objectives were maintained, with more emphasis put on the reduction of the public sector deficit.

Creation of the Financial Stabilization Fund to finance Social Security.

September

The Government increases civil servants' salaries by 12 per cent; this increase is the normal yearly increase of wages, usually set in January, and that was anticipated to 1st October 1989, because of higher-than-expected inflation.

Approval of the overall revision of the system of remuneration of civil servants.

Public-owned buildings that are not actually used or are not suited to needs of the services, can be sold; 80 per cent of the revenue will be attributed to the ministry that has made it available, complementing its budget for investments.

November

The government increases retirement and invalidity pensions paid by the social security scheme. The increases, which are to come into force in December 1989 range from 14 per cent to 16.4 per cent.

December

Approval of the 1990 budget.

Approval of the revised 1989 budget.

1990

February

Personal income tax brackets were increased by 20 per cent, and several deductions were also increased (maximum amount that can be deducted from gross income from employment was raised by 20 per cent, etc.), easing fiscal charges on households' income.

March

Several fiscal benefits were created, aiming at equalising fiscal treatment of different saving instruments. A special fiscal treatment was set for domestic and foreign investment projects above Esc.10 billion that are assessed to have an exceptional impact on the balance of payments, allowing to negotiate tax exemptions.

April

Approval of the Privatisation Law.

May

Revision of the system of investment incentives included in the PCEDED.

Resolution of the Council of Ministers establishing restrictions on expenditures growth; expenditures included in the budget are temporarily cut by:

- 10 per cent for "fiscal allowances";
- 20 per cent for "expenditures on goods and services", "other current expenditures" and "acquisition of capital goods";
- 30 per cent for "transportation materials".

Monetary, financial and exchange rate policy measures

1989

February

Regulation of credit-purchase financing of goods and services as well of the legal status of enterprises operating in this area.

March

Regulation of general hire-purchase systems, narrowing both its scope and term and conditions, implying stricter conditions on consumer credit, especially for passenger vehicles.

Increase in compulsory reserves ratios to a standard 17 per cent ratio (against a previous 1 to 15 per cent range according to type of deposits).

The discount rate is raised by 1 point to 14.5 per cent; the reference rate for capital market is raised by 1 point to 16 per cent; the maximum interest rate on housing credit operations is suspended and interest rates agreed prior to that date is fixed by credit institutions and is not to exceed 17.5 per cent.

The interest rate on demand deposits is not to exceed one-third of the minimum rate fixed for time deposits over 180 days up to one year.

Restrictions on the acquisition of foreign currency by residents are reduced.

Bank credit ceilings are to be set each month, instead of every two months, as a way to increase the flexibility of credit ceilings.

April

Interest rates paid by the Central Bank on reserves were fixed at 13.8 per cent for reserves on time deposits with maturities between 180 days and one year, and 14 per cent for reserves on saving deposits and time deposits over one year.

May

The Bank of Portugal communicated to banks that medium and long-term treasury bonds will be included again in credit aggregates subject to ceilings from July 1989 on (they were excluded since June 1987). Bills issued during this period (June 1987 to July 1989) would remain not subject to control, and their sale to the public without repurchase agreement would not entail a reduction in the amount of credit not subject to ceilings.

July

Interest rates on required reserves were changed and set as follows:

- 14/17th of minimum cash holdings corresponding to deposits in escudos and residents' and emigrants' deposits in foreign currencies over 180 days up to one year will be remunerated at a 13.1 per cent rate;
- 16/17th of minimum cash holdings corresponding to deposits in foreign currencies and deposits over one year or saving deposits will be remunerated at a 13.5 per cent rate.

September

Regulations governing investment in foreign securities by residents are changed, widening the limits set for institutional investors and individuals.

1990

March

Compulsory credit ceilings are suspended. At the same time, the authorities announce a maximum rate recommended for the growth of domestic bank credit (minus 2.5 per cent) for the first half of the year.

Rules governing investment in foreign securities by residents are changed, widening again the limits set for juridical persons (20 per cent of total portfolio) and for physical persons (Esc.10 million).

April

Residents who receive foreign currency directly from non-residents must proceed to its sale to an institution authorised to deal in foreign exchange, within a period of 15 days as from the date of receipt.

Residents may settle merchandise, invisibles or capital operations, by issuing non-negotiable and crossed cheques, drawn on escudo accounts, provided that their amount does not exceed Esc.500 000.

Total or partial bilateral clearing of net balances resulting from transactions with non-residents is permitted, provided that prior notice is given to the Central Bank.

Purchases by residents of foreign banknotes and coins as well as other means of payment for the settlement of travel or tourism expenses abroad are free.

May

Minimum reserve requirement regime was revised and is now applicable to the non-monetary financial institutions. It provides a widening of the set of liabilities subject to reserve requirements and a reduction of the time lag between the assumption of liabilities and the building-up of corresponding reserves.

The Security Market's Regulation Law is approved by the Council of Ministers but will only be effective when approved by Parliament.

June

Change in regulations governing the activity of savings banks.

Minimum rates on time deposits over 180 days up to one year and on deposits opened under housing-savings accounts increased to 14 and 14.5 per cent, respectively.

As of 25th June, and for 90-day period, the forward foreign exchange against escudos, from non-residents, is suspended. This suspension does not cover operations directly associated with Portuguese exports of goods and services and capital operations duly authorised under the terms of the foreign-exchange regulation in force.

July

The Bank of Portugal imposes the opening of a non-remunerated deposit at the Bank, denominated in escudos for non-banking resident bodies:

i) Using loans or financial credits (including financial leasing operations) negotiated with non-residents;
ii) Using loans or financial credits expressed in foreign currencies granted by resident financial institutions;
iii) Issuing bonds or other debt instruments on external markets;
iv) Placing with non-residents domestic issues of bonds with private subscription.

The deposit (equal to 40 per cent of each operation, or of the proceeds of issues on foreign markets or of domestic issues placed with non-residents) shall be frozen up to the repayment of the relative operations.

September

The following changes are introduced in the management of exchange rate policy:

– An index with the main currencies of the ERM, weighted by their share in

Portuguese external trade, will be used as a reference for the long-term objective of exchange rate policy: this objective will be a depreciation of 3 per cent.

- The exchange rate will respond to supply and demand pressures: it will fluctuate within an interval of a few percentage points around the central objective.

Income policy measures

1989

January

Minimum wage raised by 10.3 per cent in the non-agriculture sectors, 14.5 per cent in the agricultural sector and 14.9 per cent in domestic services sector, as a step to gradually set a uniform minimum wage.

July

Minimum wage raised by 5 per cent, 5.6 per cent and 7.1 per cent in the non-agricultural sectors, agricultural sectors and domestic services sectors, respectively, implying annual growth rates of 13.1 per cent, 17.7 per cent and 19 per cent.

1990

February

Minimum wage raised by 11.1 per cent in the non-agriculture sectors, 13.3 per cent in agricultural sectors and 16.7 per cent in domestic services sector, to Esc.35 000, Esc.34 000 and Esc.28 000, respectively.

October

Economic and Social Agreement between the government, the Employers' Association and the Socialist trade Union (UGT) signed.

Annex III

The privatisation process

Historical background

After the April 1974 revolution, almost the whole financial system (commercial banks and biggest insurance companies) was nationalised, as well as some transportation companies and many large industrial concerns. These included heavy industry, but also a wide range of other industrial sectors. Due to the structure of the initial financial conglomerates, the resulting set of public enterprises was a group of companies without any internal logic.

At the time of nationalisation, the non-financial public enterprises already had financial problems. Their economic and financial performance deteriorated further as investments, based upon artificially low oil prices, were not profitable. In addition, they were largely financed by external loans, with uncertain financial costs due to exchange rate instability. Irrational pricing policies, overmanning and the building up of arrears from the State (government subsidies in compensation for low tariffs were not paid) contributed to these imbalances[1]. All this caused a rapid financial deterioration of public enterprises in the first half of the 1980s. Most affected were the major industrial enterprises, their losses accounting for the largest part of public sector losses: Quimigal (chemicals), Setenave (shipbuilding), Siderurgia Nacional (steel), CNP (petrochemicals). However, the financial situation of public enterprises improved over the second half of the 1980s. Their borrowing requirement fell from 8 per cent of GDP in 1984 to 1 per cent in 1989. At present, the set of public enterprises includes firms in financial difficulties as well as others in relatively good financial health; it also includes both "public service" enterprises, regulated by the State and generally working as monopolies, and enterprises working in the competitive sector.

From 1984 onwards, foreign and domestic commercial banks as well as new insurance companies were allowed to begin operations in Portugal. Until 1993, however, in accordance with the Treaty of Accession to EC, monetary authorities can block the entry of new banks, on grounds of "economic necessity". They can also control the expansion of branch networks of banks already settled. While the private financial sector has been growing rapidly, the eleven publicly-owned banks and eight insurance companies nevertheless still accounted for 80 per cent and 60 per cent of their respective markets in 1989. The profitability of nationalised banks is depressed by large holdings of low interest bearing public debt. They are also plagued by undercapitalisation, heavy structures and overmanning. Another problem is that banks have large pension liabilities which, being unfunded, are not reflected in their balance-sheet positions.

"Partial" privatisations

The main provisions of the 1988 law allowing partial privatisation were:

- A quota of at least 20 per cent of the shares was reserved to be sold to small shareholders and to the workers of the company;
- Any non-public entity could buy no more than 10 per cent of the shares to be sold;
- The amount of shares being acquired by groups of foreign entities could not exceed 10 per cent of the stock to be sold;
- The receipts of the State from the operation would be allocated to the financial assistance of loss-making public companies and to the repayment of public debt;
- Buyers of this first sale of shares would have preferential rights on subsequent sales of the remaining equity, to be honoured after the constitutional amendment was adopted in June 1989.

The Privatisation Law

In April 1990, the Privatisation Law was passed allowing full privatisation of enterprises nationalised after 25th April 1974. The stated objectives of privatisation are:

- To modernise economic units, increase their competitiveness and contribute to sectorial restructuring;
- To reinforce the capacity of national enterprises;
- To reduce the role of the State in the economy;
- To contribute to the development of capital markets;
- To make a wide participation of Portuguese citizens in the ownership of enterprises possible, through an adequate dispersion of equity ownership, paying particular attention to the workers of the enterprises and to small shareholders.

The public enterprises to be privatised are first transformed into corporations, with a prior evaluation being made by two independent entities. Each privatisation is regulated by a specific decree outlining the form, method, ground and special conditions for buying shares.

The privatisation is made, as a rule, by the sale of shares in the stock exchange or by public subscription. In certain cases, dictated by national interest, or wider economic considerations, the process can be made by open sale to qualified candidates or by direct sale. There will be a reserved quota for small shareholders (including emigrants) and for the workers of the enterprise, that will benefit from special conditions, as long as shares are not sold before a minimum delay after acquisition. Maximum quotas for shares that each individual entity can buy as well as quotas on foreign shareholdings will be defined for each privatisation. For important companies the government may introduce a "golden share" that confers the right of veto in specific areas and circumstances.

State receipts will be exclusively used for one or several of the following objectives:

- General government debt redemption;
- Public enterprises debt redemption;
- To cover interest payments that resulted from nationalisations;
- New capital transfers for the restructuring of the productive public sector.

1. For details on the situation of public enterprises see OECD *Economic Survey on Portugal*, April 1988, Part III, and July 1989, Part III.

STATISTICAL ANNEX

Selected background statistics

	Average 1980-89	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
A. *Percentage changes*											
Private consumption [1]	2.6	3.8	2.8	1.7	−1.3	−2.7	0.5	4.8	6.8	6.5	3.1
Gross fixed capital formation [1]	3.8	8.6	5.7	1.7	−6.9	−17.0	−3.4	10.9	20.2	16.0	7.5
GDP [1]	2.7	4.8	1.3	2.1	−0.2	−1.8	3.0	4.1	4.6	4.2	5.4
GDP price deflator	18.6	20.8	18.0	20.7	24.7	24.4	21.5	20.4	12.0	11.3	12.8
Industrial production	4.1	5.2	2.2	7.8	3.5	2.7	0.7	6.1	2.3	6.3	4.9
Employment	1.4	2.2	0.5	−0.1	3.9	−0.1	−0.5	0.2	2.6	2.7	2.2
Compensation of employees (current prices)	19.7	28.4	22.2	22.4	19.6	16.1	22.8	19.1	16.5	13.8	17.1
Productivity (real GDP/employment)	1.3	2.5	0.8	2.1	−4.0	−1.7	3.5	4.0	1.9	1.5	3.1
Unit labour costs (compensation/real GDP)	16.6	22.5	20.7	19.9	19.9	18.2	19.3	14.4	11.4	9.2	11.1
B. *Percentage ratios*											
Gross fixed capital formation as percent of GDP at constant prices	25.0	26.2	27.4	27.3	25.4	21.5	20.2	21.5	24.7	27.5	28.0
Stockbuilding as percent of GDP at constant prices	3.7	6.3	5.1	4.9	1.6	1.5	2.1	2.6	4.0	4.2	4.5
Foreign balance as percent of GDP at constant prices	−9.1	−11.5	−13.1	−12.8	−7.6	−3.4	−1.6	−4.3	−9.8	−14.3	−13.1
Compensation of employees as percent of GDP at current prices	47.6	51.5	52.7	52.3	50.3	47.7	46.8	44.5	44.3	43.4	42.8
Direct taxes as percent of household income	4.9	4.4	5.0	5.1	5.9	4.9	5.3	4.7	4.1	4.5	5.3
Household saving as percent of disposable income	26.8	28.6	27.2	28.7	27.7	27.6	28.3	26.7	26.0	23.8	23.5
Unemployment rate [2]	7.5	8.0	7.7	7.5	7.9	8.6	8.7	8.6	7.1	5.8	5.0
C. *Other indicator*											
Current balance (billion dollars)	−0.9	−1.3	−2.9	−3.2	−1.6	−0.6	0.4	1.1	0.4	−1.1	−0.6

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

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Private consumption	670.3	845.5	1 045.4	1 287.1	1 596.2	1 990.3	2 393.2	2 876.2	3 335.7	3 909.2	4 540.9
Public consumption	137.6	182.6	225.9	276.2	348.4	423.1	546.9	678.8	787.8	962.8	1 150.2
Gross fixed investment	264.0	358.8	463.0	574.8	671.5	663.7	768.0	977.0	1 250.8	1 611.2	1 904.3
Final domestic demand	1 071.8	1 387.0	1 734.3	2 138.0	2 616.1	3 077.1	3 708.1	4 532.0	5 374.3	6 483.3	7 595.4
	(23.9)	(29.4)	(25.0)	(23.3)	(22.4)	(17.6)	(20.5)	(22.2)	(18.6)	(20.6)	(17.2)
Stockbuilding	29.1	53.2	55.8	56.4	–20.8	–37.7	–40.8	10.6	171.0	169.8	195.0
	(1.1)	(2.4)	(0.2)	(0)	(–4.2)	(–0.7)	(–0.1)	(1.5)	(3.6)	(0)	(0.4)
Total domestic demand	1 100.8	1 440.1	1 790.2	2 194.4	2 595.2	3 039.4	3 667.3	4 542.6	5 545.3	6 653.1	7 790.4
	(24.4)	(30.8)	(24.3)	(22.6)	(18.3)	(17.1)	(20.7)	(23.9)	(22.1)	(20.0)	(17.1)
Exports	268.7	344.0	389.5	488.5	721.2	1 048.6	1 315.2	1 466.6	1 774.7	2 129.5	2 652.1
Imports	376.3	528.0	678.5	832.5	1 014.8	1 272.3	1 458.6	1 588.8	2 145.2	2 779.9	3 308.3
Foreign balance	–107.5	–184.1	–289.0	–344.0	–293.5	–223.7	–143.4	–122.2	–370.6	–650.4	–656.2
	(–1.2)	(–7.7)	(–8.4)	(–3.7)	(2.7)	(3.0)	(2.9)	(0.6)	(–5.6)	(–5.4)	(–0.1)
GDP (market prices)	993.3	1 256.1	1 501.1	1 850.4	2 301.7	2 815.7	3 523.9	4 420.4	5 174.7	6 002.8	7 134.2
	(26.2)	(26.5)	(19.5)	(23.3)	(24.4)	(22.3)	(25.2)	(25.4)	(17.1)	(16.0)	(18.8)
Net factor income from abroad	–21.4	–30.6	–61.0	–103.0	–119.6	–177.3	–196.4	–151.6	–130.8	–125.8	–126.1
GNP (market prices)	971.9	1 225.4	1 440.1	1 747.4	2 182.1	2 638.4	3 327.5	4 268.8	5 043.9	5 877.0	7 008.1
	(25.8)	(26.1)	(17.5)	(21.3)	(24.9)	(20.9)	(26.1)	(28.3)	(18.2)	(16.5)	(19.2)

Note: Figures in parentheses are annual growth rates; for stockbuilding and the foreign balance they are contributions to GDP growth.
Sources: 1979-1985: OECD *National Accounts*; INE. 1986-1989: Central Planning Department; Bank of Portugal.

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

Billion escudos

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Private consumption	464.2	477.2	485.3	479.0	466.0	468.4	490.8	524.2	558.3	575.6
Public consumption	104.8	110.7	114.9	119.3	119.7	127.4	136.5	139.3	145.6	148.5
Gross fixed investment	188.8	199.5	202.9	188.9	156.8	151.5	168.0	201.9	234.2	251.8
Final domestic demand	757.7	787.3	803.0	787.2	742.5	747.2	795.3	865.4	938.1	975.9
	(5.5)	(3.9)	(2.0)	(–2.0)	(–5.7)	(0.6)	(6.4)	(8.8)	(8.4)	(4.0)
Stockbuilding	45.0	37.3	36.3	11.7	11.1	15.7	20.2	32.9	35.9	40.3
	(0.3)	(–1.1)	(–0.1)	(–3.3)	(–0.1)	(0.6)	(0.6)	(1.6)	(0.4)	(0.5)
Total domestic demand	802.8	824.6	839.4	798.9	753.6	762.9	815.6	898.3	974.0	1 016.2
	(5.5)	(2.7)	(1.8)	(–4.8)	(–5.7)	(1.2)	(6.9)	(10.1)	(8.4)	(4.3)
Exports	164.3	157.7	167.5	189.9	210.4	225.4	242.7	268.9	288.0	335.5
Imports	247.2	253.4	262.8	246.2	234.9	237.2	276.2	349.1	409.5	452.9
Foreign balance	–83.0	–95.7	–95.3	–56.3	–24.5	–11.9	–33.4	–80.2	–121.5	–117.4
	(–1.3)	(–1.8)	(0.1)	(5.2)	(4.3)	(1.7)	(–2.9)	(–6.0)	(–5.0)	(0.5)
GDP (market prices)	719.8	728.9	744.1	742.6	729.1	751.0	782.1	818.1	852.5	898.8
	(4.8)	(1.3)	(2.1)	(–0.2)	(–1.8)	(3.0)	(4.1)	(4.6)	(4.2)	(5.4)

Note: Figures in parentheses are annual growth rates; for stockbuilding and the foreign balance they are contributions to GDP growth.
Sources: 1980-1985: OECD *National Accounts*; INE. 1986-1989: Central Planning Department; Bank of Portugal.

Table C. Gross domestic product, by kind of activity

Billion escudos and percentage changes

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
At current prices										
(Billion escudos)										
Agriculture, forestry and fishing	129.9	134.6	162.9	183.3	234.4	281.2	328.7	379.0	365.1	..
Industry[1]	376.4	449.3	521.0	647.4	824.5	1 018.6	1 214.7	1 435.7	1 600.0	..
Electricity, gas and water	26.5	16.1	33.0	57.3	91.6	135.1	158.0	187.7	254.9	..
Construction	88.9	113.0	149.5	175.2	166.8	200.4	245.7	296.5	368.5	..
Services	676.1	841.6	1 061.3	1 331.3	1 598.0	2 015.7	2 360.0	2 768.5	3 256.9	..
of which: Public administration	144.7	176.7	214.7	269.1	327.3	410.3	..	..	..	..
Trade	234.9	280.2	357.4	445.8	522.4	670.5	..	..	..	..
Subtotal	1 297.8	1 554.6	1 927.7	2 394.5	2 915.3	3 651.0	4 307.1	5 067.4	5 845.4	..
GDP (at market prices)	1 256.1	1 501.1	1 850.4	2 301.7	2 815.7	3 523.9	4 420.4	5 174.7	6 002.8	7 134.2
At 1977 prices										
(Percentage changes)										
Agriculture, forestry and fishing	2.3	–10.6	6.0	–1.4	9.1	8.1	3.1	4.1	–11.5	7.4
Industry[1]	4.2	2.0	–0.8	–1.3	–3.8	2.6	6.2	3.0	2.0	5.0
Electricity, gas and water	16.4	–18.3	34.8	11.4	7.9	12.4	–6.3	3.4	14.8	7.0
Construction	7.1	4.7	2.0	0.7	–9.4	–5.6	2.3	7.9	10.9	8.0
Services	6.3	3.5	3.1	0.7	–3.4	2.6	4.1	7.5	4.4	5.0
of which: Public administration	15.3	4.6	4.0	4.9	1.7	3.2	..	..	..	..
Trade	5.4	1.9	0.9	–3.6	–5.5	1.0	..	..	..	..
GDP (at market prices)	4.8	1.3	2.4	–0.3	–1.6	3.0	4.1	5.1	4.0	5.4

1. Manufacturing and mining.

Sources: INE; OECD, *National Accounts*; Central Planning Department estimates.

Table D. **Household appropriation account**

Billion escudos

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Compensation of employees	646.8	790.3	967.3	1 157.1	1 343.4	1 650.2	1 965.3	2 290.5	2 605.7	3 051.3
Property and entrepreneurial income	437.4	532.7	687.1	912.5	1 208.2	1 493.8	1 680.5	1 833.9	2 086.9	2 504.3
Domestic transfers	136.8	176.3	250.0	314.2	390.1	474.0	631.0	739.8	..	..
Foreign transfers	150.1	178.6	215.0	242.0	316.7	353.7	385.1	479.1	..	..
Gross total income	1 371.2	1 677.9	2 119.4	2 625.8	3 258.4	3 971.7	4 661.9	5 343.3	6 090.1	7 130.5
Direct taxes	60.6	84.6	108.5	155.1	160.4	209.8	216.8	219.9	273.8	380.6
Social security contributions	126.4	157.5	205.5	264.0	348.9	426.3	522.3	615.5	687.6	805.2
Disposable income	1 184.2	1 435.7	1 805.4	2 206.7	2 749.1	3 335.6	3 922.8	4 507.9	5 128.7	5 944.8
Consumption	845.5	1 045.4	1 287.1	1 596.2	1 990.3	2 393.2	2 876.2	3 335.7	3 909.2	4 546.8
Savings ratio[1]	28.6	27.2	28.7	27.7	27.6	28.3	26.7	26.0	23.8	23.5
Real disposable income, percentage change	3.5	0.7	3.9	–2.6	–2.4	1.8	2.5	5.8	3.3	2.9

1. As a percentage of disposable income.
Sources: Ministry of Finance; Bank of Portugal.

Table E. General government account

Billion escudos

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Current receipts	387.5	486.4	617.9	852.7	973.3	1 176.6	1 649.4	1 865.6	2 262.0	2 793.7
Direct taxes[1]	80.2	112.8	141.7	196.1	233.8	293.8	356.3	407.9	983.8	1 265.9
Social security contributions	109.8	136.4	177.6	228.7	263.5	321.9	392.3	449.1	..	..
Indirect taxes	176.5	213.7	261.9	358.1	426.6	497.6	729.4	794.1	967.2	1 089.4
Other current receipts	21.1	23.6	36.7	69.8	49.4	63.3	171.4	214.5	311.0	438.4
Current expenditure	396.0	550.1	714.5	949.6	1 200.9	1 396.8	1 809.0	2 011.6	2 399.2	2 770.4
Expenditure on goods and services	161.4	217.6	266.6	333.6	405.5	501.8	598.6	688.8	1 121.8	1 324.5
Subsidies	60.9	82.7	104.4	158.9	212.8	150.4	138.1	142.4	128.6	170.0
Interest paid	39.3	77.0	101.1	147.0	199.5	277.9	407.7	404.3	504.8	522.3
Current transfers	134.4	172.8	242.4	310.1	383.1	466.7	664.6	776.1	644.0	753.6
Current balance	–8.5	–63.7	–96.6	–96.9	–227.6	–220.2	–159.6	–146.0	–137.2	23.3
Capital income	1.7	1.6	7.3	6.4	7.7	12.4	37.2	92.9	63.8	74.5
Capital expenditure	67.7	77.2	102.6	117.9	117.9	194.4	258.4	325.8	337.3	402.8
Fixed investment	52.1	63.4	62.9	70.3	73.5	87.3	113.4	137.7	229.5	260.7
Transfers	15.5	13.8	39.7	47.6	44.4	107.1	145.0	188.1	107.8	142.1
Overall balance	–74.5	–139.2	–191.9	–208.4	–337.8	–402.2	–380.8	–378.9	–410.7	–305.0
(as a percentage of GDP)	–5.9	–9.3	–10.4	–9.1	–12.0	–11.4	–8.6	–7.3	–6.8	–4.3
Loans	21.1	18.2	25.9	30.9	39.3	37.1	78.0	107.5	82.7	45.0
Total borrowing requirement	–95.6	–157.4	–217.8	–239.3	–377.1	–439.3	–458.8	–486.4	–493.4	–350.0
(as a percentage of GDP)	–7.6	–10.5	–11.8	–10.4	–13.4	–12.5	–10.4	–9.4	–8.2	–4.9

Note: New basis as from 1987.

1. Including social security contributions, as from 1988.

Source: Bank of Portugal, until 1987; Ministry of Finance, from 1988.

Table F. **Prices and wages**

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Indices										
Consumer prices[1]										
1976 = 100 ; 1983 = 100										
Total[2]	225.0	269.9	330.3	414.6	536.1	639.6	714.3	781.7	..	232.6
Food and drink	228.3	272.8	338.6	423.5	553.9	651.9	711.4	773.7	..	226.8
Clothing and footwear	238.4	287.3	332.1	397.8	494.9	610.2	753.3	872.3	..	273.8
Housing costs	223.7	269.3	323.5	417.3	558.3	665.4	736.1	790.4	..	224.4
Miscellaneous	209.8	253.3	310.8	397.3	495.6	605.9	689.6	751.7	..	..
Wages in manufacturing industry										
1980 = 100										
Nominal	100.0	120.1	144.7	171.7	204.0	247.1	288.6	329.0	366.2	420.9
Real	100.0	100.1	98.6	93.2	86.0	87.1	91.0	94.8	96.2	98.2
Percentage changes										
Consumer prices[1]										
Total[2]	16.7	20.0	22.4	25.5	29.3	19.3	11.7	9.4	9.6	12.6
Food and drink	10.0	19.5	24.1	25.1	30.8	17.7	9.1	8.8	9.2	14.4
Clothing and footwear	37.5	20.5	15.6	19.8	24.4	23.3	23.5	15.8	13.2	10.5
Housing costs	27.4	20.4	20.1	29.0	33.8	19.2	10.6	7.4	10.1	11.8
Miscellaneous	21.6	20.7	22.7	27.8	24.7	22.3	13.8	9.0	..	..
Wages in manufacturing industry										
Nominal	26.2	20.1	20.5	18.7	18.8	21.1	16.8	14.0	11.3	14.9
Real	8.2	0.1	–1.5	–5.4	–7.8	1.2	4.5	4.2	1.5	2.1

1. Mainland. New index as from 1988.
2. Excluding rent.

Sources: INE; Bank of Portugal; OECD, *Main Economic Indicators*.

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

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

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Fishing	75.9	75.0	68.2	63.1	96.4	95.0	89.6	82.5	..	..
Mining	93.1	92.8	91.0	87.0	99.7	100.2	95.5	88.7	97.2	96.2
Manufacturing	101.7	101.3	99.7	97.1	98.9	97.1	95.6	95.2	94.6	94.3
Construction	88.6	93.6	94.4	89.8	89.5	78.4	72.1	71.8	71.6	71.5
Electricity, gas and water	139.5	140.9	143.5	..	102.3	109.9	111.1	112.1	111.6	..
Transports and communications	106.7	106.2	105.8	105.5	96.8	92.5	90.8	89.3	89.5	90.8
Trade	99.1	100.0	99.3	97.2	98.6	95.2	93.3	92.9	92.4	..
Banking, insurance, real estate	146.1	152.7	157.2	161.3	100.2	97.9	94.3	92.4	92.4	96.5
Personal services	103.6	104.8	106.2	104.6	100.7	100.2	100.4	102.3	104.5	106.8
Total	101.7	102.4	101.5	99.5	98.1	95.1	93.2	92.6	92.4	92.7

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 and its counterparts**

Billion escudos at end of period

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Total money supply (L)	1 345.6	1 736.8	2 198.8	2 650.0	3 385.4	4 309.1	5 279.1	6 044.8	6 850.4	7 571.4
Money (M1-)	478.6	524.6	610.6	666.4	772.6	980.7	1 334.4	1 527.2	1 719.4	1 889.5
Notes and coins in circulation	165.2	188.4	219.5	240.1	267.4	319.0	399.3	457.7	509.7	580.9
Sight deposits, households and enterprises	313.4	336.2	391.1	426.3	505.2	661.7	935.1	1 069.5	1 209.7	1 308.6
Quasi money	867.0	1 212.2	1 588.2	1 983.6	2 612.7	3 328.4	3 944.7	4 517.7	5 131.1	5 682.0
Counterparts										
Net foreign assets	339.6	411.7	569.0	759.0	1 039.3	1 162.8	1 084.3	1 295.4	1 905.0	2 566.1
Net lending to the public sector	172.3	320.6	494.8	651.9	896.8	1 345.2	1 858.3	2 324.5	2 612.1	2 540.4
Lending to the private sector	1 077.3	1 348.6	1 681.0	2 065.6	2 469.4	2 731.3	3 070.0	3 206.3	3 444.6	3 697.5
Miscellaneous, net	–243.6	–344.1	–546.0	–826.5	–1 020.1	–930.2	–733.5	–781.4	–1 111.3	–1 232.6

1. Including migrant deposits and Treasury bills.
Source: Banco de Portugal, *Quarterly bulletin.*

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

Thousands

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Total	6 977.0	7 277.0	7 299.3	8 875.0	9 811.0	11 691.7	13 056.9	16 173.3	16 076.7	16 470.9
Spain	5 051.1	5 226.9	5 173.3	6 512.6	7 308.8	8 798.2	9 960.2	12 583.3	12 124.4	12 185.9
United Kingdom	483.9	548.5	570.6	629.5	709.7	880.4	1 069.1	1 204.3	1 139.7	1 137.3
Germany	300.1	306.6	289.5	355.3	344.0	413.0	430.3	526.0	568.7	611.0
France	237.4	239.0	288.4	327.9	326.6	347.3	350.1	434.8	593.4	646.4
Netherlands	127.7	128.7	124.7	156.2	151.9	163.8	171.7	214.2	285.2	332.7
United States	135.5	141.7	154.2	186.8	209.4	229.5	149.8	195.1	223.3	234.7
Italy	72.7	68.3	72.5	66.1	71.8	93.4	108.5	134.4	154.7	185.1
Brazil	60.9	64.4	80.2	57.4	60.2	69.2	82.5	71.7	92.1	102.4
Canada	40.3	43.5	42.0	46.8	56.1	70.3	73.8	77.5	79.1	90.9
Sweden	62.7	71.3	71.1	65.5	71.5	54.1	69.4	70.1	86.5	94.7
Belgium	45.6	48.4	48.6	61.4	59.1	67.6	67.7	90.3	116.9	150.7
Switzerland	40.0	41.3	41.2	46.1	53.2	61.1	66.4	70.6	73.3	77.7
Other countries	319.1	348.4	343.0	363.4	388.7	443.9	457.3	501.5	539.5	621.3

Source: INE, *Boletim mensal de estatistica.*

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

Million US dollars and percentages

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Imports, total (Mn.$)	9 270.6	9 787.4	9 540.7	8 256.7	7 975.3	7 649.7	9 454.0	13 965.7	17 884.8	..
As a percentage of total										
Food and beverages	11.9	13.9	11.3	10.7	11.5	11.0	11.0	10.6	10.3	..
Basic material and semi-finished goods	33.9	33.3	35.9	37.1	42.3	39.1	25.0	19.4	15.9	..
Manufactures	54.1	52.6	52.6	51.9	46.0	49.6	63.4	69.6	73.7	..
Chemicals	10.8	9.8	9.2	10.0	9.9	10.2	11.3	10.5	9.8	..
Goods classified chiefly by material	15.2	13.0	13.3	12.4	12.0	14.5	17.7	19.2	19.2	..
Machinery and transport equipment	24.9	26.5	26.4	26.1	21.1	21.6	29.3	33.9	38.3	..
Miscellaneous	3.2	3.4	3.6	3.4	3.0	3.3	5.1	6.1	6.3	..
Unspecified	0.1	0.1	0.2	0.3	0.2	0.3	0.6	0.3	0.1	..
Exports, total (Mn.$)	4 633.3	4 147.1	4 173.3	4 601.4	5 207.5	5 685.4	7 204.9	9 318.3	10 989.7	..
As a percentage of total										
Food and beverages	11.2	10.4	9.7	9.6	8.8	7.8	8.2	7.3	7.7	..
Basic material and semi-finished goods	16.7	18.4	15.2	15.6	15.2	14.5	12.2	11.9	12.8	..
Manufactures	70.9	69.9	73.3	72.6	75.3	76.0	78.4	80.1	79.1	..
Chemicals	6.2	6.0	8.2	7.5	7.7	7.0	6.1	5.4	6.0	..
Goods classified chiefly by material	31.6	31.5	29.9	28.7	28.1	27.7	26.4	25.4	25.4	..
Machinery and transport equipment	13.3	12.6	14.0	15.4	17.3	15.6	15.7	16.5	16.7	..
Miscellaneous	19.8	19.9	21.1	21.0	22.2	25.7	30.3	32.8	31.0	..
Unspecified	1.3	1.3	1.8	2.2	0.8	1.7	1.2	0.7	0.4	..

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

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

Billion escudos and percentages

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Exports, total *(Bn.escudos)*	231.6	256.9	331.7	508.6	760.6	971.7	1 082.3	1 311.0	1 582.0	1 994.4
As a percentage of total										
OECD countries	80.7	77.5	81.8	82.6	83.8	85.3	88.7	90.7	90.1	90.4
EEC	58.6	56.5	60.9	62.5	61.8	62.5	68.0	70.8	71.6	71.5
Germany	13.6	12.5	12.9	13.3	13.7	13.7	14.7	15.3	14.7	15.7
France	10.6	12.6	13.3	13.5	12.4	12.7	15.2	15.8	15.2	15.1
Italy	5.7	4.2	4.8	4.1	4.3	3.9	4.0	3.9	4.2	4.2
United Kingdom	14.8	14.4	14.8	14.8	15.4	14.6	14.2	14.1	14.3	12.3
Spain	3.6	2.8	3.5	4.0	4.4	4.1	6.6	9.0	11.2	12.5
Other EEC	10.4	9.9	11.5	12.8	11.6	13.4	13.4	12.6	12.1	11.6
United States	5.7	5.2	6.2	6.1	8.8	9.2	7.0	6.4	5.9	6.0
Other OECD countries	16.4	15.8	14.7	14.0	13.2	13.5	13.7	13.5	12.6	12.9
Non OECD countries	19.3	22.5	18.2	17.4	16.2	14.7	11.3	9.3	9.9	9.6
of which: OPEC	..	3.7	2.9	3.5	2.5	2.5	1.6	1.5	1.1	0.7
Previous Escudo Area	6.0	7.6	5.0	4.5	4.4	3.9	2.2	2.1	2.7	3.3
Imports, total *(Bn.escudos)*	475.5	609.0	754.0	899.3	1 160.6	1 326.5	1 442.5	1 965.3	2 570.3	2 973.0
As a percentage of total										
OECD countries	68.5	68.7	69.4	69.6	66.2	67.1	78.3	81.5	83.8	83.1
EEC	45.3	44.9	46.9	44.9	43.0	45.9	63.7	63.7	67.1	67.9
Germany	11.7	11.0	11.8	11.4	10.2	11.5	14.2	15.0	14.6	14.4
France	7.3	7.8	8.7	8.2	7.9	8.1	10.1	11.2	11.5	11.6
Italy	5.2	5.4	5.6	5.2	4.7	5.2	7.9	8.7	9.2	9.1
United Kingdom	8.7	8.1	7.8	7.6	6.7	7.5	7.5	8.1	8.3	7.4
Spain	5.5	6.6	6.0	5.1	7.1	7.4	10.9	11.7	13.1	10.9
Other EEC	6.8	6.1	7.0	7.3	6.4	6.3	13.1	9.0	10.3	14.5
United States	11.0	12.0	10.8	14.1	13.5	9.7	7.0	4.8	4.3	4.5
Other OECD countries	12.2	11.8	11.7	10.6	9.8	11.5	7.6	13.0	12.4	10.8
Non OECD countries	31.5	31.3	30.6	30.4	33.8	32.9	21.7	18.5	16.2	16.9
of which: OPEC	19.3	18.6	19.2	18.5	18.5	17.3	8.4	6.0	5.0	6.1
Previous Escudo Area	0.5	0.4	0.5	0.5	0.7	1.2	0.8	0.4	0.2	0.4

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

Table L. **Balance of payments**

Million US dollars

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Exports, fob	4 575.0	4 088.0	4 108.0	4 569.0	5 177.0	5 673.0	7 202.0	9 268.0	10 875.0	12 782.0
Imports, fob	8 781.0	9 283.0	8 941.0	7 643.0	7 307.0	7 177.0	8 882.0	12 849.0	16 393.0	17 934.0
Trade balance	–4 206.0	–5 195.0	–4 833.0	–3 074.0	–2 130.0	–1 504.0	–1 680.0	–3 581.0	–5 518.0	–5 152.0
Services, net	–45.0	–544.0	–1 092.0	–742.0	–674.0	–361.0	–85.0	250.0	137.0	219.0
Travel	859.0	777.0	609.0	588.0	728.0	901.0	1 203.0	1 721.0	1 869.0	2 013.0
Transports	–194.0	–147.0	–282.0	–200.0	–192.0	–184.0	–135.0	–373.0	–587.0	–713.0
Investment income	–612.0	–975.0	–1 269.0	–1 066.0	–1 202.0	–1 152.0	–1 014.0	–932.0	–877.0	–802.0
Government transactions	–50.0	–141.0	–65.0	–37.0	–40.0	–44.0	–56.0	–123.0	–131.0	–124.0
Other services	–48.0	–58.0	–85.0	–27.0	32.0	118.0	–83.0	–43.0	–137.0	–155.0
Transfers, net	3 000.0	2 887.0	2 680.0	2 171.0	2 179.0	2 251.0	2 915.0	3 775.0	4 317.0	4 382.0
Current balance	–1 251.0	–2 852.0	–3 245.0	–1 645.0	–625.0	386.0	1 150.0	444.0	–1 064.0	–551.0
Medium and long-term capital	1 175.0	1 954.0	2 582.0	1 458.0	1 333.0	1 109.0	–293.0	194.0	843.0	2 560.0
Private	770.0	1 433.0	1 946.0	858.0	835.0	729.0	–196.0	195.0	804.0	2 560.0
Official	405.0	521.0	636.0	600.0	498.0	380.0	–97.0	–1.0	39.0	..
Short-term and unrecorded	934.0	750.0	786.0	–564.0	–221.0	–523.0	–1 079.0	1 273.0	1 826.0	1 858.0
Non-monetary transactions, net	858.0	–148.0	123.0	–751.0	487.0	972.0	–222.0	1 911.0	1 605.0	3 867.0
Private monetary institutions short-term capital	–498.0	42.0	–15.0	–310.0	–289.0	4.0	199.0	–101.0	–671.0	614.0
Balance on official settlements	360.0	–106.0	108.0	–1 061.0	198.0	976.0	–23.0	1 810.0	934.0	4 481.0
Use of IMF credit	–102.0	–55.0	–43.0	366.0	221.0	0	0	0	0	0
Miscellaneous official accounts	–335.0	–9.0	–103.0	0	–287.0	–284.0	–82.0	–309.0	–556.0	92.0
Changes in reserves (increase = -)	77.0	170.0	38.0	695.0	–132.0	–692.0	105.0	–1 501.0	–378.0	–4 573.0

Source : Bank of Portugal.

STRUCTURAL ANNEX

Table M. **Labour-market indicators**

A. LABOUR MARKET PERFORMANCE

	Cyclical Peak: 1979	Cyclical Trough: 1984	1985	1989*
Standardised unemployment rate	..	7.9	8.4	5.7
Unemployment rate: Total	8.3	8.5	8.6	5.0
Male	4.3	6.0	6.4	3.4
Women	14.0	12.1	11.7	7.2
Youth[1]	14.6	19.9	20.1	11.4
Share of long-term unemployment in total unemployment[2]	–	47.0	52.9	38.2

B. STRUCTURAL OR INSTITUTIONAL CHARACTERISTICS

	1970*	1980*	1985	1989*
Participation rate[3]: Total	56.7	65.4	67.8	68.4
Male	91.2	88.3	81.6	80.4
Women	26.9	45.0	55.2	57.2
Employment/population (15-64 years)	52.8	–	62.0	64.9
Non-wage labour costs[5] (as a percentage of total compensation)	..	15.4	18.0	20.2[4]
Unemployment insurance replacement ratio[6]	40	39	29	31
Minimum wage, non-agricultural sector (workers of 20 years and more, as a percentage of the average earnings)	..	..	56.4	52.3

Average percentage changes (annual rates)	1970/1960	1980/1970	1989*/1980
Labour force	–	2.5	0.7
Employment: Total	–0.5	2.8	1.3
Industries	0.5	3.8	1.0
Services	1.2	3.5	4.3

* Census data.
1. People between 15 and 24 years as a percentage of the labour force of the same age group.
2. Persons seeking a job for 12 months and over as a percentage of total unemployed.
3. Labour force as a percentage of relevant population group, aged between 15 and 64 years.
4. 1988.
5. Employers' contributions to social security and pension funds.
6. Umployment benefits per unemployed as a percentage of compensation per employee.

Sources: INE; Ministry of Employment and Social Security.

Table N. **Public sector**

A. BUDGET INDICATORS: GENERAL GOVERNMENT ACCOUNT

Per cent of GDP[1]

	1970	1980	1985	1988
Current receipts	26.0	30.8	33.4	37.7
Non-interest expenditure	23.9	33.6	36.9	36.1
Primary budget balance	2.0	–2.8	–3.5	1.6
Interest payments	0.5	3.1	7.9	8.4
General government budget balance	1.5	–5.9	–11.4	–6.8

B. THE STRUCTURE OF EXPENDITURE AND TAXATION

Per cent of GDP

1. Structure of general government expenditure

	1970	1980	1985	1988
Totale expenditure	24.5	36.8	44.8	44.5
Of which:				
Current consumption	14.2	12.9	14.2	18.7
Transfers to persons	4.2	10.7	13.2	10.7
Subsidies	1.5	4.8	4.3	2.1
Capital formation	2.5	4.1	2.5	3.8
Expenditure by function:				
Education	..	3.4	3.8	..
Health	..	2.6	3.5	..
Pensions	..	0.9	0.7	..

2. Structure of taxation[2]

	Portugal		EEC	
	1980	1988	1980	1988
Total tax revenue	28.7	34.6	36.4	40.8
Income tax	5.7	7.7	12.5	13.9
Social security	8.5	9.3	10.5	11.6
Consumption tax	12.9	16.6	11.2	13.1

1. National accounts basis.
2. On the basis of revenue statistics which may be different from National Accounts.

Sources: OECD:National Accounts; Revenue Statistics of OECD member countries.

Table O. **Production and employment structures**

	Per cent share of GDP at factor cost (current prices)				Per cent share of total employment			
	1977	1980	1985	1988	1977	1980	1985	1988
Agriculture, forestry and fishing	11.9	10.3	7.7	6.2	31.8	27.2	25.4	22.8
Manufacturing	27.9	31.0	27.9	27.4	23.6	25.1	24.3	25.2
Of which:								
Food, forestry and tobacco	5.7	5.7	5.9		3.5	3.3	3.2	3.1
Textiles, clothing, leather	5.4	7.0	7.6		7.6	8.1	8.3	9.1
Wood, paper and paper products	3.4	3.7	3.1		3.1	3.2	2.9	
Chemicals and products of petroleum, coal, rubber, etc.	3.0	2.8	3.2		1.5	1.7	1.6	
Non mineral products except products of petroleum and coal	2.4	2.6	2.0		1.8	1.9	1.7	
Fabricated metal products, machinery and equipment	5.6	6.8	5.4		4.0	4.5	4.2	
Electricity, gas and water	1.9	2.1	3.7	4.4	0.6	0.8	0.9	
Construction	7.7	7.1	5.5	6.3	9.5	10.1	9.5	9.3
Services	50.6	49.5	55.2	55.7	34.4	36.8	39.9	41.7
Of which:								
Wholesale and retail trade, restaurants and hotels	21.4	21.7	21.6		13.0	13.4	13.6	14.5
Transport, storage and communication	5.6	5.5	7.5		4.6	4.5	4.4	4.3
Finances, insurance, real estate and business services	10.7	10.5	9.8		2.2	2.6	3.0	3.2

BASIC STATISTICS:

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period[1]	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany	Greece	Iceland	Ireland	Italy	Japan	Luxembourg	Netherlands	New Zealand	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States	Yugoslavia
Population																											
Total	Thousands	1988	16 538	7 596	9 879	25 950	5 130	4 947	55 873	61 451	10 016	250	3 538	57 441	122 610	375	14 760	3 326	4 209	10 305	38 996	8 436	6 672	53 969	57 065	246 329	23 560
Inhabitants per sq.km	Number	1988	2	91	324	3	119	15	102	247	76	2	50	191	329	144	396	12	13	112	77	19	161	69	233	26	92
Net average annual increase over previous 10 years	%	1987	1.4	0.0	0.0	1.0	0.1	0.4	0.4	0.0	0.7	1.0	0.8	0.3	0.7	0.3	0.6	0.5	0.3	0.5	0.7	0.2	0.5	2.2	0.1	1.0	0.8
Employment																											
Total civilian employment (TCE)[2]	Thousands	1988	7 366	3 310	3 660 (87)	12 245	2 660	2 420	21 179	26 825	3 598 (87)	135	1 078	20 937	60 110	174	5 934	1 503	2 079	4 280	11 780	4 399	3 481	16 550	25 555	114 968	..
of which: Agriculture	% of TCE		5.9	8.1	2.7	4.5	5.8	9.8	6.8	4.0	26.6	10.4	15.4	9.8	7.9	3.4	4.8	10.4	6.4	20.7	14.4	3.8	5.7	50.6	2.3	2.9	..
Industry	% of TCE		26.4	37.4	28.0	25.6	27.2	30.6	30.3	39.8	27.2	31.1	27.8	32.4	34.1	31.6	26.4	26.0	26.4	35.1	32.5	29.5	35.1	20.4	29.8	26.9	..
Services	% of TCE		67.8	54.5	69.3	69.8	67.1	59.6	62.9	56.1	46.2	58.5	56.8	57.7	58.0	65.0	68.8	63.6	67.1	44.2	53.1	66.7	59.2	29.0	68.0	70.2	..
Gross domestic product (GDP)																											
At current prices and current exchange rates	Bill US $	1988	247.0	127.2	150.0	484.6	107.6	105.3	949.9	1 201.8	52.5	5.9	32.5	828.9	2 848.9	6.6	228.3	41.8	89.4	41.7	340.1	181.8	183.7	70.7	822.8	4 817.8	62.8
Per capita	US $		14 937	16 748	15 180	18 675	20 926	21 287	17 002	19 581	5 244	24 031	9 182	14 430	23 235	17 592	15 461	12 568	21 241	4 265	8 722	21 546	27 581	1 305	14 413	19 558	2 664
At current prices using current PPP's[3]	Bill US $	1988	221.3	94.8	124.5	477.8	70.2	68.1	758.6	867.5	67.9	4.0	28.8	744.4	1 751.5	5.8	189.1	36.5	67.0	65.9	363.6	124.4	110.8	235.6	765.1	4 817.8	..
Per capita	US $		13 383	12 482	12 599	18 413	13 655	13 772	13 577	14 134	6 786	16 087	8 131	12 960	14 285	15 528	12 807	10 972	15 916	6 737	9 325	14 743	16 641	4 348	13 402	19 558	..
Average annual volume growth over previous 5 years	%	1988	4.5	2.2	2.2	4.7	2.3	3.5	2.2	2.5	2.1	4.4	3.0	3.0	4.5	4.1	2.3	1.8	3.4	2.7	3.6	2.7	2.7	6.0	3.6	4.4	..
Gross fixed capital formation (GFCF)	% of GDP	1988	25.0	23.5	17.8	22.0	18.4	25.0	20.1	19.9	17.4	18.8	17.0	19.9	30.5	24.2	21.4	19.7	29.1	26.8	22.5	19.7	26.6	24.0	19.2	17.1	17.2
of which: Machinery and equipment	% of GDP		12.1	9.9	8.0	7.5	7.5	10.1	8.8	8.8	7.1	5.8	9.6	10.0	11.7	10.5	10.3	8.8	9.0	9.8 (86)	7.8 (87)	8.9	9.3	9.3 (85)	9.3	7.9	..
Residential construction	% of GDP		5.9	4.9	4.1	7.3	4.2	6.5	5.2	5.2	4.7	4.0	3.7 (87)	5.0	6.3	4.4	5.7	4.3	5.0	4.8 (86)	4.1 (87)	4.8	17.3[9]	3.3 (85)	4.0	4.8	..
Average annual volume growth over previous 5 years	%	1988	6.1	3.8	5.4	8.3	5.6	3.1	3.0	2.4	–1.3	5.3	–2.6	3.8	7.9	6.0	6.0	0.0	3.1	3.2	7.1	5.6	6.3	6.3	7.2	6.8	..
Gross saving ratio[4]	% of GDP	1988	22.4	25.2	19.3	20.4	16.0	23.8	20.5	24.6	16.7	16.2	18.0	20.7	33.5	58.8	23.5	17.0	22.7	25.3	22.7	18.2	32.8	26.0	16.4	15.2	..
General government																											
Current expenditure on goods and services	% of GDP	1988	17.4	18.4	15.3	18.8	25.8	20.2	18.6	19.5	20.6	18.6	16.7	17.2	9.4	17.0	15.7	17.1	21.0	16.0	14.3	26.0	12.8	8.8	19.9	18.3	14.2
Current disbursements[5]	% of GDP	1988	32.0	45.8	49.0	41.7	57.3	35.9	46.9	43.1	45.7	30.5	50.0 (87)	46.1	26.8	46.2 (86)	53.3	..	49.7	40.4 (86)	36.1 (86)	57.2	30.4	..	41.2 (87)	34.8	..
Current receipts	% of GDP	1988	34.3	46.8	44.3	40.4	59.5	40.3	47.1	43.7	35.1	35.7	43.8 (87)	39.9	34.3	54.2 (86)	52.2	..	55.1	37.6 (86)	35.0 (86)	61.9	34.8	..	40.7 (87)	31.5	..
Net official development assistance	% of GNP	1988	0.41	0.21	0.44	0.48	0.88	0.55	0.73	0.39	..	0.05	0.20	0.37	0.31	0.10	0.98	0.27	1.10	0.08	0.06	0.88	0.32	..	0.30	0.20	..
Indicators of living standards																											
Private consumption per capita using current PPP's	US $	1988	7 703	6 952	7 951	10 666	7 283	7 353	8 198	7 747	4 652	9 968	4 708	7 930	8 192	8 873	7 615	6 830	8 426	4 387	5 872	7 821	9 756	2 817	8 456	12 999	1 333*
Passenger cars, per 1 000 inhabitants	Number	1988	497 (85)	370	349	454 (86)	321	344	394	457	130	488	201 (86)	408	241	443	348	490	388	135 (82)	263	400	419	18 (82)	318	559	121 (83)
Telephones, per 1 000 inhabitants	Number	1985	540 (83)	460 (83)	414 (83)	664	783	615	614	641 (86)	373	525 (83)	235 (83)	448	535 (83)	425 (86)	410 (86)	646	622 (84)	166 (83)	381	890 (83)	1 334	55 (83)	521 (84)	650 (84)	122 (83)
Television sets, per 1 000 inhabitants	Number	1985	..	300 (81)	303 (84)	471 (80)	392	370 (86)	394 (86)	377 (86)	158 (80)	303	181 (80)	244	250 (80)	336 (83)	317 (86)	291	346 (86)	140 (80)	256 (82)	390	337	76 (79)	336 (84)	621 (80)	175 (83)
Doctors, per 1 000 inhabitants	Number	1985	..	1.7 (82)	2.8 (84)	1.8 (82)	2.5 (84)	2.3 (86)	2.2 (86)	2.8 (87)	2.8 (83)	2.4 (84)	1.3 (82)	3.6	1.3 (82)	1.9 (86)	2.2 (84)	2.4	2.2	1.8 (82)	3.4 (86)	2.5	1.4 (84)	1.5 (83)	0.5 (83)	2.0 (85)	1.6 (82)
Infant mortality, per 1 000 live births	Number	1985	9.2 (84)	11.0	9.4	9.1 (83)	7.9	5.8 (86)	7.0 (86)	9.1	14.1	5.7	8.9	10.9	5.9 (84)	9.0	9.6 (86)	10.8	8.5 (86)	17.8	7.0 (84)	6.8	6.9	..	9.4	10.4 (86)	31.7 (83)
Wages and prices (average annual increase over previous 5 years)																											
Wages (earnings or rates according to availability	%	1988	5.3	4.5	2.7	3.8	6.0	7.9	4.8	3.8	17.2	..	6.4	7.9	2.9	..	2.0	8.9	9.4	16.4	9.3	8.0	..	..	8.4	2.8	96.5
Consumer prices	%	1988	7.1	2.8	3.0	4.2	4.6	5.1	4.3	1.2	18.1	25.7	4.6	7.1	1.1	2.3	1.0	11.3	6.9	15.6	7.8	5.9	2.1	47.8	4.7	3.5	101.3
Foreign trade																											
Exports of goods, fob*	Mill US $	1988	32 852	31 044	92 124[7]	111 600	27 108	22 176	167 508	323 244	5 484	1 416	18 576	128 484	264 864	..[8]	103 056	8 784	22 452	10 476	40 236	49 764	50 448	11 604	144 540	322 428	12 598
As % of GDP	%		13.3	24.4	58.8	23.0	25.2	21.1	17.6	26.9	10.4	23.8	57.2	15.5	9.3	..	45.1	21.0	25.1	25.1	11.8	27.4	27.5	16.4	17.6	6.7	20.0
Average annual increase over previous 5 years	%		10.3	15.0	12.1	8.7	11.0	12.1	12.0	13.8	6.6	13.7	16.6	12.1	12.5	..	9.8	10.2	4.6	18.0	15.3	12.6	14.5	15.2	9.5	9.9	9.5
Imports of goods, cif*	Mill US $	1988	33 276	36 564	92 436[7]	106 512	25 920	21 972	173 016	250 332	12 408	1 584	15 444	138 588	187 668	..	99 288	7 320	23 088	15 744	60 432	45 792	56 388	14 412	189 012	440 952	13 154
As % of GDP	%		13.4	28.7	59.0	22.0	24.1	20.9	18.2	20.8	23.6	26.7	47.5	16.7	6.6	..	43.5	17.5	25.8	37.8	17.8	25.2	30.7	20.4	23.0	9.2	21.0
Average annual increase over previous 5 years	%		12.4	13.5	10.8	11.6	9.7	11.3	11.3	10.4	7.6	14.1	11.0	11.5	8.3	..	10.4	6.5	11.4	14.2	15.8	11.9	14.1	8.9	13.7	11.3	6.0
Total official reserves[6]	Mill SDR's	1988	10 105	5 475	6 935[7]	11 437	8 000	4 733	18 849	43 486	2 690	216	3 780	25 798	71 879	..	11 945	2 132	9 510	3 810	27 550	6 310	17 985	1 758	32 773	27 305	1 774
As ratio of average monthly imports of goods	ratio		3.6	1.8	0.9	1.3	3.7	2.6	1.3	2.1	2.6	1.6	2.9	2.2	4.6	..	1.4	3.5	4.9	2.9	5.5	1.7	3.8	1.5	2.1	0.7	1.6

(*) 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-residentiel 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.*

EMPLOYMENT OPPORTUNITIES

Economics and Statistics Department, OECD

The Economics and Statistics Department of the OECD offers challenging and rewarding opportunities to economists interested in applied policy analysis in an international environment. The Department's concerns extend across the entire field of economic policy analysis, both macroeconomic and microeconomic, and it is also responsible for the collection, processing and dissemination of a wide range of internationally consistent statistics. On the economic side, its main task is to provide, for discussion by committees of senior officials from Member countries, documents and papers dealing with current policy concerns. Within this programme of work, three major responsibilities are:

- To prepare regular surveys of the economies of individual Member countries;
- To issue full twice-yearly reviews of the economic situation and prospects of the OECD countries in the context of world economic trends;
- To analyse specific policy issues in a medium-term context for the OECD as a whole, and to a lesser extent for the non-OECD countries.

The documents prepared for these purposes, together with much of the Department's other economic work and its statistical output, appear in published form in the *OECD Economic Outlook, OECD Economic Surveys, OECD Economic Studies,* the Department's Working Paper series, and an extensive list of statistical publications.

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The Department is made up of about 90 professional economists and statisticians from a variety of backgrounds from all Member countries. Most projects are done by small teams and last from four to eighteen months. Within the Department, ideas and points of view are widely discussed; there is a lively professional interchange; and all professional staff have the opportunity to contribute actively to the programme of work.

Skills ESD is looking for

a) Solid competence in using the tools of both microeconomic and macroeconomic theory to answer policy questions. In our experience this requires the equivalent of a PhD in economics or substantial relevant professional experience to compensate for a lower degree.

b) Solid knowledge of economic statistics and quantitative methods; this includes how to identify data, estimate structural relationships, apply and interpret basic techniques of time series analysis, and test hypotheses. It is essential to be able to interpret results sensibly in an economic policy context.

c) A keen interest in and knowledge of policy issues, economic developments and their political/social contexts.

d) Interest and experience in analysing questions posed by policy-makers and presenting the results to them effectively and judiciously. Thus, work experience in government agencies or policy research institutions is an advantage.

e) The ability to write clearly, effectively, and to the point. The OECD is a bilingual organisation with French and English as the official languages. Candidates must have excellent knowledge of one of these languages, and some knowledge of the other. Knowledge of other languages might also be an advantage for certain posts.

f) For some posts, expertise in a particular area may be important, but a successful candidate can expect to be asked to contribute in a broader range of topics relevant to the work of the Department. Thus, except in rare cases, the Department does not recruit narrow specialists.

g) The Department works on a tight time schedule and strict deadlines. Moreover, much of the work in the Department is carried out in small groups of economists. Thus, the ability to work with other economists from a variety of professional backgrounds, and to produce work on time is important.

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The salary for recruits depends on educational and professional background but positions carry a basic salary from FF 232 476 or FF 286 848 for Administrators (economists) and from FF 334 584 for Principal Administrators (senior economists). This may be supplemented by expatriation and/or family allowances, depending on nationality, residence and family situation. Initial appointments are for a fixed term of two to three years.

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For further information on employment opportunities in the Economics and Statistics Department, contact:

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