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May 25, 1983

To: Members of the Executive Board  
From: The Secretary  
Subject: Portugal - Recent Economic Developments

This paper provides background information to the staff report on the 1983 Article IV consultation discussions with Portugal, which was circulated as SM/83/88 on May 18, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. D. N. Lachman, ext. 60886.

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INTERNATIONAL MONETARY FUND

PORTUGAL

Recent Economic Developments

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Approved by the European Department

May 19, 1983

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# Basic Data

## Area and population

Area	34,312 square miles
Population (1981 estimate)	10 million
GDP per capita (1981 estimate)	US\$2,361

## Income and expenditure in 1981 (at current prices)

	In billions of escudos	In per cent
Private consumption	1,110	76
Public consumption	231	16
Gross capital formation	394	27
Exports of goods and services	386	27
Aggregate expenditure	2,121	146
Imports of goods and services	668	46
GDP at market prices	1,453	100

## Selected economic indicators (annual percentage change)

	1980	1981	1982 Estimate
Real GDP at market	4.9	1.8	3.3
Manufacturing output	6.0	1.5	3.2
Wage per man in manufacturing	23.5	19.8	22.5
Consumer prices	16.6	20.0	22.4
Unemployment rate (level)	7.8	8.2	7.2
Broad money, year-end	34.8	28.6	26.9
Domestic credit, year-end	28.2	28.6	26.5

## Public sector accounts (as per cent of GDP)

<u>General Government</u>			
Tax revenue	28.3	29.8	29.4
Current expenditure	33.5	36.3	34.6
Current balance	-3.5	-5.5	-3.8
Overall balance	-10.6	-11.4	-9.6

## Balance of payments (in millions of U.S. dollars)

Exports	4,575	4,089	3,997
Imports	8,781	9,251	8,927
Trade balance	-4,206	-5,162	-4,930
Net invisibles	2,955	2,452	1,615
Current account balance	-1,251	-2,710	-3,315
Medium- and long-term capital	718	1,282	2,186
Short-term capital	1,391	1,268	1,224
Overall balance	858	-160	95
Foreign exchange reserves, year-end	751	477	393
External debt outstanding, year-end	7,680	11,015	13,464
Gold, year-end (in millions of ounces)	22	22	22
Effective exchange rate (per cent change)	-3.4	-4.9	-12.1

Sources: Data provided by the Portuguese authorities; and staff estimates.



## I. Domestic Economy

### 1. Overview

Since 1979, the stance of financial policy in Portugal moved significantly out of phase with that of its main trade partners thereby contributing to a marked deterioration in the external accounts and to the maintenance of a rapid rate of inflation. Following the successful implementation of a stabilization program supported by the Fund in 1978, financial policies were relaxed at the end of 1979 with the objective of stimulating investment and of securing a recovery in real disposable income. The easier stance of demand management policy was accompanied by a strengthening of price controls and by a 6 per cent revaluation of the escudo in February 1980. In response to a considerable weakening in the external accounts, some restrictive monetary and fiscal measures were introduced in the second half of 1981. However, the overall stance of financial policies remained broadly accommodating in 1982 leading to a further deterioration in economic performance. Overall domestic credit expansion decelerated only marginally from 28 3/4 per cent in 1981 to 26 1/2 per cent in 1982, while the cash deficit of the General Government remained in the region of 10 1/2 per cent of GDP.

In reflection of the ease in financial policies, real domestic demand increased by 6 3/4 per cent in 1980 before decelerating to an estimated 4 1/4 per cent in both 1981 and 1982 (Table 1). Over this period, private consumption expenditure remained buoyant being sustained by a positive growth in real disposable income and by a sizable decline in the savings ratio probably related to the maintenance of negative real interest rates on most domestic financial assets. The growth of fixed investment, albeit decelerating, remained significantly positive in real terms reflecting the relative ease of credit conditions and the lack of effective control by the Government over the investment plans of the public enterprises. A further impetus to growth of domestic demand was provided by a sustained rebuilding of inventories spurred by the accommodating stance of credit policy as well as by adverse exchange rate expectations.

The rapid increase in real domestic demand in recent years far outstripped the corresponding increase in domestic supply. This in part reflected unfavorable domestic cost developments as well as the adverse effects of a prolonged and severe drought on the domestic supply of agricultural and energy products. These factors contributed to a marked deterioration in Portugal's real foreign balance. In reflection of a cumulative 24 per cent increase in import volumes over the past three years, the negative contribution of the foreign balance to GDP growth over these years averaged around 2 1/2 percentage points. As a result, real GDP growth slowed from an average 4 3/4 per cent in 1979 and 1980 to 1 3/4 per cent in 1981 and an estimated 3 1/4 per cent in 1982.

The rate of inflation as measured by consumer prices was reduced from 24 per cent in 1979 to below 17 per cent in 1980. In part this reflected favorable weather conditions and the postponement of certain administered price increases to the end of 1980. The subsequent administered price corrections, coupled with adverse weather conditions and continuous demand pressures, resulted in a pick-up in inflation to an average 20 per cent in 1981 and to 22 per cent in 1982. However, during the course of 1982 there was an appreciable moderation in inflation from around 25 per cent at the end of 1981 to 19 per cent by the end of 1982. This deceleration mainly reflected a moderation of food prices, delays in some administered price adjustments and a three-month wage-price freeze following the 9 1/2 per cent discrete devaluation in June 1982.

## 2. Developments in aggregate demand

Following a period of restraint in 1978 and 1979, when real domestic demand was constrained to an annual growth of around 1 per cent, domestic demand rebounded by 6 3/4 per cent in 1980 before decelerating to an estimated 4 1/4 per cent in both 1981 and 1982 (Table 1). This performance was in marked contrast to that of Portugal's main OECD trade partners where since 1979 on a cumulative basis domestic demand increased by only around 1 per cent. In contrast, the contribution of the external balance which had been positive at the equivalent of around 3 percentage points in both 1978 and 1979, was significantly negative between 1980 and 1982. This was in part the result of a relatively weak performance of exports which were adversely affected by the international recession, by some loss in competitiveness and by the continued application abroad of protective policies particularly against textile exports. However, more important was the rapid growth in import volumes induced by the high level of domestic demand and by unfavorable weather conditions in Portugal.

### a. Consumption

Following three years of slow growth averaging around 1 per cent a year, consumer expenditure rebounded by 5 per cent in 1980 before decelerating to an estimated 3 1/2 per cent in 1981 and 2 1/2 per cent in 1982. The upturn in consumer expenditure in 1980 mainly reflected a 4 per cent increase in real disposable income which resulted from a recovery in real wage earnings and from a strong expansion in government current transfers (Table 2). The subsequent deceleration in the growth of consumer expenditures in 1981 and 1982, was mainly due to a leveling off in the growth of real disposable income. In part this was a reflection of the stagnation in real wage earnings over the past two years as nominal wage increases barely kept pace with rising inflation. In addition, over the past two years there was a significant deceleration in the growth of government current transfers to households and an appreciable slowdown, particularly in 1982, of emigrants' remittances from abroad.

Since peaking at around 17 3/4 per cent in 1979, there has been a steady decline in the savings ratio of individuals to an estimated 11 1/4 per cent by 1982 (Table 2). In part, this decline may be attributed to the reduced share in disposable income of emigrants' remittances, which are generally characterized by a low marginal propensity to consume. Also important would appear to have been the decline of real interest rates on financial savings and increased anticipatory buying stimulated by rising inflationary expectations. This trend in consumer behavior was especially pronounced in 1981 on the purchase of durable consumer goods in general, and on color television sets and imported automobiles in particular. However, available indicators of consumer expenditure would suggest that the deceleration in overall consumer spending in 1982 was evenly distributed as between durable and nondurable goods.

On a national accounts basis, public sector consumption is estimated to have decelerated from an increase of 6 1/2 per cent in 1981 to around 3 1/2 per cent in 1982. This primarily reflected the authorities' increased efforts at controlling public sector recruitment and job up-grading.

b. Investment

Gross fixed capital formation which had declined by 1 1/2 per cent in 1979, rebounded by 9 per cent in 1980 before moderating to increases of 5 per cent in 1981 and 2 1/2 per cent in 1982 (Table 1). The relative strength in investment expenditures over the past three years was mainly due to investment by the private sector and the public sector enterprises. Private sector investment was supported by the relative ease of credit and by an improvement in the financial conditions of enterprises from their depressed situation at the end of the 1970s. An additional element of support was the introduction of a generous system of financial and fiscal incentives (SIII) which were granted on a selective basis according to sectoral and regional priorities. As regards the components of investment, investment in machinery and transport equipment was particularly strong as is suggested by the various indicators of the import and the domestic production of investment goods. In addition up until the end of 1981 housing investment was relatively buoyant being boosted by emigrant demand for housing, by public administration projects and by the more generous allocation of housing credits associated with various incentive schemes to encourage home ownership. The relative tightening in domestic credit to the private sector since the third quarter of 1981 has, however, contributed to a weakening in construction investment, with much of the activity in this sector reflecting the completion or continuation of work already under way. Preliminary indicators would suggest that in 1982 the main impetus to investment continued to come from investment in machinery and transport equipment.

Fixed capital formation by the public sector enterprises which currently accounts for around 25 per cent of total investment, is estimated to have decelerated strongly from a growth of 14 3/4 per cent in 1980 to 5 3/4 per cent in 1981 and to 2 per cent in 1982. This deceleration has

resulted from the sharp scaling back of investment plans of some public enterprises in view of the inadequate generation of self-financing and other nonbank sources of finance. The most significant increase in public enterprise investment continued to be concentrated on electricity, gas and water whereas the weakest areas were in the transport and communication sectors. There was also a deceleration in investment by the General Government which accounts for around 20 per cent of total investment. The brunt of the efforts made at curbing the growth of the public sector deficit was borne by public investment expenditures. As a result, the latter is estimated to have grown by around 2 per cent in 1981 and to have shown no growth in 1982.

As regards inventory accumulation, the increase in stocks contributed around 1 per cent to GDP growth in 1981 and a further 2 per cent in 1982. On the basis of surveys of industry and commerce, this accumulation appears to have been concentrated in the manufacturing sector and in particular in the textile, clothing, cork, wood and paper industries where external demand continued to be weak. In addition, there appears to have been a significant increase in speculative stockbuilding of imported goods. Stocks of agricultural products, on the other hand, were drawn down over the past two years as a consequence of the drought while stocks of petroleum products were reduced to more normal levels from their peak of around 120 days of imports at the end of 1980.

In reflection of the trends described above, the ratio of total gross investment (including stockbuilding) rose as a proportion to GDP from a low point of 22 1/4 per cent in 1979 to 27 per cent in 1981 and 28 1/4 per cent by 1982 (Table 3). Over this period, there was a marked change in the pattern of financing of this investment, with a substantially greater proportion being financed from abroad. As a proportion of GDP, external savings rose from less than one half a per cent in 1979 to 11 1/2 per cent in 1981 and 14 1/2 per cent by 1982. Correspondingly, domestic savings declined from a peak of 22 per cent of GDP in 1979 to less than 14 per cent by 1982. The major factor in this performance was the sharp decline in savings of private sector, including the public enterprises, which as indicated above was partly a reflection of rising inflationary expectations and low interest rates on financial savings.

### 3. Aggregate supply developments

The relatively rapid growth in Portugal's GDP of around 5 per cent in 1980, mainly derived from a domestic demand induced expansion of the manufacturing and construction sectors (Table 4). The subsequent deceleration in GDP growth to 1 3/4 per cent in 1981 was in a large measure the result of a slackening in manufacturing output and a poor performance in the agricultural sector. Manufacturing production in 1981 was adversely affected by a weakening in external demand and a deterioration in competitiveness, while agricultural production was severely affected by an intensification of drought conditions. Preliminary indications for 1982 suggest a recovery of GDP growth to around 3 1/4 per cent. To

a large degree this reflects some recovery in agricultural and hydro-electric production from their very depressed levels of 1981 as well as a pickup in manufacturing output resulting from a recovery in foreign market shares lost in the previous two years. The growth of the service sector, on the other hand, is estimated to have decelerated from around 4 1/2 per cent in 1981 to 2 1/2 per cent in 1982, reflecting both the falling off in tourist activity and the authorities' efforts to curb the growth in the size of the public administration.

a. Manufacturing

At 35 per cent of GDP, the Portuguese industrial sector is relatively larger than that of other Mediterranean countries and comparable to those of the EC countries. Historically this sector has been the key to Portugal's economic growth with metal products, machinery and equipment as the dynamic industries, though textiles, clothing and footwear have played an important role in total manufacturing exports. The main impetus to growth in this sector has been concentrated on a relatively small number of large and modern enterprises that have had access to credit and foreign technology. Nevertheless, small- and medium-sized firms account for the bulk of total output and for 90 per cent of manufacturing exports.

The recovery in industrial output that began in 1979 continued through 1980 in response to the general buoyancy of domestic demand. However, against the background of the deepening international recession, industrial production weakened toward the end of 1980. For 1981 as a whole industrial production increased by only 1 1/2 per cent mainly reflecting the weakening in external demand and the increase in undesired manufactured inventories (Table 5). Preliminary indications for 1982 suggest a moderate rebound in industrial growth to around 3 1/4 per cent led principally by a recovery of production in the heavy industries, in part reflecting the coming onto full stream of the petrochemical plant at Sines.

Over the past two years, the main support to industrial production was derived from the heavy industries which benefited from the more favorable domestic demand conditions and, in particular, from the relative strength in construction and investment demand. The subsectors recording the most favorable rates of expansion were those of mechanical machinery, electrical and transport material, and nonmetallic mineral products. In contrast, there was a relative contraction in the growth of the light industries which include a higher proportion of export-oriented industries. Particularly affected in this regard were the textile, paper, wood and cork industries. Moreover, food processing was adversely affected by the relatively poor performance in the agricultural sector.

b. Agriculture

Over the past three years, agricultural production in Portugal was severely effected by the adverse climatic conditions which prevailed over virtually the whole period. The intensification of the drought in 1981 was followed by extreme out-of-season frosts which had a severe impact on all wine, fruit and vegetable production. Overall crop production is estimated to have declined by 21 1/2 per cent in 1981 (Table 6). This decline was only in part offset by a 10 per cent increase in live-stock production which reflected an increased rate of slaughter induced by an unprecedented heatwave in June 1981. Preliminary indications for 1982 suggest a 24 per cent rebound in crop production reflecting a strong recovery in production of all crops from the very depressed levels of the previous year. However, despite this recovery, crop production in 1982 remained below trend in reflection of the continuation of drought conditions. At the same time, there was a small decline in livestock production suggesting an end to the cycle of reducing herds. In reflection of the above developments, overall agricultural production on a national accounts basis which declined by 6 per cent in 1981 is estimated to have increased by 6 per cent in 1982 (Table 4).

At present Portugal has the lowest agricultural production per unit of labor or land among the western European countries and the yields for most crops are substantially lower than those of Spain or Greece. The main causes of weakness are poor land use planning, especially in the south, technological backwardness, inadequate extension services, and the adverse effects on efficiency of the existing system of administered prices and subsidies. Studies of the Portuguese agricultural sector show, however, that if certain policy steps were taken, there would be good prospects for major advances in food production. With a better use of agricultural land and of installed irrigation facilities, as well as appropriate fertilizer use, various livestock-crop production combinations could be developed that could bring agricultural yields to the levels prevailing in other Mediterranean countries.

4. Developments in the labor market

a. Employment

Shortcomings in the labor market statistics, together with major institutional changes since the revolution, complicate the analysis of employment trends in Portugal. In addition, the post revolution legislation intended to protect employment has had the effect of limiting labor shedding during economic slowdowns and similarly reducing the need for hiring during upturns. As a result, variations in employment since 1974 have been considerably narrower than the corresponding swings in economic activity. Estimates of the rate of unemployment vary widely from that of the National Institute of Statistics' (NIS) estimate of 7.2 per cent based on a survey in the first half of 1982, to estimates of around 13 per cent from other sources.

Based on NIS employment surveys, it would appear that the improving trend in the labor market associated with the economy's growth since 1979 came to an end in the first half of 1982. Thus, following a cumulative 5 percentage point growth in employment between 1979 and 1981, employment declined by 3/4 per cent in the first half of 1982 (Table 7). As regards the sectoral trends in employment, the service sector which had provided the main impetus to employment growth since 1979, continued to provide the main support to employment in 1982. However, significant declines were recorded in employment in construction and manufacturing, particularly in the food and nonmetallic industries. Despite the fall in employment the overall rate of unemployment is estimated to have declined to 7.2 per cent in the first half of 1982 or well below the corresponding average for the OECD countries. This decline mainly reflected a sharp drop of around 2 per cent in the activity rate. It is not however clear to what extent this might simply reflect a statistical aberration resulting from the sampling procedures used by the NIS, rather than more fundamental underlying demographic factors such as the continued aging of the population.

b. Wages

Following the use of mandatory wage ceilings during the stabilization program of 1977 and 1978, over the past three years wage policy was conducted on the basis of wage guidelines. These guidelines were set in line with the official targets for inflation of 17 per cent in 1981 and 19 per cent in 1982. The authorities also tried to influence wage negotiations in the private sector by limiting increases in civil servants' salaries to rates below the general guidelines. Available information on overall wage developments in the last two years would suggest that the guidelines were significantly exceeded as inflation picked up but that wage increases over this period were broadly in line with inflation. As regards the sectoral behavior of wages, in the manufacturing sector wages rose by 20 per cent in 1981 and by 22 1/4 per cent in the first three quarters of 1982 while in agriculture wage increases accelerated from 16 1/2 per cent in 1981 to 22 per cent in 1982 in reflection of the better conditions prevailing in that sector (Table 8). In contrast wage increases in construction are estimated to have decelerated from 24 1/2 per cent to 18 1/2 per cent in line with the slowdown characterizing this sector.

For 1983 the authorities have set a 17 per cent limit on wage increases for purposes of authorizing increases in prices subject to the various regimes of administrative control. In addition it is envisaged that wage increases in excess of the 17 per cent limit would be subject to a surcharge in the rate of social security contributions at the rate of 30 per cent for the employer and 30 per cent for the employee. This surcharge would not apply if the wage increase in excess of the target was paid in the form of a nonnegotiable Treasury bond with five-year maturity. If the wage guideline for 1983 were to be met, it would imply a significant fall in the real wage following two years in which they were virtually unchanged.

5. Developments in prices

Against the background of strong pressures of aggregate domestic demand, inflation as measured by consumer prices picked up from an average 16 1/2 per cent in 1980 to 20 per cent in 1981 and to 22 1/2 per cent in 1982 (Table 9). The initial acceleration in inflation in 1981 reflected to a considerable degree the delayed increases made in administered prices (essentially for food, energy and transport products) as well as an easing in the system of price controls. <sup>1/</sup> Among these changes were a reduction in the weight of food products in the "family basket" whose prices are set administratively and the raising of the turnover threshold above which firms must declare their prices. The relaxation of these controls, together with the reduced supply of foodstuffs occasioned by the drought and the increase in the local currency cost of imports stemming from the depreciation of the escudo vis-à-vis the U.S. dollar, had a particularly strong impact on food prices which constitute over 50 per cent of the consumer price index. By the end of 1981 the price of food products increased on a 12-month basis by 28 per cent while the nonfood component of the index rose by around 22 per cent.

Although the average rate of inflation was higher in 1982 than in 1981, during the course of the year there was an appreciable deceleration to around 19 per cent by year-end. The deceleration in the overall price index largely mirrored that in food prices which benefited from a somewhat better agricultural year as well as from a moderation in international commodity prices. Nonfood prices, on the other hand, showed little deceleration. The deceleration in inflation also reflected the fact that the increases in administered prices and the reductions in subsidies that were made in 1982 were largely concentrated at the beginning of the year. Moreover, following the 9 1/2 per cent effective devaluation in June, prices were frozen through August while administered price increases were delayed until the end of the year and the beginning of 1983. In reflection of the subsequent administered price corrections, inflation picked up to reach 20 1/2 per cent on a 12-month basis by February 1983.

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<sup>1/</sup> The widespread system of price controls in Portugal is described more fully in the Recent Economic Development report on Portugal of May 1982 (SM/82/95, 5/17/83), p. 9.

Table 1, Portugal: National Accounts at Constant Prices, 1970-82

	1981	1970-73 Annual average percentage change	1974	1975	1976	1977	1978	1979	1980	1981	1982 Est.
Composition of expenditures			Percentage change								
Gross domestic expenditures	119.3	9.6	6.3	-8.9	7.1	7.3	0.3	1.6	6.7	4.3	4.3
Private consumption	76.3	9.7	9.7	-0.9	3.5	0.6	0.4	1.7	5.0	3.5	2.5
Public consumption	15.9	7.6	17.3	6.6	7.0	11.7	6.0	5.2	2.7	6.6	3.5
Investment	27.1	10.8	-8.5	-45.3	29.6	34.7	-4.7	-2.1	14.7	5.1	9.8
Of which:											
Gross fixed capital formation	22.2	10.9	-7.0	-11.3	0.8	12.0	4.0	-1.6	9.0	5.0	2.6
Exports of goods and services	26.5	10.9	-15.7	-15.6	--	5.9	14.6	27.3	8.3	-1.5	3.5
Imports of goods and services	45.9	13.2	4.8	-25.2	3.4	12.0	-1.8	7.8	12.8	3.1	6.0
GDP at market prices	100.0	8.6	1.1	-4.3	6.9	5.6	3.2	4.5	4.9	1.8	3.3
Memorandum items:											
Partner countries' real GNP <u>1/</u>	...	4.8	0.6	-1.3	4.2	2.8	3.2	3.2	0.9	-0.2	-0.1
GDP deflator	...	7.4	19.4	15.8	15.4	26.1	20.2	22.0	15.7	18.3	22.1
Savings ratio <u>2/</u>	...	24.8	19.5	14.1	14.3	13.2	16.6	17.7	15.8	12.9	11.2
Contribution to growth rate of: <u>3/</u>											
Domestic expenditure	...	10.2	6.9	-10.2	7.9	8.0	0.3	1.8	7.3	4.9	5.1
Of which:											
Changes in stocks	...	0.4	-0.8	-8.5	3.8	3.7	-1.6	-0.1	1.5	1.0	2.1
Foreign balance	...	-1.5	-5.8	5.9	-1.0	-2.3	3.2	3.2	-2.4	-3.1	-1.8

Sources: Bank of Portugal, Annual Report; National Institute of Statistics, Monthly Bulletin of Statistics; data provided by the Portuguese authorities; and staff estimates.

1/ Industrial countries, trade-weighted.

2/ Household savings as a proportion of disposable incomes.

3/ Change in constant prices as a percentage of previous years' GDP.

Table 2. Portugal: Disposable Income of the Personal Sector, 1976-82

(In billions of escudos) 1/

	1976	1977	1978	1979	1980	1981	1982 Estimate
National income	398.4 (20.9)	529.1 (32.0)	664.0 (25.5)	832.6 (28.5)	991.4 (19.1)	1,158.3 (16.8)	1,438.0 (24.1)
Plus public debt interest (internal)	4.6	9.4	20.5	28.5	38.8	79.7	101.0
Plus government current transfers (net)	50.2 (80.6)	60.9 (21.3)	73.9 (21.3)	79.6 (7.7)	120.3 (51.1)	147.4 (22.5)	181.0 (22.8)
Plus private transfers from abroad (net)	29.8 (8.9)	43.5 (45.6)	72.6 (67.0)	121.3 (66.6)	150.1 (23.7)	179.1 (19.3)	211.0 (17.8)
Less income from government sector property and enterprises	4.7	5.7	11.1	18.3	21.5	14.3 )	
Less profits of public enterprises )						)	85.0
Less undistributed profits of private ) companies )	-5.6	14.6	25.0	35.0	40.0	55.0 )	
Less direct taxation, including social security contributions	55.7 (18.2)	80.9 (45.2)	103.6 (28.1)	124.0 (19.7)	168.1 (35.6)	220.8 (31.4)	278.0 (25.9)
Equals disposable income	428.4 (22.1)	541.7 (26.5)	691.3 (26.1)	884.7 (30.5)	1,061.4 (20.0)	1,274.4 (20.1)	1,568.0 (23.0)
Less private consumption expenditure	367.2 (20.4)	470.2 (28.5)	576.4 (22.1)	727.8 (26.3)	893.5 (22.8)	1,109.7 (24.2)	1,393.0 (25.5)
Equals individuals' savings	61.2	71.5	114.9	156.9	167.9	164.7	175.0
<u>Memorandum item:</u>							
Savings rate	14.3	13.2	16.6	17.7	15.8	12.9	11.2

Sources: Bank of Portugal; Central Planning Department; and staff estimates.

1/ Figures in parentheses represent percentage rates of growth.

Table 3. Portugal: Flow of Funds, 1978-82

(As per cent of GDP)

	1978	1979	1980	1981	<u>1982</u> Estimate
Investment	23.3	22.3	25.7	27.1	28.3
Gross fixed capital formation	(20.1)	(19.1)	(20.9)	(22.2)	(22.1)
Stocks	(3.2)	(3.2)	(4.8)	(4.9)	(6.2)
Savings	23.3	22.3	25.7	27.1	28.3
Foreign savings <u>1/</u>	4.6	0.3	5.2	11.5	14.5
Domestic savings	18.7	22.0	20.5	15.6	13.8
Public sector	(-3.3)	(-3.8)	(-3.5)	(-5.5)	(-3.8)
Private sector	(22.0)	(25.8)	(24.0)	(21.1)	(17.6)
<u>Memorandum item:</u>					
Remittances from abroad	9.3	12.0	12.1	12.0	11.2

Sources: Bank of Portugal; and IMF staff estimates.

1/ External current account balance.

Table 4. Portugal: Origin of Gross Domestic Product, 1974-82

	1981 Percentage of total	1974	1975	1976	1977	1978	1979	1980	1981	1982 Est.
		Percentage changes at constant prices								
Agriculture <sup>2/</sup>	11.9	-2.1	-1.9	-1.5	-10.0	4.0	9.0	3.0	-6.0	6.0
Mining	0.6	14.8	2.9	-14.3	15.3	1.2	10.0	5.3	-1.1)	3.3
Manufacturing	34.7	3.1	-9.7	4.5	9.4	3.3	4.9	6.0	1.5)	
Electricity, gas and water	2.2	13.9	3.2	0.3	20.0	5.2	6.5	-2.0	-5.0	10.0
Construction	6.5	3.5	-15.8	5.0	11.0	4.7	-4.0	9.0	4.0	2.0
Services	30.8	-4.5	-5.3	7.7	5.8	1.2	2.9	5.2	4.1)	2.5
Public administration	13.2	15.0	30.9	18.6	7.0	4.0	6.0	3.1	6.2)	
GDP at factor cost	100.0	1.8	-2.7	6.1	5.6	3.1	4.5	4.9	1.8	3.3
GDP, excluding public administration	86.8	0.5	-6.0	4.6	5.4	2.9	4.3	5.2	1.2	...

Sources: National Institute of Statistics, Monthly Bulletin of Statistics; Bank of Portugal, Annual Report, 1981; Grandes Opcoes do Plano for 1983; data provided by the Portuguese authorities; and staff estimates.

<sup>1/</sup> Provisional estimates.

<sup>2/</sup> Includes forestry and fishing.

Table 5. Portugal: Gross Value Added in Manufacturing Industry, 1974-82

	1981 Proportion of total manufacturing	1974	1975	1976	1977	1978	1979	1980	1981	1982 Jan.-Oct.
		Percentage change								
Food, beverages, and tobacco	15.5	7.5	4.1	1.2	6.4	6.0	-1.5	-1.0	5.5	-3.2
Textiles, clothing, and shoes	21.3	12.9	-14.1	6.4	-3.9	--	14.0	8.0	-2.3	1.2 <u>2/</u>
Wood, cork, and furniture	5.0	1.6	-26.4	-0.4	11.3	-0.5	7.0	--	-6.2	-5.1 <u>3/</u>
Paper and paper products	8.6	6.4	-15.3	1.3	6.2	-6.0	12.0	8.5	4.5	1.7 <u>4/</u>
Chemicals	11.2	0.1	-9.3	7.4	12.6	4.5	8.6	-1.0	-4.0	8.7
Nonmetallic mineral products	9.7	3.6	-1.3	8.9	15.0	7.5	-3.0	7.0	4.2	3.5
Base metals	3.1	-14.4	-13.6	20.5	21.5	20.5	-5.0	10.5	-3.7	20.5
Mechanical, electric, and transportation products	24.5	-3.9	-8.4	-0.2	16.6	4.5	--	13.0	6.1	10.6
Miscellaneous	<u>1.0</u>	<u>-3.3</u>	<u>-9.5</u>	<u>19.8</u>	<u>30.0</u>	<u>-8.0</u>	<u>6.0</u>	<u>1.0</u>	<u>4.7</u>	<u>...</u>
Total	100.0	3.1	-9.7	4.5	9.4	3.3	4.9	6.0	1.5	4.3

Sources: Bank of Portugal, Annual Report, 1980; and data provided by the Portuguese authorities.

1/ On basis of first three quarters of 1981.

2/ Not including clothing and shoes.

3/ Not including furniture.

4/ Not including paper products.

Table 6. Portugal: Agricultural and Livestock  
Production in Continental Portugal, 1978-82

(Percentage change)

	1978	1979	1980	1981	<u>1982</u> Est. 1/
Total agriculture and livestock	8.7	13.4	-1.2	-1.1	7.2
Agriculture	5.6	22.9	-13.1	-21.5	24.1
Cereals	11.3	1.4	23.7	-23.7	21.2
Root crops	-2.0	-9.3	15.1	-30.4	18.6
Vegetables	-5.1	-12.4	-17.0	-14.1	9.0
Wine	-3.4	121.1	-44.3	-12.1	10.4
Olive oil	34.3	42.3	2.7	-27.9	170.9
Fruit	2.6	-0.4	18.1	-18.4	23.3
Livestock	12.2	0.7	21.8	10.0	-2.7
Meat	9.7	-9.2	15.6	9.7	-10.1
Dairy products	20.8	18.5	-16.5	7.2	15.1
Eggs	11.1	13.9	-1.2	85.9	-26.4

Source: Bank of Portugal.

1/ Provisional figures.

Table 7. Portugal: Selected Labor Market Indicators, 1977-82

	1977	1978	1979	1980	1981	1982 Estimate <sup>1/</sup>
	(Percentage change)					
Total resident population	0.9	0.4	1.4	0.7	1.0	0.5
Civilian labor force	1.1	0.3	2.2	1.4	1.6	-2.3
Total employment	-0.5	-0.3	2.1	1.9	1.1	0.7
	(In per cent)					
Participation ratio	44.7	44.6	45.0	45.3	45.6	44.9
Male	57.0	56.7	56.1	56.2	55.5	54.7
Female	33.1	33.8	35.0	35.5	36.7	36.1
Overall unemployment rate	7.5	8.2	8.2	7.8	8.2	7.2
Male	5.9	5.5	4.9	4.1	4.4	3.4
Female	10.1	12.1	13.0	13.0	13.5	12.6

Source: National Institute of Statistics.

<sup>1/</sup> Based on available indicators for the first half of 1982.

Table 8. Portugal: Selected Wage Indicators, 1974-82

	<u>Manufacturing</u>		<u>Construction</u>		<u>Agriculture</u>	
	Nominal wages	Real wages	Nominal wages	Real wages	Nominal wages	Real wages
<u>(Annual percentage change)</u>						
1974	45.4	13.7	48.1	15.8	35.2	5.7
1975	32.9	10.3	30.2	8.1	27.5	5.9
1976	18.7	0.5	11.4	-5.8	14.1	-3.4
1977	16.4	-8.7	14.1	-10.3	16.1	-8.9
1978	15.3	-5.5	14.7	-6.0	16.0	-5.0
1979	19.0	-4.2	19.4	-3.9	22.0	-1.7
1980	22.0	4.6	25.7	7.8	18.8	1.9
1981	20.0	--	24.5	3.9	16.4	-3.0
1982 (estimate)	22.3 <u>1/</u>	-2.7 <u>1/</u>	18.6 <u>2/</u>	-4.5 <u>2/</u>	21.9	-0.4
<u>(Percentage change over corresponding quarter of previous year)</u>						
1981						
Fourth quarter	21.5	-2.6	25.3	0.2	18.1	-5.5
1982						
First quarter	21.7	-3.0	15.3	-8.0	20.8	-3.7
Second quarter	22.8	-2.4	19.7	-4.8	20.5	-4.2
Third quarter (estimate)	...	...	20.6	-0.6	22.3	0.8
Fourth quarter (estimate)	...	...	...	...	23.7	3.9

Source: Bank of Portugal.

1/ First six months of 1982.

2/ First three quarters.

Table 9. Portugal: Consumer Prices, 1977-82

	<u>Total</u> Excluding housing rents	Food and Drink	Clothing and Footwear	Housing	Other
<u>(Annual percentage change)</u>					
1977	27.3	31.9	18.7	26.5	19.7
1978	22.1	22.4	19.5	23.8	21.1
1979	24.2	28.0	25.1	13.1	19.0
1980	16.6	10.4	34.4	26.3	21.6
1981	20.0	19.5	20.5	20.4	20.7
1982	22.4	24.1	15.6	20.1	22.7
<u>(Percentage over corresponding quarter of previous year)</u>					
1981					
First quarter	15.3	10.2	28.8	23.3	18.4
Second quarter	17.7	16.4	23.0	20.1	17.2
Third quarter	21.8	22.7	19.3	20.1	21.1
Fourth quarter	24.8	27.7	16.9	15.8	25.3
1982					
First quarter	25.4	30.1	14.3	19.1	22.6
Second quarter	25.8	28.8	16.1	21.0	25.4
Third quarter	21.3	21.5	18.3	21.3	22.4
Fourth quarter	19.0	18.8	18.6	20.7	19.1

Sources: Bank of Portugal; and National Institute of Statistics.

## II. Public Finance

### 1. Structure and main trends in the public sector

The structure of the public sector in Portugal is characterized by a complex interaction of the Administrative Public Sector (General Government) with a large number of public enterprises, which have played an increasingly important role in the Portuguese economy since the 1974 revolution. The Administrative Public Sector comprises the State, the Autonomous Funds and Services of the Central Government, the Social Security Administration, and local authorities. <sup>1/</sup> All of these entities have their own budgets, but significant flows of transfers occur among them. "Public enterprises", many of which were the result of the 1975 nationalization, is a loose term encompassing legal bodies under a variety of statutory forms, with at least partial government participation. Currently, there are 56 Nonfinancial Public Enterprises (NPEs), which include some of the largest companies in the country in terms of sales and value added, although not necessarily in terms of employment. Their principal activities include public services (mainly transport and energy), and manufacturing (chemicals, steel, shipbuilding, cement, and petroleum refining and distribution).

During the early years of the post-revolutionary period, the public sector grew rapidly in response to social policy objectives. General Government and public enterprises became responsible for income distribution and employment policies. The public sector bore the burden of the broadening of coverage by the social security system, of the creation of unemployment insurance, and of improvements in the general level of pensions. In addition, both the public administration and the public enterprises assumed responsibility for absorbing the reflow of emigrants from former colonies and for supporting subsidized prices for certain essential goods and services. For the past three years, expenditures of the General Government have hovered at over 40 per cent of GDP (Table 10). Among current outlays, the rate of growth of public consumption has decelerated from 26 per cent in 1980 to 24 per cent in 1981 and to under 20 per cent in 1982. Similar trends have been experienced in subsidies to enterprises and other current transfers. On the other hand, interest payments have registered high rates of growth, including a doubling in 1981, as a result of enlarged fiscal deficits, the continuation of high interest rates on external debt, and compensations in connection with post-1974 nationalizations. In the area of capital outlays, the growth of fixed investment expenditure has markedly decelerated from 36 per cent in 1980 to 26 per cent in 1981 and to 13 per cent in 1982. The most dynamic category in this area has been capital transfers, which doubled in 1979, rose by over 30 per cent in 1981 and doubled again in 1982.

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<sup>1/</sup> The coverage of the Administrative Public Sector in this report excludes the activities of the Highway Authority, the Housing Development Fund, the Sines Industrial Complex, the National Lottery, port administrations, as well as those of the autonomous regions of Azores and Madeira.

The fluctuations in this item reflect not only the changing financial requirements of public enterprises and other peripheral public entities, but also a policy of offsetting through capital transfers the declining trend in subsidy payments.

The deficits of the General Government, which in the past few years have oscillated at over 10 per cent of GDP, have been the result not only of the steady increase in current expenditures, but also of the insufficient response of the tax system to various discretionary measures adopted by the Government in its effort to curtail the growing fiscal imbalances. Taxes on income and property have accounted for less than half of total revenue in recent years and this share has shown a declining trend. The system of direct taxation is relatively inelastic due to its administrative complexity; personal income taxes are still collected from a schedular scheme based on different categories of incomes. The Government has attempted to compensate for such rigidities through the introduction of layered surcharges and tax rate increases, but, not surprisingly, few beneficial effects have emerged. As incentives were eroded and taxpayer compliance was undermined, the authorities have shifted since 1980 the emphasis toward tax administration and enforcement--a campaign that, for the following two years, yielded satisfactory results. In terms of instrument choice, however, it still remains true that the authorities prefer to adopt marginal measures, while the need for a full-fledged tax reform becomes increasingly pressing.

An increasingly worrisome example of the complex interactions among public sector entities is provided by the case of the Supply Fund (one of the Autonomous Funds) and the enterprises that distribute subsidized goods. The purpose of the Supply Fund, which was originally intended to be financially self-sufficient, is to raise revenue--almost exclusively from the taxation of petroleum products--to subsidize public enterprises such as EPAC for cereals, QUIMIGAL for fertilizers, PETROGAL for industrial fuels, and some other minor enterprises. As the revenue of the Fund proved progressively inadequate to finance the subsidized commodities (or, alternatively, as the prices of those products were not adjusted in time to changing economic conditions), it became necessary for the Supply Fund to receive transfers from the State Budget. Eventually, the transfers themselves turned out to be inadequate and the Supply Fund began to accumulate arrears vis-à-vis the distributors, which in turn accrued commensurate deficits. This complex scheme has resulted in the emergence of public sector deficits that are not adequately reflected in General Government's operations, and which, therefore, obscure the real magnitude of General Government's financial needs. Since there are no reliable and consistent statistics on the operations of the consolidated public sector, a global view can only be obtained through monetary statistics. On that basis, the public sector's borrowing requirement, which stood at around 16 per cent of GDP in 1978 and 1979, is estimated to have reached nearly 22 per cent of GDP in 1982 (Table 10). <sup>1/</sup>

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<sup>1/</sup> Even this figure is probably an underestimate of the true magnitude of the public sector's deficit to the extent that arrears have been accumulated by some public entities vis-à-vis private suppliers.

In addition to the emergence of large government deficits, the mode of financing has changed substantially in the past few years. After a gradual increase through 1981, the share of external financing rose sharply in 1982 and is expected to increase further during the current year (Table 11). Also, several NPEs have increasingly resorted to external borrowing with the permission and, often, the encouragement of central government authorities in order to finance not only investment projects, but also imports of essential consumer goods. In 1981 the external financing of the NPEs' deficit was 69 per cent of their total borrowing requirement, and in 1982 it is estimated at 67 per cent--a very sharp increase from 16 per cent in 1978 (Table 11). The switch in the mode of financing has been from the domestic banking system to external borrowing, with virtually no recourse to domestic borrowing from the nonbank public. This limited access of government to local financial markets implies that government deficits have a direct impact on primary liquidity in the economy, which, in turn, is the principal factor for sustaining high levels of aggregate demand and for promoting concealed capital outflows.

## 2. Developments in 1982

### a. The General Government and the State

The primary objective of the 1982 general government budget was to reverse the deteriorating trend of public finances. The Government's effort was reflected both in the targeted magnitude of the deficit, as well as in the timing of the budget implementation. For the first time in five years the budget was approved by Parliament prior to the beginning of the fiscal year and envisaged a reduction in the overall deficit of the General Government from 11.4 per cent of GDP in 1981 to 8.4 per cent of GDP in 1982. This 3 percentage point reduction would have resulted from a 2 percentage point cut in current expenditure and a 1 percentage point increase in revenue.

Despite the timely implementation of the 1982 budget, the fiscal outturn for the year did not measure up to policymakers' expectations. According to preliminary estimates, which are especially tentative as regards local authorities' operations, the overall balance of General Government (on a national accounts basis) registered a deficit of Esc 176.7 billion, equivalent to 9.6 per cent of GDP and 14 per cent higher than the budget estimate of Esc 154.5 billion. The deficit on a cash basis, which is a more meaningful measure of the fiscal impact on aggregate demand and liquidity creation, rose to Esc 196.3 billion, equivalent to 10.7 per cent of GDP and 23 per cent higher than the original estimate of Esc 159.5 billion (Tables 12 and 15). In contrast with past experience, the higher-than-anticipated deficits reflect not only expenditure overruns, but also a shortfall in revenue collections compared with budget estimates.

On the revenue side, current receipts were almost Esc 5 billion lower than the budgeted amounts. Although taxes on income and property

surpassed budget projections by 8.8 per cent, indirect tax yields and social security contributions--which together account for over 70 per cent of revenues--fell short of budget estimates by nearly 4 per cent (Table 12). A strong performance of direct taxes was offset by the shortfall in indirect tax revenue which occurred despite rate increases in stamp taxes and in the tobacco excise tax, as well as the introduction of a tax on entertainment by business firms and a surcharge on short-term credit operations. There is indirect evidence that evasion in the turnover tax continues at a relatively high rate, despite stepped-up efforts of enforcement. Nontax revenue was virtually unchanged with respect to initial projections, but was sharply higher than in 1981 mainly in reflection of higher transfers from the Bank of Portugal to the budget. Capital revenue exceeded budgetary projections by nearly Esc 5 billion, but this was due to the transfer of interest receipts from a special Treasury account to the general state budget upon authorization by the Minister of Finance (Tables 12 and 14).

On the expenditure side, current outlays exceeded the budget estimate by 4.2 per cent, whereas capital expenditures (including net lending), registered a smaller increase than the corresponding budget authorization. In broad terms, the Government was successful in containing the growth of public consumption to under 20 per cent over 1981, or Esc 1.6 billion more than the budgeted amount. The growth of health care expenses also decelerated as a result of the an increase in user fees, which were approved by Parliament amidst considerable political controversy (Tables 12 and 13).

As regards other current outlays, the 1982 fiscal outcome was less satisfactory. The 27 per cent reduction in current subsidies and the marginal increase in capital transfers to enterprises envisaged in the 1982 budget did not materialize. Instead, subsidies rose by 10 per cent and capital transfers practically doubled (Table 12). In view of the fact that capital transfers are often used to cover operating losses, the considerable overruns in these outlays are largely a reflection of the failure to take adequate corrective steps, including administered price adjustments, with respect to the finances of public enterprises and of the Supply Fund. The current and capital transfers of the State budget to the Supply Fund totaled almost Esc 21 billion instead of the budgeted Esc 15 billion (Tables 12 and 13). On a national accounts basis the Fund showed a marginal surplus of Esc 0.6 billion, but continued to accumulate arrears vis-à-vis the supplying enterprises, which in 1982 are estimated to have risen by over Esc 20 billion.

Capital expenditures of the General Government in 1982 fell short of budgetary appropriations by more than Esc 3 billion. While government fixed capital formation increased by merely 13 per cent in nominal terms over 1981, capital transfers and net lending rose by 58 per cent and exceeded the budgetary allocation by 33 per cent (Table 12).

The Esc 196.3 billion cash deficit that emerged from General Government's operations in 1982 is equivalent to 10.7 per cent of GDP and represents a drop of less than 1 percentage point compared with

the corresponding outcome in 1981. 1/ The overall public sector borrowing requirement is estimated to have increased last year to 21.8 per cent of GDP, which represents an all-time high (Table 11).

The overshoot in the cash deficit by 23 per cent over budget projections was mainly financed by external borrowing, which exceeded budgetary appropriations by 65 per cent, also in reflection of the continuing devaluation of the escudo vis-à-vis the U.S. dollar. It was also financed by an overrun of 20 per cent in domestic bank financing, which was due to a greater participation in the interbank bond market by commercial banks, although as a proportion of total financing this instrument declined for a third year in a row. Gross borrowing from the nonbank public was 30 per cent below the programmed level and resulted in an overall net amount of Esc 2.9 billion, the lowest in the recent past. The obvious lack of attractive alternatives in terms of government securities for the nonbank public underscores the need for a structural change in the mode of financing of the public sector deficit (Table 15).

b. Other sectors

In 1982 the operations of the Autonomous Funds 2/ resulted in a deficit of Esc 1 billion, which represented a substantial decline compared with the deficits of over Esc 5 billion registered in 1980 and 1981. It must be noted, however, that the consolidated accounts of this sector do not fully reflect the deficits of some autonomous funds, especially that of the Supply Fund, due to the accumulation of arrears toward their suppliers, who, in turn, are compelled to expand their own deficits. 3/ Current revenue of this sector in 1982 increased by 15 per cent and exceeded budgetary projection by over Esc 2 billion, mainly thanks to receipts from indirect taxes collected by the Supply Fund (notably levied on petroleum products) which rose by 29 per cent. The Supply Fund also received Esc 21 billion in transfers from the State Budget instead of the budgeted amount of Esc 15 billion. On the other hand, subsidies extended by the Supply Fund for industrial fuel, fertilizers, cereals, milk and sugar were the main factor behind an 11 per cent overrun in current expenditures compared with the budget estimate. As a result, the current surplus of

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1/ The major adjustment factor between the deficit on a national accounts basis and on a cash basis is Treasury operations, the importance of which has grown significantly in the last two years. Treasury operations are in essence loans extended by the Treasury to Autonomous Funds or other extrabudgetary entities over and above authorizations covered by the supplementary budget. If properly classified, they should become part of net lending.

2/ The Autonomous Funds include the Supply Fund, the Unemployment Fund, the Tourism Fund, the Special Fund for Overland Transportation, the Fund for the Renovation of the Fishing Industry, and the Fund for the Renovation of the Merchant Marine.

3/ The operations of the Supply Fund were recently reviewed by an auditing firm with a view to reconciling any discrepancies between its accounts and those of the corresponding public enterprises.

Esc 13.6 billion, although almost double the 1981 amount, fell short of budget projections by over Esc 6 billion. The overall negative balance is due to capital outlays and, in particular, to transfers from the Unemployment Fund to the State budget for the financing of investment expenditures, and also to loans from the Unemployment Fund, the Tourism Fund and the Fund for Overland Transportation for projects in the area of unemployment policy and in the tourist and transport sectors (Table 16).

The Autonomous Services in 1982 developed into a major drain of the public sector's financial resources, with an overall deficit of Esc 6.1 billion, almost eight times higher than in 1981 and twice as high as the original budget estimates. The deterioration of their finances reflect developments in their current account: compared with 1981, expenditures rose by nearly 11 per cent but revenue increased by only 2.3 per cent, thus shifting the current balance from a surplus into a deficit--the first time in the recent past. Over 75 per cent of current outlays represent expenditures on wages, salaries, goods and services, the greatest part of which is absorbed by health care services. The widening of the deficit occurred despite the fact that the 11 per cent increase in current expenditures represents a significant reduction over the average increase of over 30 per cent registered in the previous two years. This deceleration probably reflects the moderation of health care outlays after the introduction of user fees for medical services and hospitals in January 1982. Nonetheless, nearly all of current revenue for this sector is accounted for by transfers from the rest of General Government, which have not kept up with the growth of expenditures (Table 17). It should also be noted that in 1982 the National Health Service was the recipient of Esc 4 billion in the form of Treasury operations, which suggests a higher cash deficit than the one indicated by the National Accounts statistics.

Next to State, the Social Security Administration is the most important subsector in respect both of revenue collected and of expenditure disbursed. Developments in this area broadly reflect the Government's policy of accommodating new entrants under the expanded coverage of the system after 1974, and of keeping benefits constant in real terms. Thus, expenditures on benefits in 1982 rose by over 24 per cent in reflection of both a higher number of beneficiaries and of an increase in family allowances and in benefits under Old-Age, Survivors and Disability insurance. On the other hand, social security taxes rose by 23 per cent, broadly in line with the estimated average rise of wages and salaries during the year. The overall balance stood at a deficit of Esc 7.5 billion, in continuation of the upward trend of recent years (Table 17). Appendix II provides an analysis of the structure and developments of the Social Security System since 1974.

Despite its relatively small size, the local government subsector has become an important factor in the activities of general government. Its overall surplus of the mid-1970s declined progressively through 1980 and turned into a deficit in 1981, which continued to grow in 1982. According to preliminary estimates, last year the deficit stood at

Esc 5.6 billion, because of a continuing divergence between receipts and expenditures in the capital account that was only partially offset by the current account surplus, which has remained at about the same level for the past three years (Table 19). The principal factor behind the stagnation of the current surplus has been the rapid expansion of public consumption, which in the past two years rose at an annual rate of 32 per cent. This development is primarily due to the fact that the hiring freeze for civil servants did not apply to the local sector. In parallel, although the finances of local authorities are subject to inspection by the Ministry of Finance, the lack of timely data on their activities renders the control of their expenditures very difficult. The major source of revenue for local governments is transfers from the rest of general government, which in 1982 represented 64 per cent of current revenue. Transfers from the State budget are currently equivalent to 18 per cent of the higher of two amounts--state revenue from direct taxes and expenditures on goods and services (except salaries, wages and interest payments). Capital outlays are exclusively allocated to investment projects, especially for low-rent housing, basic sanitation, rural roads, and elementary education schoolbuildings. Capital expenditures in 1982 rose by 20 per cent in contrast to capital revenue that increased by only 5 per cent (Table 19). According to the revenue-sharing scheme currently in force, 18 per cent of the excess of state expenditure over direct tax revenue is earmarked for the local government's capital outlays. In general, the lack of effective control over this sector's activities is exacerbated by the authority granted to local governments to borrow directly from the banking system up to half of their revenues for capital spending and up to one twelfth of their receipts for current outlays.

### 3. The 1983 budget

The 1983 budget was formulated in the light of growing recognition by the Government that the financial policies of the past had contributed to the continuation of high domestic inflation rates and to the widening of the balance of payments deficit. In realization of the importance of reversing the deteriorating trend of public finances, the Government set as a target for the State budget deficit in 1983 the same nominal amount as in the initial 1982 budget, which would imply a decline in relation to GDP from 8.2 per cent in 1982 to 6.7 per cent in the current year. For the General Government the corresponding figures would be 9.6 per cent for 1982 and 6.9 per cent for 1983. This reduction is predicated on a 31 per cent boost in revenues against a 21 per cent increase in expenditures (Tables 10, 11, and 12).

For most direct taxes the revenue increases projected for this year rest on the assumed rates of growth of the tax bases. However, the budget also introduces a series of surcharges estimated to yield Esc 12.5 billion at the following rates: for the capital gains, transfer, and estate and gift taxes, 15 per cent; and for the capital tax 10 per cent. Compared with the 1982 outcome, social security contributions are projected to increase by nearly 25 per cent, or about 8 percentage points more than

the Government's official guideline of 17 per cent for wage increases. In the area of indirect taxation, the estimated revenue increase of 28 per cent is ascribed primarily to discretionary rate increases in three taxes: first, the general rate of the turnover tax is raised from 15 per cent to 17 per cent; second, the import surcharge is sharply increased from 10 per cent to 30 per cent; and third, the excise tax on beer is raised from Esc 12 per liter to Esc 15 per liter (Table 14).

The outlook on the expenditure side of the budget is heavily influenced by the rapidly growing interest payments on the public debt and by entitlements outlays, especially social security payments. With spending on these two items largely nondiscretionary, the burden of adjustment falls on goods and services, subsidies, and capital outlays. In the 1983 budget interest payments represent 20 per cent of current expenditures and a 47 per cent increase over last year's budget. This dramatic evolution reflects the cumulative impact of increasing deficits in recent years, as well as the growing share of external financing, which has been adversely influenced by the depreciation of the escudo during the period. Social security benefits are budgeted to rise by 21 per cent, or roughly by the expected rate of inflation. At the same time other current transfers are estimated to increase by 30 per cent, in reflection of the rising dependence of the National Health Service, the CP company (Portuguese Railways), and the Housing Development Fund on direct budgetary assistance. The intention of the Government is also to keep the transfers to the Supply Fund at Esc 15 billion, in the hope that declining import prices and appropriate price adjustments in subsidized products will ameliorate the financial position of public enterprises and, by extension, of the Fund itself. If some of the optimistic assumptions are realized, it may even be possible for the Fund to accumulate a surplus and thus to begin repaying its arrears toward its suppliers. In terms of direct subsidies to enterprises, the 1983 budget provides for an 11 per cent increase for both current and capital transfers over last year's budget (Table 12).

Expenditures on goods and services are budgeted to increase by 21 per cent. The Government has set a 17 per cent guideline for wage increases, but it is expected that with the usual wage drift actual raises will be around 20 per cent. Given the expected inflation rate, the budget targets a small decline in public consumption in real terms. Fixed capital formation is budgeted to rise by 13 per cent, a reduction of over 7 per cent at constant prices (Table 12). In this connection it should also be noted that investment plans for public enterprises under the Public Enterprises Investment Program (PISEE) will be restricted in 1983, with the exception of projects related to export promotion or import substitution. In general, mainly projects at a late stage of implementation are expected to be included in the program.

Despite the Government's intentions, there are two main reasons that are likely to cause a significant deviation of the 1983 budget outturn from the initial targets: first, the delayed implementation of the budget, second, the fact that the 1983 estimates were mainly based on the 1982 budget rather than the outturn. The delayed implementation

of the budget was due to the political uncertainties in the late part of 1982 and early 1983. In consequence, although the disbursement of expenditures according to the new authorizations began in March, the increases in tax rates did not become effective until April. As a result, a revenue shortfall of at least Esc 10 billion is now expected, mainly in the area of the turnover tax. The authorities are studying ways to reduce expenditures in order to offset partially the expected revenue loss, but it is unclear in what areas such cutbacks could take place.

More importantly, the final version of the 1983 budget was not appropriately adjusted after the 1982 outturn became available. It thus appears that in many instances the 1983 budget projections are rather optimistic. This is clearly the case with respect to the stamp and the turnover taxes, which in 1982 fell significantly short of the target. Similarly, the expected boost in the import surcharge collections appears too optimistic in the light of increased pressures by importers for exemption under the tax. Along the same lines, although social security contributions in 1983 are 20 per cent higher than the 1982 budget estimates, they are 25 per cent higher than the year's collections--a difference that cannot be defended solely on the expected settlement of past arrears (Tables 12, 13, and 18). In general, one must also allow for the adverse effects of steep rate adjustments on taxpayers' compliance. On the expenditures side, weak areas are the subsidies and capital transfers. It is questionable that, compared with the 1982 outturn, both subsidies and capital transfers will be reduced by 26 per cent in 1983, particularly in view of the fact that the authorities are also trying to restrict the recourse to external borrowing by public enterprises. If, as is likely to happen, the National Health Service and the Housing Development Fund are unable to repay the loans they received in 1982 in the form of Treasury operations, then, such loans will be probably transformed into transfers to be incorporated in the 1983 supplementary budget.

Table 10. Portugal: Selected Fiscal Indicators, 1979-83

(In per cent)

	1979	1980	1981	1982 Prov.	1983 Budget 1/
Public sector borrowing requirement as per cent of GDP 2/	...	18.3	21.5	22.0	...
General government cash deficit as per cent of GDP	10.0	10.3	11.4	10.7	7.1
General government overall deficit as per cent of GDP 3/	9.9	10.9	11.4	9.6	6.9
General government expenditures as per cent of GDP 4/	36.9	41.4	42.8	41.2	40.5
General government tax revenue as per cent of GDP	24.7	28.5	29.8	29.4	30.9
Indirect tax revenue as per cent of private consumption	16.8	19.5	19.0	18.7	20.4
Taxes on income and property as per cent of national income	7.0	7.7	8.6	9.6	10.2
Social security taxes as per cent of gross compensation of employees	14.3	16.3	16.3	16.4	...
Social security benefits as per cent of household disposable income	7.1	8.7	9.3	9.4	9.4
Public sector fixed investment as per cent of domestic fixed investment 3/	19.2	19.6	19.4	17.6	...
Public enterprises' fixed investment as per cent of domestic fixed investment 3/	28.2	29.7	30.0	26.7	...

Source: Portuguese authorities.

1/ As per cent of corresponding macro variables based on staff forecasts.

2/ Cash basis. Information for 1979 is unavailable due to a revision of external debt data.

3/ National accounts basis.

4/ Includes net lending.

Table 11. Portugal: Public Sector Borrowing Requirement, 1980-82 <sup>1/</sup>

(In billions of escudos)

	1980	1981	1982 Est.
General Government			
Overall cash financing	120.6	172.3	196.3
External	21.5	34.6	53.5
Domestic bank	89.0	133.6	140.4
Domestic nonbank	10.1	4.1	2.4
Nonfinancial public enterprises			
Overall cash financing	99.6	140.3	207.3
External	65.5	96.9	143.0
Domestic bank	34.1	37.7	57.7
Domestic nonbank	--	5.7	6.6
Nonfinancial public sector			
Consolidated borrowing requirement	220.2	312.6	403.6
External	87.0	131.5	196.5
Domestic bank	123.1	171.3	198.1
Domestic nonbank	10.1	9.8	9.0
Memorandum item			
Public sector borrowing requirement as a per cent of GDP	18.3	21.5	22.0

Sources: Ministry of Finance and Planning; and Bank of Portugal. Note: Due to a revision of external debt data, no information is currently available for years prior to 1980.

<sup>1/</sup> National accounts basis.

Table 12. Portugal: General Government Operations, 1979-83 <sup>1/</sup>

(In billions of escudos)

	1979	1980	1981	1982 Budget	1982 Prov.	1983 Budget
Current revenue	264.3	362.6	447.1	568.8	564.0	746.7
Indirect taxes	122.0	173.0	212.0	271.3	261.1	347.3
Taxes on income and property	59.4	77.4	107.9	127.6	138.8	176.3
Social security taxes	64.6	90.7	112.9	144.5	139.0	173.3
Nontax revenue	18.3	21.5	14.3	25.4	25.1	49.8
Current expenditure	302.2	404.6	527.3	608.3	633.6	774.7
Wages and salaries )	147.6	185.6	230.8	275.1	276.7	334.4
Purchases of goods and services )						
Subsidies to enterprises	46.5	59.8	69.4	50.8	76.6	56.3
Other current transfers	79.6	120.4	147.4	173.4	181.2	225.0
Interest payments	28.5	38.8	79.7	109.0	101.1	160.0
Current balance	-37.9	-42.0	-80.2	-39.5	-69.6	-28.0
Capital revenue	4.2	5.8	8.5	9.7	14.2	11.4
Capital expenditure and net lending	64.9	91.2	94.5	124.7	121.3	139.0
Fixed investment	36.4	49.4	62.5	86.7	70.9	98.0
Capital transfers	10.5	20.7	14.0	18.3	27.6	20.2
Net lending	18.0	21.1	18.0	19.7	22.8	20.8
Overall balance	-98.6	-127.4	-166.2	-154.5	-176.7	-155.6

Source: Ministry of Finance and Planning.

<sup>1/</sup> National accounts basis; excluding Highway Authority, Housing Development Fund and the autonomous regions of Azores and Madeira.

Table 13. Portugal: State Operations, 1979-83 <sup>1/</sup>

(In billions of escudos)

	1979	1980	1981	1982 Budget	1982 Prov.	1983 Budget
Current revenue	<u>151.0</u>	<u>199.8</u>	<u>259.1</u>	<u>334.3</u>	<u>333.1</u>	<u>466.3</u>
Indirect taxes	<u>88.5</u>	<u>125.0</u>	<u>160.1</u>	<u>207.5</u>	<u>197.0</u>	<u>274.9</u>
Taxes on income and property	48.3	62.4	90.6	107.3	117.6	152.4
Transfers from rest of						
General Government	0.6	2.4	0.6	1.0	0.3	1.4
Other revenue	13.6	10.0	7.8	18.5	18.2	37.6
Current expenditure	<u>196.2</u>	<u>255.8</u>	<u>348.7</u>	<u>400.3</u>	<u>415.7</u>	<u>523.2</u>
Wages and salaries	<u>76.9</u>	<u>99.7</u>	<u>123.3</u>	<u>149.0</u>	<u>150.5</u>	<u>191.3</u>
Purchases of goods and services	15.8	18.6	20.2	33.9	27.4	37.2
Subsidies to enterprises	11.1	11.2	14.6	10.7	14.4	11.8
Transfers to rest of						
General Government	59.3	76.3	103.3	108.4	111.8	120.9
Other current transfers	6.5	13.4	12.4	4.2	13.2	20.8
Interest payments	26.6	36.6	74.9	94.1	98.4	141.1
Current balance	<u>-45.2</u>	<u>-56.0</u>	<u>-89.6</u>	<u>-66.0</u>	<u>-82.6</u>	<u>-56.9</u>
Capital revenue	<u>5.5</u>	<u>11.7</u>	<u>16.7</u>	<u>16.0</u>	<u>16.7</u>	<u>19.7</u>
Capital expenditure and net lending	<u>56.3</u>	<u>79.6</u>	<u>81.1</u>	<u>100.1</u>	<u>99.0</u>	<u>113.1</u>
Fixed investment <sup>3/</sup>	<u>18.1</u>	<u>20.8</u>	<u>27.3</u>	<u>47.6</u>	<u>31.5</u>	<u>57.7</u>
Transfers to rest of						
General Government	17.7	21.0	22.9	21.4	21.7	20.9
Other capital transfers	8.5	19.1	13.1	15.0	25.4	18.1
Net lending	12.0	18.7	17.8	16.1	20.4	16.4
Overall balance	<u>-96.0</u>	<u>-123.9</u>	<u>-154.0</u>	<u>-150.1</u>	<u>-164.9</u>	<u>-150.3</u>

Source: Ministry of Finance and Planning.

<sup>1/</sup> National accounts basis.

Table 14. Portugal: State Tax Revenue, 1979-83

(In billions of escudos)

	1979	1980	1981	<u>1982</u> Budget	<u>1982</u> Prov.	<u>1983</u> Budget
State tax revenue	<u>139.8</u>	<u>193.8</u>	<u>257.7</u>	<u>323.1</u>	<u>323.8</u>	<u>437.5</u>
Taxes on income and property	<u>52.3</u>	<u>67.9</u>	<u>97.6</u>	<u>115.6</u>	<u>126.8</u>	<u>162.7</u>
Industrial tax	10.2	21.0	28.1	34.4	33.0	38.9
Professional tax	16.0	18.1	27.8	32.5	36.2	43.8
Capital tax	9.1	13.6	22.8	29.0	35.4	42.6
Complementary tax	7.2	8.4	11.3	11.3	12.8	14.5
Estate and gift tax <u>1/</u>	0.7	0.9	1.3	1.2	1.6	1.7
Transfer tax <u>1/</u>	3.0	4.1	5.2	6.0	6.6	7.7
Other taxes <u>1/</u>	6.1	1.8	1.0	1.1	1.2	1.0
Extraordinary taxes	--	--	--	--	--	12.5
Taxes on goods and services	<u>87.5</u>	<u>125.9</u>	<u>160.1</u>	<u>207.6</u>	<u>197.0</u>	<u>274.8</u>
Import taxes <u>2/</u>	13.0	14.6	18.1	21.0	22.7	41.3
Stamp taxes	16.7	22.4	28.8	42.5	39.0	51.5
Turnover tax	37.0	57.3	71.7	93.3	82.3	116.8
Motor vehicle sales tax	7.1	12.3	16.5	18.7	19.8	25.2
Tobacco tax	8.9	12.0	15.9	19.1	20.9	26.0
Other taxes	4.8	7.3	9.1	13.0	12.3	14.0

Source: Ministry of Finance and Planning.

1/ Estate and gift tax, transfer tax and capital gains tax are classified as capital revenue on a national accounts basis.

2/ Customs duties, import surcharges plus national salvation tax.

Table 15. Portugal: Financing of General Government Operations, 1980-82

(In billions of escudos)

	1980	1981	1982 Budget	1982 Prov.
Overall balance <u>1/</u>	<u>-127.4</u>	<u>-166.2</u>	<u>-154.5</u>	<u>-178.5</u>
Adjustments for:				
Unpaid obligations	3.7	4.1	--	12.1
Treasury operations	4.7	-7.5	--	-23.0
Financial liabilities <u>2/</u>	-1.6	-1.6	-0.7	-1.3
Compensation for nationalization	--	-1.1	-4.3	-5.6
Overall cash balance	<u>-120.6</u>	<u>-172.3</u>	<u>-159.5</u>	<u>-196.3</u>
Overall cash financing	<u>120.6</u>	<u>172.3</u>	<u>159.5</u>	<u>196.3</u>
External financing, net	<u>21.5</u>	<u>34.6</u>	<u>32.4</u>	<u>53.5</u>
Drawings	<u>23.0</u>	<u>36.6</u>	<u>35.0</u>	<u>56.8</u>
Amortization	-1.5	-2.0	-2.6	3.3
Domestic bank financing, net <u>3/</u>	<u>89.0</u>	<u>133.6</u>	<u>116.9</u>	<u>140.4</u>
Bank of Portugal, net	<u>31.3</u>	<u>74.9</u>	<u>101.5</u>	<u>115.8</u>
Other monetary institutions, net	6.9	46.2	15.4	18.4
Interbank bond market	50.8	12.5	--	6.2
Domestic nonbank financing, net	<u>10.1</u>	<u>4.1</u>	<u>10.2</u>	<u>2.4</u>
Subscriptions by nonbank public	<u>14.6</u>	<u>16.6</u>	<u>21.2</u>	<u>14.9</u>
Amortization	-4.5	-12.5	-11.0	12.5

Sources: Ministry of Finance and Planning, and Bank of Portugal.

1/ National accounts basis. The discrepancy in the figure for 1982 between this Table and Table 12 is due to the provisional nature of the data.

2/ Includes repayment of debt on behalf of former colonies and payment for certain foreign exchange losses of financial institutions.

3/ Not including financing to the Highway Authority, the Housing Development Fund, and to autonomous regions of Azores and Madeira.

Table 16. Portugal: Operations of Autonomous Funds, 1979-83 <sup>1/</sup>

(In billions of escudos)

	1979	1980	1981	1982 Budget	1982 Prov.	1983 Budget
Current revenue	<u>50.1</u>	<u>71.4</u>	<u>84.3</u>	<u>97.2</u>	<u>99.5</u>	<u>100.1</u>
Indirect taxes	<u>31.6</u>	<u>44.0</u>	<u>48.3</u>	<u>60.3</u>	<u>62.1</u>	<u>66.5</u>
Income and property taxes	6.2	7.6	10.5	12.9	12.6	15.1
Transfers from rest of General						
Government	10.0	16.5	23.9	22.3	23.1	16.2
Other revenue	2.3	3.3	1.6	1.7	1.7	2.3
Current expenditure	<u>45.8</u>	<u>67.0</u>	<u>77.2</u>	<u>77.1</u>	<u>85.9</u>	<u>81.5</u>
Wages and salaries )	<u>2.1</u>	<u>3.2</u>	<u>5.7</u>	<u>6.2</u>	<u>3.2</u>	<u>1.6</u>
Purchases of goods and salaries )						
Subsidies to enterprises	33.8	48.6	54.7	40.0	65.2	44.2
Transfers to rest of General						
Government	6.5	8.6	11.6	13.3	12.5	16.5
Other current transfers	1.9	4.9	1.0	3.3	3.1	1.2
Interest payments	1.5	1.7	4.2	14.3	1.9	18.0
Current balance	<u>4.3</u>	<u>4.4</u>	<u>7.1</u>	<u>20.1</u>	<u>13.6</u>	<u>18.6</u>
Capital revenue	<u>0.4</u>	<u>0.3</u>	<u>1.5</u>	<u>1.2</u>	<u>5.0</u>	<u>1.0</u>
Capital expenditure and net lending	<u>5.8</u>	<u>10.4</u>	<u>13.8</u>	<u>18.8</u>	<u>19.6</u>	<u>18.4</u>
Fixed investment	<u>0.8</u>	<u>0.6</u>	<u>2.3</u>	<u>3.4</u>	<u>2.9</u>	<u>1.4</u>
Transfers to rest of General						
Government	1.4	6.0	10.2	8.7	9.2	11.1
Other capital transfers	1.3	1.5	0.8	2.9	1.9	1.5
Net lending	2.3	2.3	0.5	3.8	5.6	4.4
Overall balance	<u>-1.1</u>	<u>-5.7</u>	<u>-5.2</u>	<u>2.5</u>	<u>-1.0</u>	<u>1.2</u>

Source: Ministry of Finance and Planning.

<sup>1/</sup> National accounts basis but excluding the Housing Development Fund.

Table 17. Portugal: Operations of Autonomous Services, 1979-83 <sup>1/</sup>

(In billions of escudos)

	1979	1980	1981	<u>1982</u> Budget	<u>1982</u> Prov.	<u>1983</u> Budget
Current revenue	<u>44.2</u>	<u>52.6</u>	<u>70.8</u>	<u>69.8</u>	<u>72.7</u>	<u>88.2</u>
Indirect taxes	<u>0.4</u>	<u>1.1</u>	<u>1.4</u>	<u>1.1</u>	<u>1.1</u>	<u>3.0</u>
Transfers from rest of General						
Government	43.1	49.1	67.5	67.4	70.3	79.2
Other revenue	0.7	2.4	1.9	1.3	1.3	6.0
Current expenditure	<u>43.1</u>	<u>52.0</u>	<u>69.2</u>	<u>70.8</u>	<u>76.7</u>	<u>87.6</u>
Wages and salaries )	<u>30.5</u>	<u>41.2</u>	<u>53.0</u>	<u>51.1</u>	<u>59.0</u>	<u>62.0</u>
Purchases of goods and services )						
Subsidies to enterprises	1.6	--	0.1	0.1	0.1	0.3
Transfers to rest of General						
Government	2.0	0.6	0.9	0.7	0.7	1.0
Other current transfers	8.9	10.0	15.0	18.9	16.9	24.3
Interest payments	0.1	0.2	0.2	--	--	--
Current balance	<u>1.1</u>	<u>0.6</u>	<u>1.6</u>	<u>-1.0</u>	<u>-4.0</u>	<u>0.6</u>
Capital revenue	<u>1.1</u>	<u>1.3</u>	<u>1.8</u>	<u>0.8</u>	<u>0.8</u>	<u>1.4</u>
Capital expenditure and net lending	<u>5.1</u>	<u>3.8</u>	<u>4.2</u>	<u>2.9</u>	<u>2.9</u>	<u>4.9</u>
Fixed investment	<u>2.9</u>	<u>3.2</u>	<u>3.8</u>	<u>2.2</u>	<u>2.2</u>	<u>3.2</u>
Transfers to rest of General						
Government	0.1	0.1	0.1	0.2	0.2	0.4
Other capital transfers	0.7	0.1	0.1	0.4	0.4	0.6
Net lending	4.0	0.4	0.2	0.1	0.1	0.7
Overall balance	<u>-5.5</u>	<u>-1.9</u>	<u>-0.8</u>	<u>-3.1</u>	<u>-6.1</u>	<u>-2.9</u>

Source: Ministry of Finance and Planning.

<sup>1/</sup> National accounts basis; excluding the Highway Authority.

Table 18. Portugal: Social Security Operations, 1979-83 1/

(In billions of escudos)

	1979	1980	1981	Budget 1982	Prov. 1982	Budget 1983
Current revenue	<u>71.4</u>	<u>101.6</u>	<u>122.5</u>	<u>157.0</u>	<u>151.1</u>	<u>189.8</u>
Social security taxes	<u>64.6</u>	<u>93.0</u>	<u>112.9</u>	<u>144.5</u>	<u>139.0</u>	<u>173.3</u>
Transfers from rest of General Government	5.8	7.5	8.2	10.7	10.3	14.5
Other revenue	1.0	1.1	1.4	1.8	1.8	2.0
Current expenditure	<u>71.0</u>	<u>102.6</u>	<u>128.1</u>	<u>157.0</u>	<u>158.9</u>	<u>189.6</u>
Wages and salaries )	<u>6.8</u>	<u>8.5</u>	<u>9.1</u>	<u>10.0</u>	<u>10.9</u>	<u>10.9</u>
Purchases of goods and services )						
Social security benefits	64.2	94.1	119.0	147.0	148.0	178.7
Current balance	<u>0.4</u>	<u>-1.0</u>	<u>-5.6</u>	<u>--</u>	<u>-7.8</u>	<u>0.2</u>
Capital revenue	<u>1.1</u>	<u>1.7</u>	<u>1.9</u>	<u>1.9</u>	<u>2.0</u>	<u>1.8</u>
Capital expenditure and net lending	<u>0.8</u>	<u>1.5</u>	<u>1.6</u>	<u>2.1</u>	<u>1.7</u>	<u>2.0</u>
Fixed investment	<u>1.1</u>	<u>1.8</u>	<u>2.1</u>	<u>2.5</u>	<u>1.9</u>	<u>2.7</u>
Net lending	-0.3	-0.3	-0.5	-0.3	-0.2	-0.7
Overall balance	<u>0.7</u>	<u>-0.8</u>	<u>-5.3</u>	<u>-0.3</u>	<u>-7.5</u>	<u>--</u>

Source: Ministry of Finance and Planning.

1/ National accounts basis.

Table 19. Portugal: Local Government Operations, 1979-83 <sup>1/</sup>

(In billions of escudos)

	1979	1980	1981	<u>1982</u> Budget	<u>1982</u> Prov.	<u>1983</u> Budget
Current revenue	<u>15.4</u>	<u>23.0</u>	<u>26.2</u>	<u>32.9</u>	<u>32.6</u>	<u>40.7</u>
Indirect taxes	<u>1.5</u>	<u>2.0</u>	<u>2.2</u>	<u>2.4</u>	<u>0.9</u>	<u>2.9</u>
Taxes on income and property	<u>4.9</u>	<u>7.4</u>	<u>6.8</u>	<u>7.4</u>	<u>8.6</u>	<u>8.8</u>
Transfers from rest of General Government	<u>8.3</u>	<u>12.4</u>	<u>15.6</u>	<u>21.0</u>	<u>21.0</u>	<u>27.1</u>
Other revenue	<u>0.7</u>	<u>1.2</u>	<u>4.3</u>	<u>2.1</u>	<u>1.9</u>	<u>1.9</u>
Current expenditure	<u>13.9</u>	<u>16.4</u>	<u>19.9</u>	<u>25.5</u>	<u>26.5</u>	<u>31.2</u>
Wages and salaries )						
Purchases of goods and services)	<u>13.6</u>	<u>14.8</u>	<u>19.5</u>	<u>24.9</u>	<u>25.7</u>	<u>30.4</u>
Current transfers	--	<u>1.3</u>	--	--	--	--
Interest payments	<u>0.3</u>	<u>0.3</u>	<u>0.4</u>	<u>0.6</u>	<u>0.8</u>	<u>0.8</u>
Current balance	<u>1.5</u>	<u>6.6</u>	<u>6.3</u>	<u>7.4</u>	<u>6.1</u>	<u>9.5</u>
Capital revenue	<u>15.3</u>	<u>18.0</u>	<u>19.8</u>	<u>20.1</u>	<u>20.7</u>	<u>19.9</u>
Fixed investment expenditure	<u>15.3</u>	<u>23.5</u>	<u>27.0</u>	<u>31.0</u>	<u>32.4</u>	<u>33.0</u>
Overall balance	<u>3.3</u>	<u>1.1</u>	<u>-0.9</u>	<u>-3.5</u>	<u>-5.6</u>	<u>-3.6</u>

Source: Portuguese authorities.

<sup>1/</sup> National accounts basis.

Table 20. Portugal: Government Debt, 1979-82 1/

(In billions of escudos; end of period)

	1979	1980	1981	<u>1982</u> Est.
Total	<u>514.5</u>	<u>585.8</u>	<u>866.1</u>	<u>1,168.5</u>
Direct debt	<u>419.7</u>	<u>478.2</u>	<u>709.7</u>	<u>955.8</u>
Domestic	<u>328.5</u>	<u>361.0</u>	<u>544.5</u>	<u>677.5</u>
Consolidated debt	<u>17.6</u>	<u>5.1</u>	<u>5.1</u>	<u>5.1</u>
Treasury bonds <u>2/</u>	303.9	353.7	535.3	<u>3/</u> 668.4 <u>3/</u>
National development promissory notes	4.6	--	--	--
Debt related to the Cabora Bassa Dam	2.2	2.0	4.0	3.8
Other	0.2	0.1	0.1	0.2
External	<u>91.2</u>	<u>117.2</u>	<u>165.2</u>	<u>278.3</u>
IMF Subscription	<u>6.1</u>	<u>6.1</u>	<u>10.2</u>	<u>10.2</u>
Debt related to the Cabora Bassa Dam	21.2	21.0	11.0	12.5
Other	63.9	90.1	144.0	255.6
Government guaranteed debt	<u>101.1</u>	<u>112.9</u>	<u>156.6</u>	<u>212.9</u>
Domestic	<u>32.4</u>	<u>46.4</u>	<u>51.8</u>	<u>58.3</u>
External	68.7	66.5	104.8	154.6
Less: Debt held by the Treasury	<u>6.3</u>	<u>5.2</u>	<u>0.2</u>	<u>0.2</u>

Source: Ministry of Finance and Planning.

1/ Based on external debt figures before revision by the Central Bank.

2/ Includes saving certificates and promissory notes of the Treasury.

3/ Includes bonds issued as compensation for nationalizations, amounting to Esc. 128.8 billion in 1981 and to Esc 156.0 billion in 1982.

### III. Money and Credit

Portuguese monetary policy suffers from a lack of coordination with other aspects of economic policy, notably budgetary and external debt policies. It is further hindered by the lack of flexibility in the use of some important instruments, notably interest rates, and by the consequent need to rely heavily on administrative controls, with attendant rigidities and distortions.

The stance of monetary policy over the last three years has been largely accommodating as indicated by increases in domestic credit on the order of 28-30 per cent in 1980-82 and increases in credit to the public sector in particular on the order of 35-40 per cent (Tables 21-24 and Chart 1). These policies contributed to a rapid deterioration in the external accounts and to a sharp rise in foreign indebtedness. Corrective steps have remained piecemeal and on the whole inadequate to secure a sustained improvement in the external position. Despite some reduction in the rate of permissible expansion in bank credit to the private sector and to the public sector enterprises, the rate of growth of domestic credit has remained very high and has been accompanied by heavy external borrowing by public enterprises (Table 25). A more appropriate level of real interest rates has only recently been established by the increases announced on March 25, 1983.

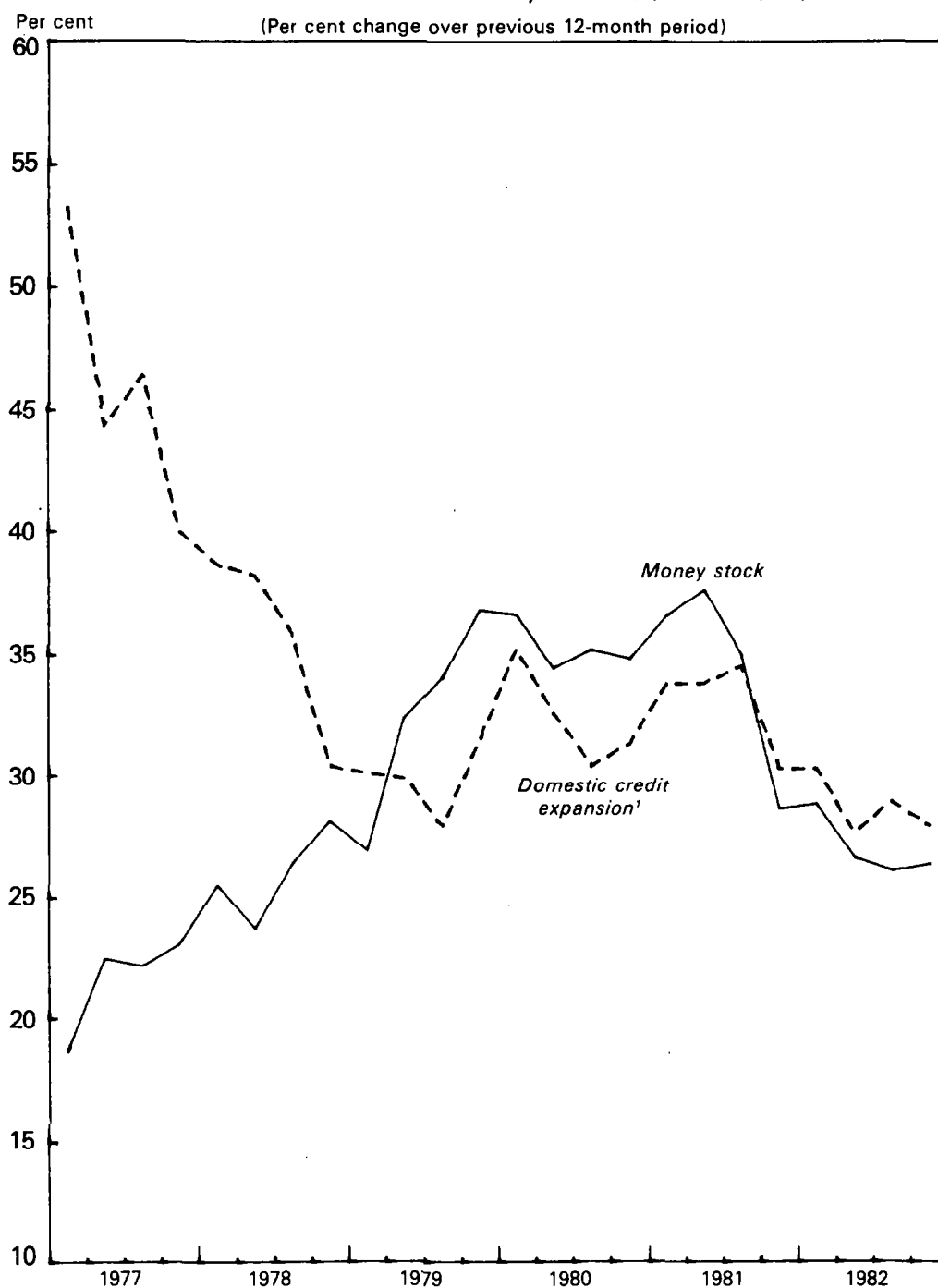
#### 1. The instruments of monetary policy

The room for maneuver by the monetary authorities in Portugal in recent years has been seriously constrained by the size of the borrowing requirements of the broadly defined public sector, including the public enterprises, which have been met largely through the expansion of domestic bank credit and through external borrowing. Given the reluctance of the authorities to accept frequent changes in interest rates, the main instrument of monetary controls have been ceilings on domestic bank credit to the private sector. Changes in reserve requirements have been resorted to infrequently, and the main way in which bank liquidity has been influenced has been through sales of Treasury paper from the portfolio of the Bank of Portugal in the interbank bond market.

##### a. Credit ceilings

The monetary authorities prepare at the beginning of each year a monetary program, which serves as a framework for the setting of credit ceilings and is revised periodically in the light of changing circumstances. The structure of the program is that of a monetary survey in which total liquidity is determined with reference to estimates of real GDP growth and of the rate of inflation provided by the Planning Department of the Ministry of Finance and Planning, with the projection of velocity reflecting the assumed stance of interest rate policy. The split in the program between the net foreign asset and the net domestic credit components of liquidity is made in connection with an estimate of the current account deficit in the balance of payments, again provided

CHART 1  
PORTUGAL  
MONEY AND CREDIT, 1977 (I)-1982 (IV)



Source: Data supplied by the Portuguese authorities and staff calculations.

<sup>1</sup> Domestic credit expansion over previous 12-month period in per cent of initial money stock.



by the Planning Department, and estimates made in the Bank of Portugal of the various items of the capital account. Apart from the relatively minor item net direct investment, extrapolated by some simple rule from past record, the net inflow of capital is determined on the basis of the current account deficit and the amortization schedule of the foreign debt, including the short-term component.

With the changes in total liquidity and net foreign assets determined in the monetary program, the increase in net domestic credit is derived residually. Subtracting from this an estimate of the domestic financing requirement of the Government leaves the "permissible" credit expansion to the private sector including the public sector enterprises. Ceilings on credit expansion by commercial banks and special credit institutions to the private sector including the public sector enterprises have been in operation since 1978. Certain types of preferential credit equivalent to 3 per cent of credits subject to ceilings at end-January 1983 are exempt from the ceilings.

The criteria determining individual bank ceilings have been modified repeatedly as has the system of penalties for excesses. Initially, total credit was distributed by the weighted-average share of each bank in total deposit liabilities, with the lowest weight assigned to demand deposits and the highest weight assigned to emigrants' time deposits, with the intention of inducing banks to attract time deposits and in particular emigrants' deposits in preference over demand deposits although, given the interest rate differential involved, these are the least costly for banks. In order to allow for changes in deposit composition, ceilings were calculated on a monthly basis. Toward the end of 1980 the system was modified to allow credit expansion to exceed the previously fixed ceilings so long as this was matched by a corresponding increase in resident or emigrants' time deposits. The result was an upward drift of the ceilings judged excessive by the authorities who in September 1981 returned to the earlier system.

Penalties for excesses over the ceilings generally have not been fully enforced although they have been increased since the latter part of 1981. Initially, penalties involved noninterest-bearing reserve requirements equivalent to 30 per cent of the excess. At present the Bank of Portugal is authorized to impose a 100 per cent reserve requirement but the rate actually enforced is much lower. In these circumstances, banks will find it profitable to exceed their ceilings so long as bank lending rates remain substantially above the return on Treasury paper in the interbank bond market, the alternative investment outlet for idle bank liquidity. For example, through most of 1982, lending rates upward of one year were about 25 per cent, while the corresponding rate in the interbank bond market stood at around 14.5 per cent (Chart 2). This implies that removing the incentive to exceed credit ceilings would require an effective penalty reserve requirement of over 70 per cent. The fact that ceilings continue to be exceeded as shown in Table 24, suggests that the actual penalty is still too low. At the same time,

banks need not worry about temporary liquidity shortages since they can always borrow on the interbank money market where rates are substantially below the Central Bank discount rate (Chart 2).

b. Interest rate policy

All interest rates in Portugal are administered by the authorities. Evidence suggests that their movements have an important bearing on velocity and hence on inflation, on the investment-savings mix, on the flow of Portuguese workers' remittances from abroad, on the degree of over- and underinvoicing of trade, on capital flows, and hence on both the current and capital accounts in the balance of payments, the exchange rate and international reserves. Developments in nominal and real interest rates together with changes in velocity, developments in the term structure of deposit and lending rates, and developments in the real interest rate differentials between Portugal on the one hand and between France, Germany, the United Kingdom, and the United States on the other are shown in Charts 3-4, and in Tables 26 and 27. The size of preferential bank credit extended to the private sector including the public sector enterprises, the associated interest rate subsidies granted by the Bank of Portugal, and the costs involved are shown in Tables 28-31.

The adjustments in deposit rates since 1975 have tended to be made in general as part of an effort to restore external balance. Hence, the most significant adjustments have been made at the end of August 1977 as a prelude to the stabilization program with the Fund concluded in May 1978 and in May 1978, as part of that program. Similarly, the adjustments in April 1982 and in March 1983 have been a response to a worsening external imbalance. These adjustments have meant an upward shift in the yield curve, with--until most recently--relatively little change in its shape. The same is true for lending rates which have generally been adjusted at the same time. The main general difference between the two sets of curves lies in the relatively much lower deposit rates at the short-term end of the spectrum. A measure of correction has only been introduced with the adjustment of interest rates in March 1983. Accordingly, it is only for reasons already noted in connection with the calculation of credit ceilings, that banks are prevented from concentrating their deposit liabilities on the short term, which profitability consideration would otherwise dictate. Clearly, this is a point to be borne in mind and acted upon if credit ceilings were to be calculated differently or altogether abolished. Otherwise, there would be an increased risk of fluctuations in velocity and, assuming some matching of maturities, the system would be biased in favor of short-term lending.

The need for the recent increase in deposit rates is highlighted by the fact that real interest rates have been generally negative. Over the period covered in Chart 3, real interest rates are seen to have fallen sharply in 1976 and early 1977, when they reached their lowest level. Subsequently, they exhibited a tendency to recover, turning briefly positive in 1980, before declining again in 1981 and in the first half of 1982. The decline was temporarily reversed during 1982, as inflation

CHART 2 (continued)  
PORTUGAL  
AVERAGE BOND LENDING RATE AND RATE IN THE  
INTERBANK BOND MARKET, JANUARY 1981 - MARCH 1983

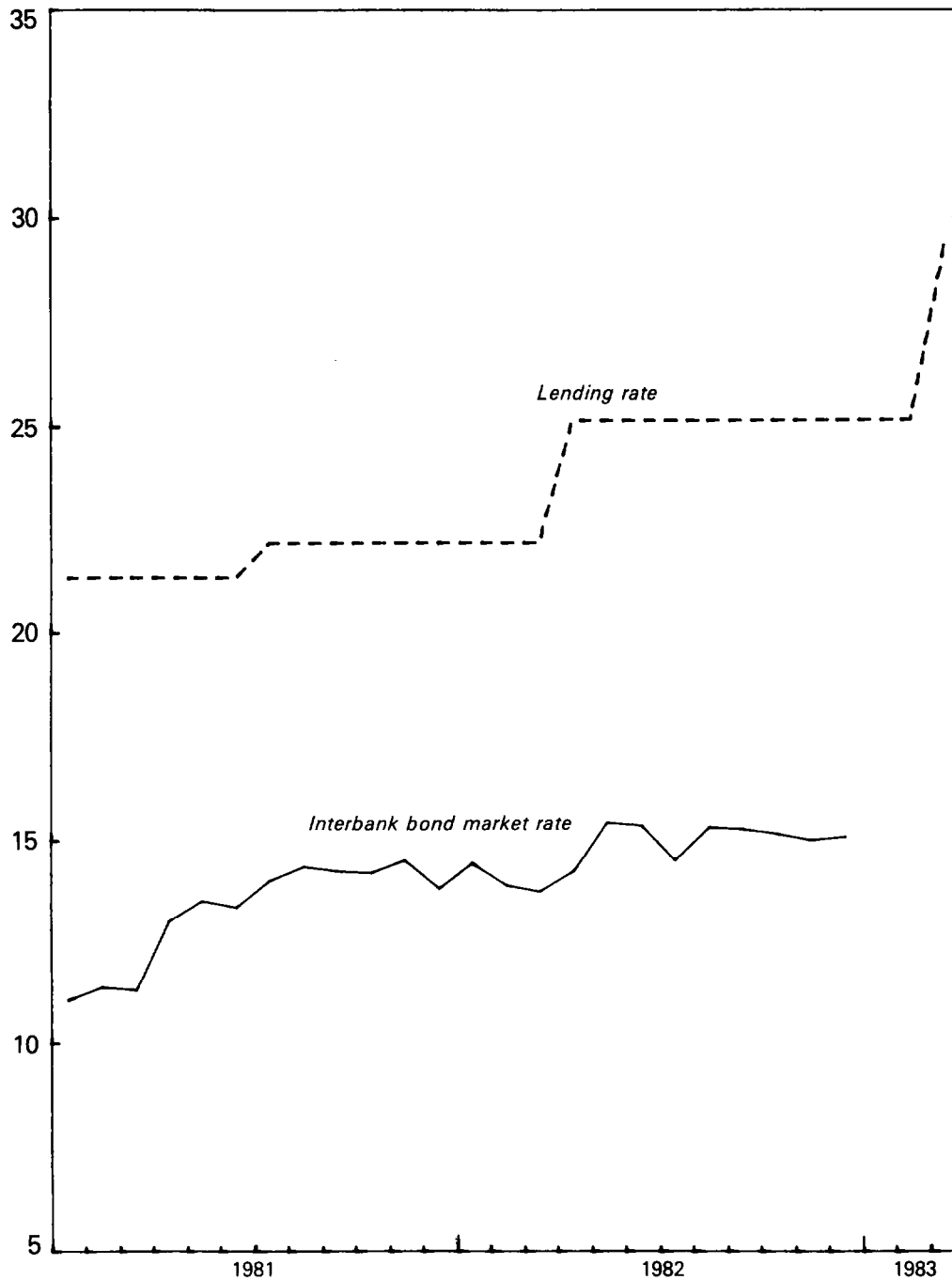




CHART 2 (concluded)

PORTUGAL

DISCOUNT RATE AND RATE IN THE INTERBANK  
MONEY MARKET, JANUARY 1981 - MARCH 1983

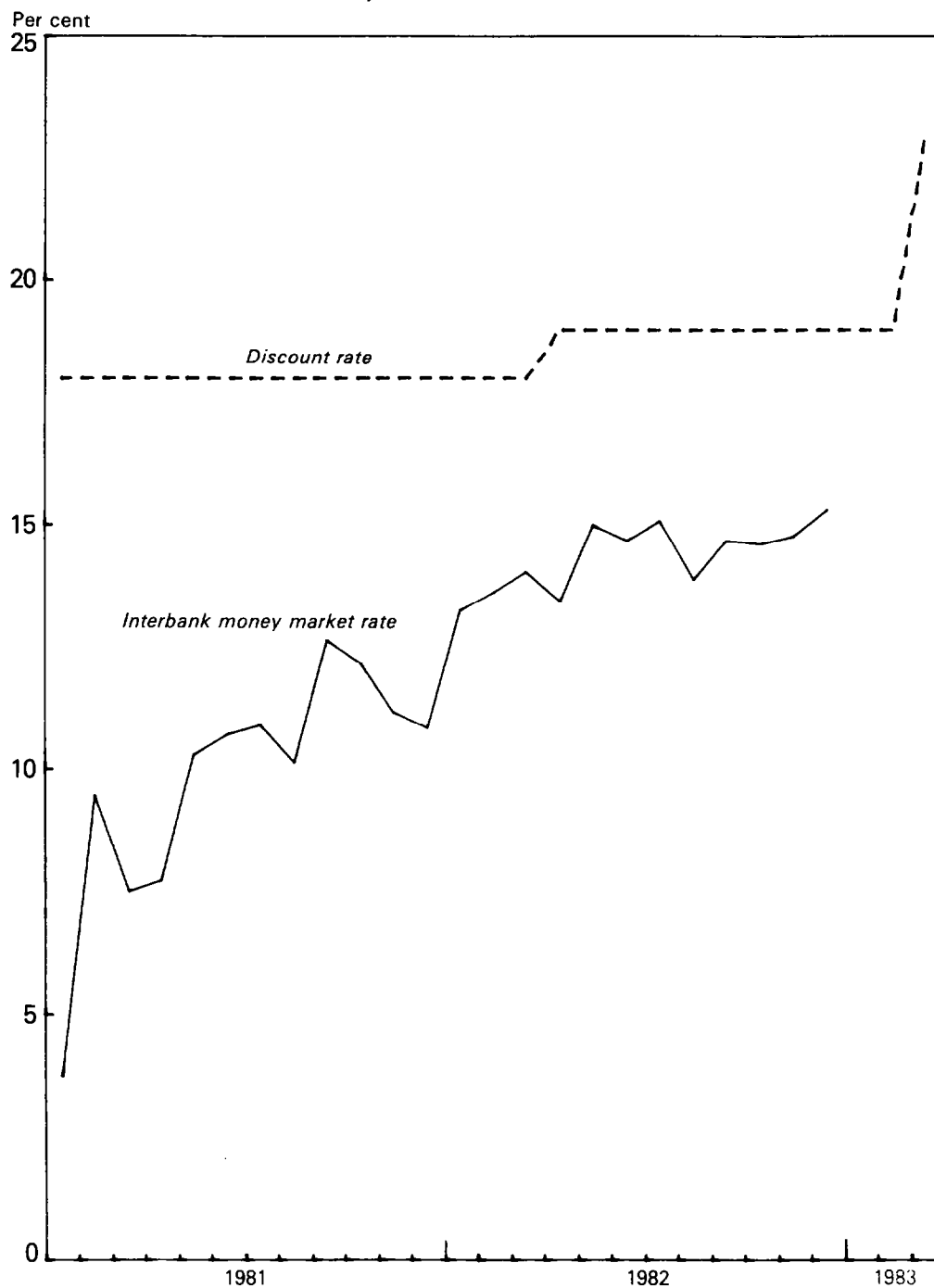
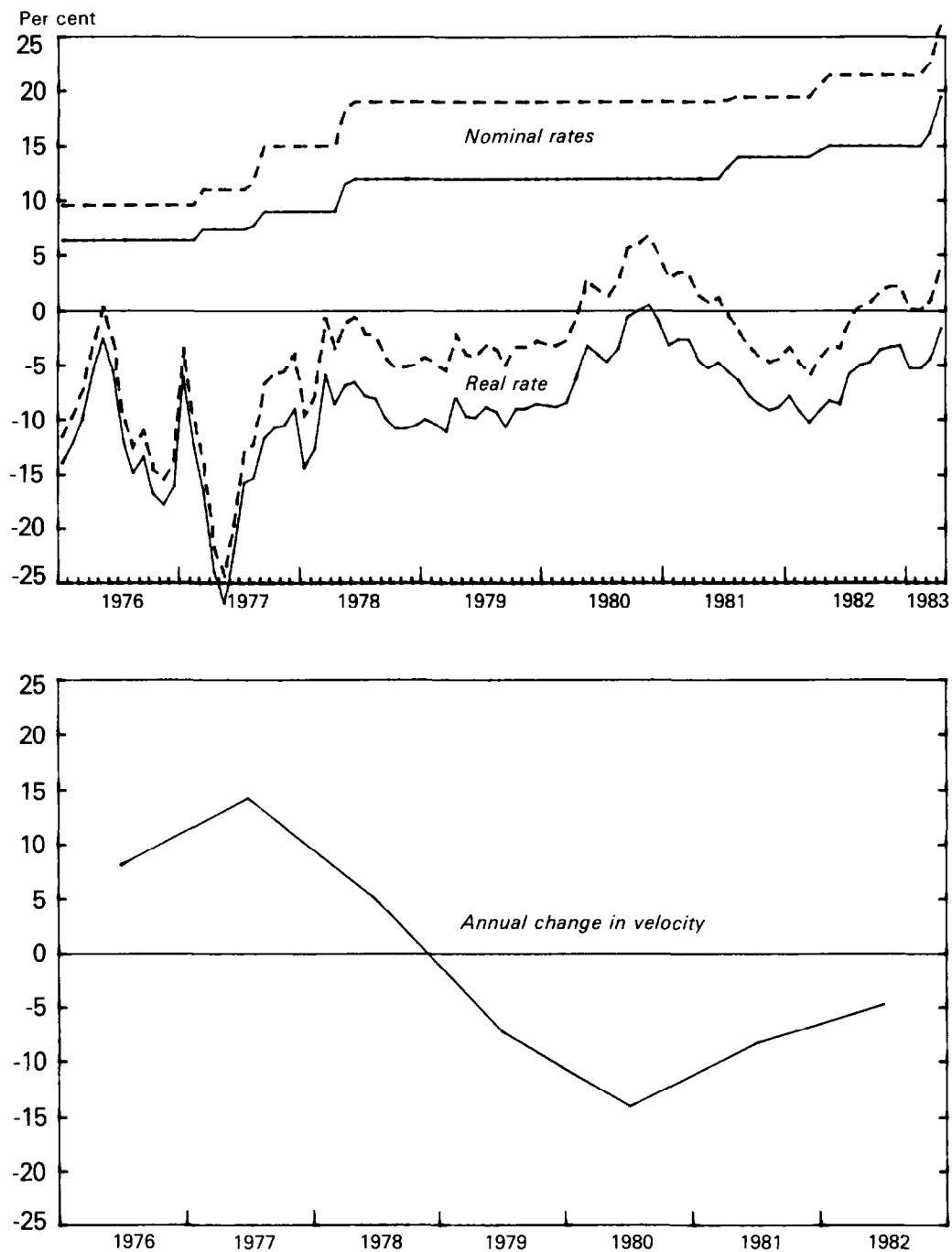




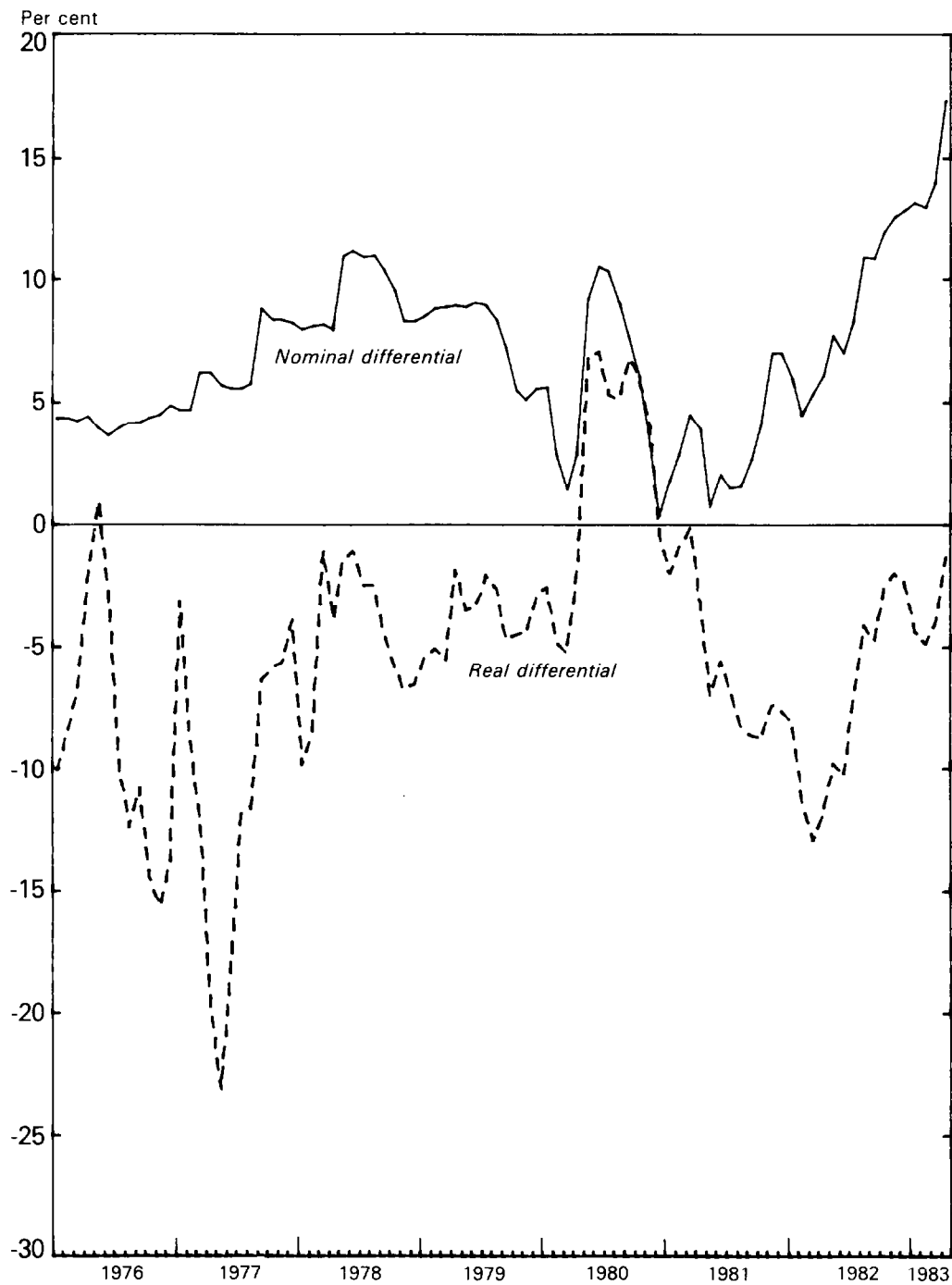
CHART 3  
PORTUGAL  
INTEREST RATES AND VELOCITY,  
JANUARY 1976 - MARCH 1983



<sup>1</sup> Solid and broken lines represent developments in interest rates on 3.6 month deposits and 6.12 month deposits, respectively.  
Real interest rates are calculated using the rate of inflation in consumer prices over the preceding 12 months.



CHART 4 (continued)  
PORTUGAL - UNITED STATES  
INTEREST RATE DIFFERENTIALS,  
JANUARY 1976 - MARCH 1983<sup>1</sup>



<sup>1</sup> Differences between interest rates on 6-12 months deposits in Portugal and interest rates on 3 month government securities (CDs) in the United States. The last observation represents a point estimate for March 25, 1983.



CHART 4 (continued)  
PORTUGAL-UNITED KINGDOM  
INTEREST RATE DIFFERENTIALS,  
JANUARY 1976 - MARCH 1983

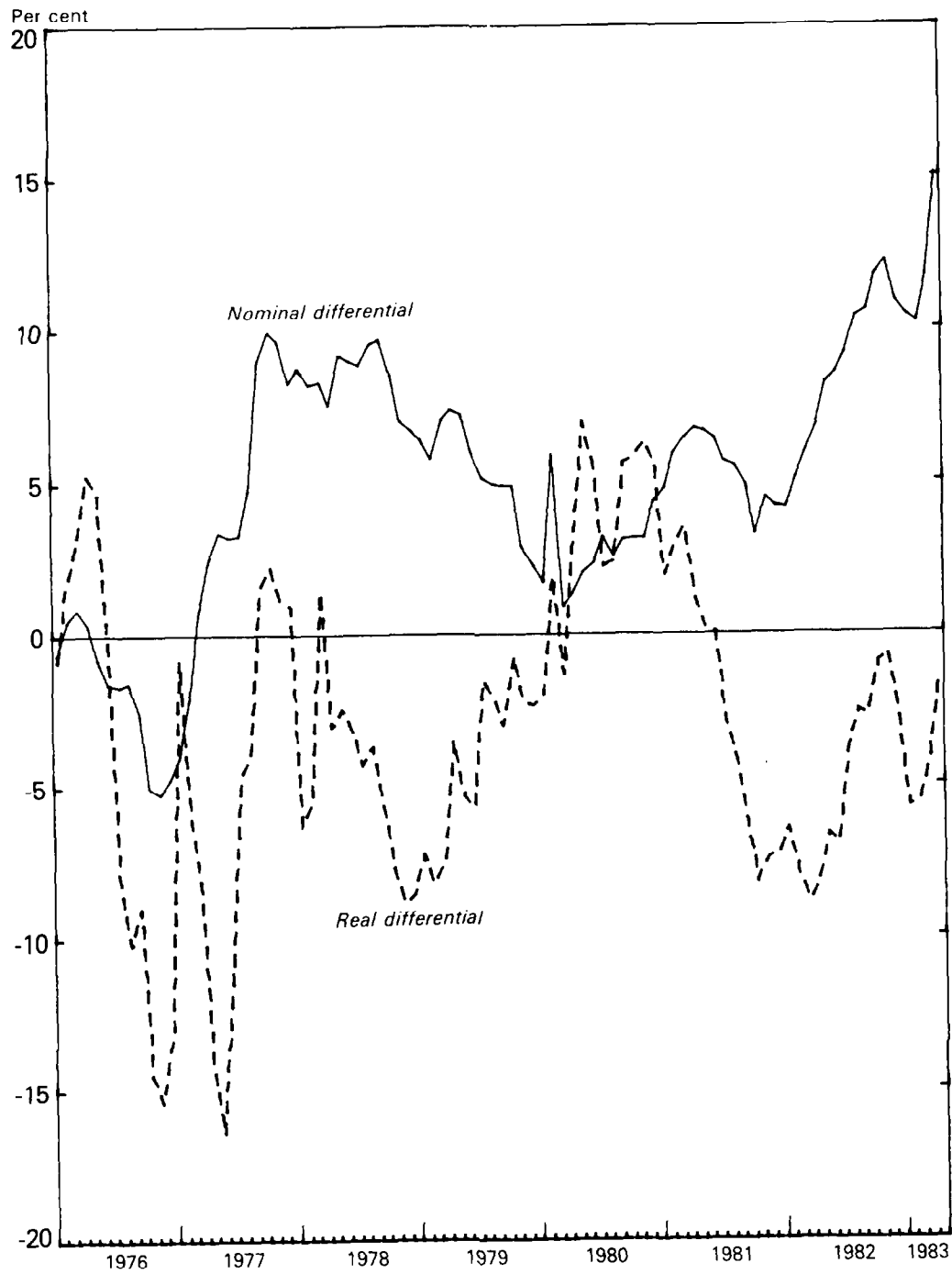




CHART 4 (continued)  
PORTUGAL-GERMANY  
INTEREST RATE DIFFERENTIALS,  
JANUARY 1976 - MARCH 1983

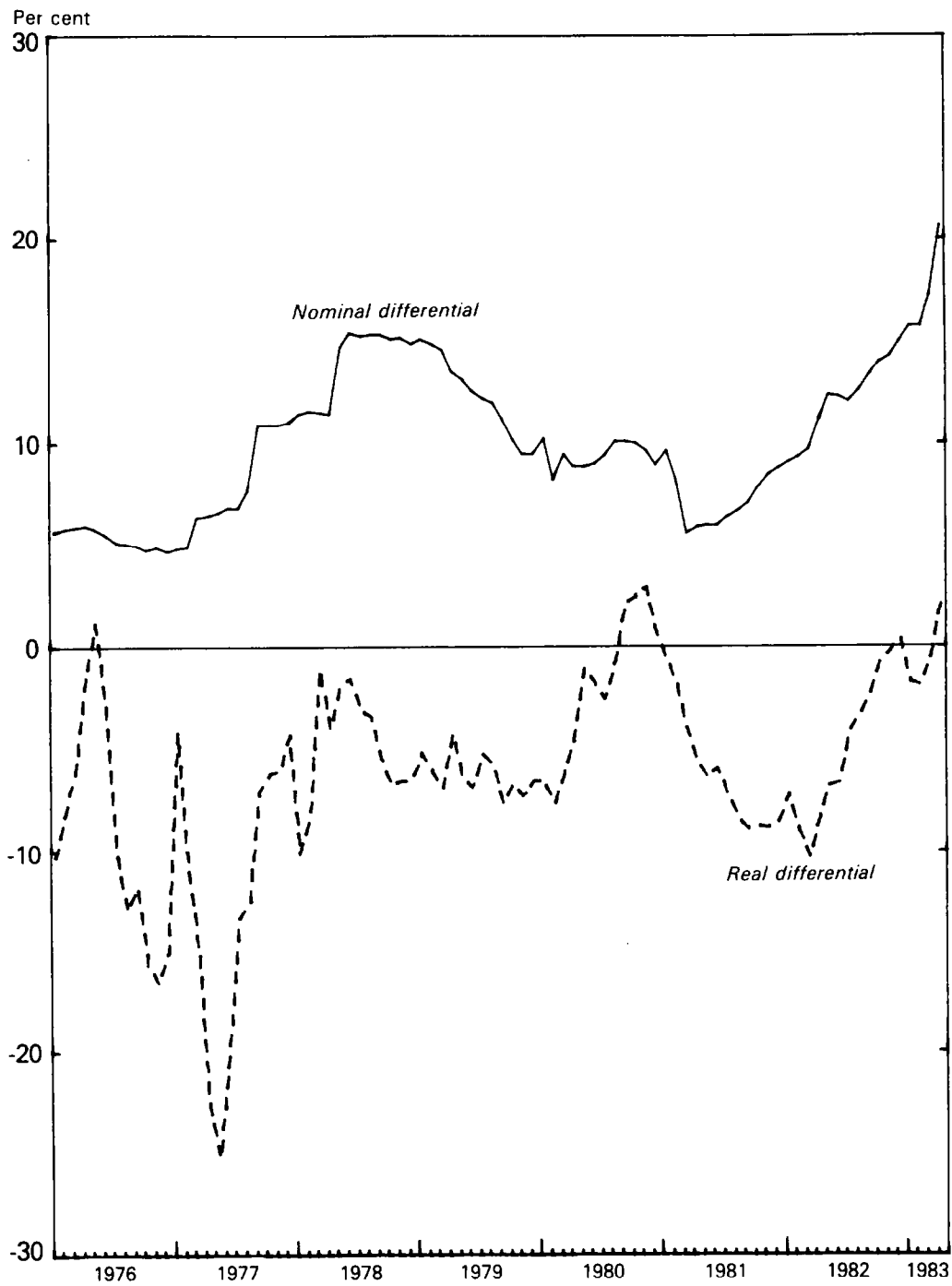
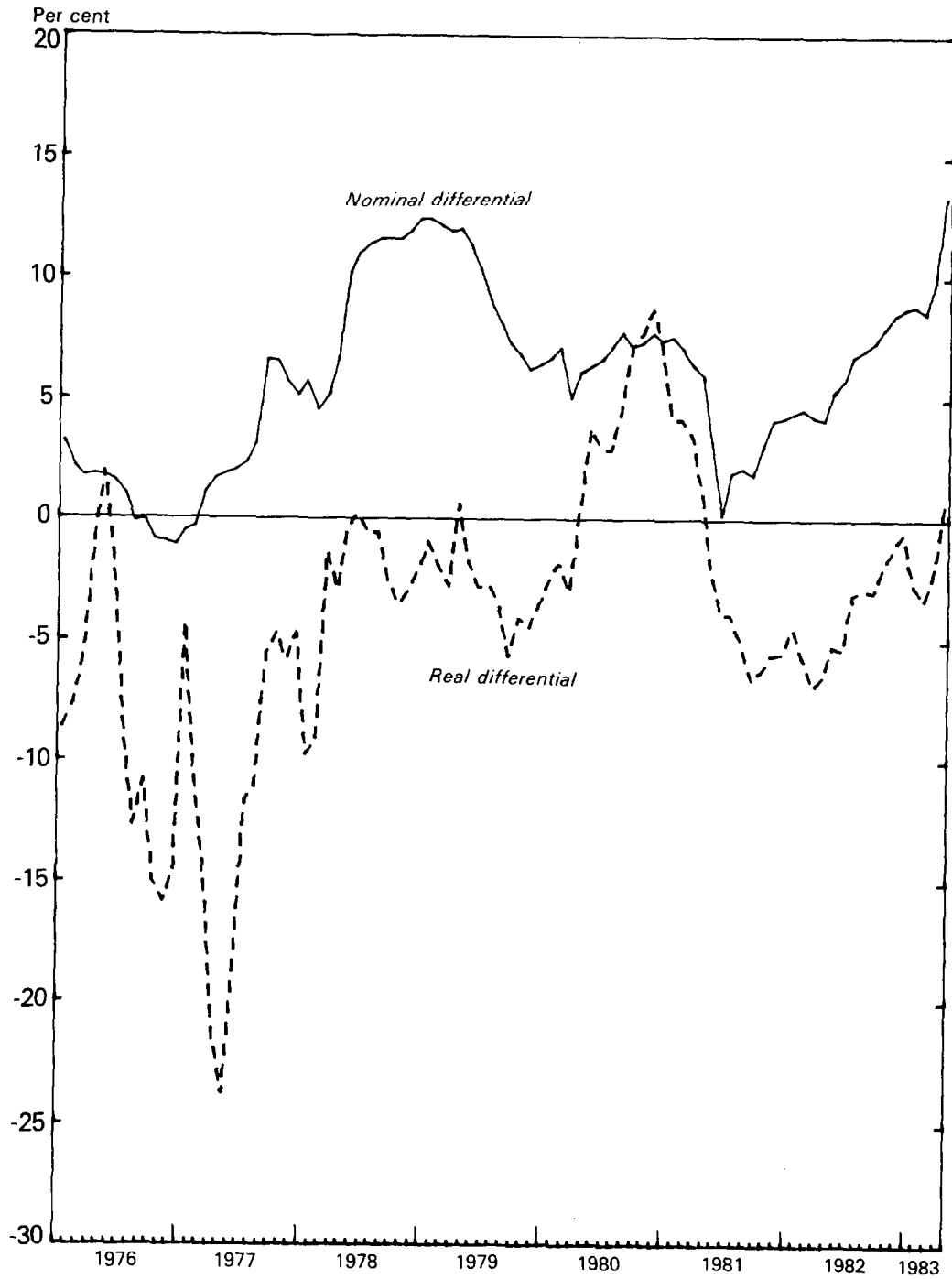




CHART 4 (concluded)  
PORTUGAL-FRANCE  
INTEREST RATE DIFFERENTIALS,  
JANUARY 1976 - MARCH 1983





decelerated, but resumed toward the end of last year when the 3-6 month rate stood at -3 per cent and the 6-12 month rate at 2 per cent. It should be noted that the use of past inflation rates that was made here in computing real interest rates ignores any effects of the upward drift of inflationary expectations and hence tends to overstate real interest levels. In these circumstances and in view of a likely further acceleration of inflation in 1983, real interest rates on 6-12 month deposits are probably around 3 per cent after the 4.5 percentage point increase in nominal rates at the end of March 1983. Chart 3 also shows the inverse relationship between movements in real interest rates and velocity, supporting the claim that a sufficiently positive real interest rate on deposits has to be maintained if an increase in velocity and hence an acceleration of inflation is to be avoided.

Generally, it may be argued that interest rates ought to be raised to the point where they equal interest rates abroad plus the expected depreciation of the escudo. Assuming that expectations can be approximated by the inflation differential, interest rates ought to be raised to the point where real interest rates at home and abroad are equal. It appears from Chart 4 that at end-1982 real 3-6 month interest rates in Portugal were some 6 percentage points too low, but in view of the likely overstatement of Portuguese real interest rates and, *mutatis mutandis*, the likely understatement of real interest rates abroad where inflation has decelerated, this is a conservative estimate and the differential may be closer to 8 percentage points. Alternatively, taking the 6-12 month interest rate in Portugal which is paid on a much larger share of total deposits the real interest rate differential would still be against Portugal, on the order of 2-4 percentage points. The recent increase in Portuguese interest rates by 4.5 percentage points on deposits up to one year clearly helps establish a measure of interest rate parity, at least for the time being.

Tables 28 and 29 document that preferential credit expanded very rapidly in 1980, with its share in total bank credit to the private sector rising from around 20 per cent to 32 per cent. Subsequently, its pace slackened somewhat, though still remaining above that of total bank credit. By the end of the first quarter of 1982 preferential credit accounted for 38 per cent of total bank credit, a share that remained unchanged through the third quarter. The two sectors benefitting from the rapid rise of preferential credit have been the investment and housing sectors. The former doubled its share of preferential credit in 1980 increasing it only modestly thereafter, while the latter's share rose more gradually over the past three years. Together, the two sectors accounted for 28 per cent of total bank credit to the private sector by end-September 1982 and for 74 per cent of preferential credit, compared with some 13 per cent and 65 per cent, respectively, at end-1979. By contrast, preferential credit to the agricultural and export sectors has remained virtually unchanged or increased only modestly. By end-September 1982 the share of credit to agriculture stood at some 2 per cent of total credit and that of exports at about 4 per cent, but in terms of preferential credit their respective shares have declined over the past three

years from 10 per cent to below 6 per cent and from 18 per cent to 11 per cent. It appears that the developments in preferential credit to the investment and housing sectors have fueled an expansion of activity, particularly in 1980, when both gross fixed investment and construction grew by 9 per cent in volume terms, the highest rates of growth in the past five years. On the contrary, export growth fell off sharply in 1980 and it appears that since then preferential credit has played an increasing role in sustaining exports as its share in total credit to the export sector has risen.

Most recent data indicate that preferential credit has come to dominate credit expansion by special credit institutions in particular, its share having risen from one third at end-1979 to over two thirds in 1981/82, while the corresponding share in commercial banks has grown from 14 per cent to near 20 per cent. In general, this demonstrates the increasing dependence of economic activity on subsidized credit while, in particular, it implies a reduction in the overall effectiveness of credit ceilings since enforcement of ceilings on preferential credit expansion tends to be relatively more lenient. The system of interest rate subsidies on preferential credit has been adjusted on several occasions. The rate of subsidy on short-term agricultural credit has been lowered from 6.5 percentage points to 3.5-5.5 percentage points in 1982, while the subsidy on fixed investment has been raised with effect from 1980 and currently may be as high as 16 percentage points in industry and fishing. On exports, subsidies have also been raised by about 1 percentage point in 1982 to 3-7.6 percentage points. Finally, subsidies on housing and for companies in financial difficulties have on the whole been lowered in 1981/82. Given the sectoral distribution of preferential credit and the adjustment in the system of interest rate subsidies, the cost of the subsidies incurred by the Bank of Portugal has risen relatively more rapidly than total preferential credit, as evidenced by the increase in the ratio of interest subsidies to the expansion of preferential credits from five in 1980 to an estimated ten in 1982.

When the Portuguese authorities announced increases in interest rates on March 25, 1983 they also introduced an interest capitalization scheme for medium- and long-term loans. Specifically, instead of paying an interest rate of 29-30 per cent before subsidy, companies that are heavily indebted or are locked into an investment project may alternatively pay a 15 per cent rate of interest and capitalize the remaining interest due. It appears that companies cannot avail themselves of both the new interest capitalization scheme and interest rate subsidies, but rather have to choose one or the other. Accordingly, medium- and long-term loan agreements with subsidized interest rates already concluded or to be concluded at the time of the new announcements shall benefit from the capitalization scheme provided that beneficiaries renounce their entitlement to subsidy.

## 2. Developments in the credit and monetary aggregates

The difficulties besetting the Portuguese economy are reflected as well as conditioned by the recent developments in the credit and monetary aggregates. A rapid and unabated expansion of domestic credit, at rates far exceeding corresponding developments abroad, has prevailed ever since 1978/79 when, as part of an effort to restore external balance, the growth of domestic credit was scaled down by 10 percentage points from over 35 per cent in 1976/77. The very success of that effort, which brought the current account of the balance of payments virtually back to equilibrium for the first time in five years, appears to have induced a reversal of policy. By early 1980 credit expansion had reaccelerated to near 30 per cent, a mark broadly maintained through the end of 1982, despite the ensuing dramatic deterioration in the external position. The present situation resembles that in evidence prior to 1978 in that excessive credit expansion puts pressure on the overall balance of payments and on reserves. This is borne out in Chart 1 which also shows that successful adjustment involves a reversal of that situation so that, with confidence renewed, the foreign component contributes proportionately more to total money growth than its domestic component.

As for the different credit aggregates, domestic credit to the public sector is seen from Table 21 to have risen consistently more rapidly--at least since the mid-1970s--than other aggregates, even though its pace slowed considerably toward the end of 1982. A very large part of the financing of the public sector deficits, namely that financed abroad and through the Bank of Portugal, gives rise to high-powered money creation (Tables 22, 23 and 25). This highlights the need for a substantial increase in the nonmonetary financing of the deficit, an area in which progress to date has been minimal. The combined share of the public sector and the public sector enterprises in total net domestic credit has remained quite high in the last several years, at around 45 per cent, as the rapid growth of credit to the General Government has compensated the slower expansion of domestic credit to the public enterprises (13.7 per cent in 1980, 13.3 per cent in 1981, and 20 per cent in 1982). External financing to the latter, on the other hand, rose very rapidly (by a cumulative 123.3 per cent) over these three years. By the end of 1982 the public sector enterprises accounted for 67 per cent of total external credit outstanding relative to 24 per cent for the General Government and 9 per cent for the private sector (Table 25).

On the liability side of the monetary survey and of the Central Bank balance sheet, developments worth noting include the steadily declining share of M1 in total liquidity, the relatively sustained, though in 1982 moderating, growth in resident time deposits, the sharp reduction in the expansion of emigrants' deposits during 1981/82, and the narrowing excess reserve position of the commercial banks and special credit institutions with the Central Bank. The share of M1 in total liquidity fell from 39 per cent at end-1979 to 28 per cent at end-1982 and to 26 per cent in January 1983 in response largely to the rising opportunity cost of holding cash and demand deposits in the presence of high rates of inflation.

In these circumstances, it is all the same surprising and indicative of a still considerable degree of money illusion that M1 is at present expanding at a year-on-year rate of around 15 per cent and that the switch into alternative financial and real assets has not assumed larger proportions. A by-product of the changing composition of total liquidity has been a decline in the currency to deposit ratio and hence a reduction in the money multiplier, at least to the extent that the latter operates under the current system of credit ceilings. In mid-1981 the upward trend in the expansion in total liquidity dating back to mid-1978 came to a halt, giving way to a declining tendency. From a year-on-year rate of increase of 37.5 per cent in June 1981 the expansion of total liquidity declined to 25.7 per cent by January 1983. While this decline was distributed across all components of liquidity, it was most pronounced in the case of emigrants' deposits and relatively least pronounced in the case of resident time deposits, which benefitted from the switch out of currency and demand deposits. Accordingly, the rate of growth in resident time deposits slowed first only modestly from 37.6 per cent in June 1981 to 35.9 per cent by year-end, before declining more perceptibly to 28.8 per cent by end-1982. By contrast, emigrants' deposits, which had more than doubled in the wake of the adjustment effort in 1978 and were still growing at a rate of over 70 per cent in June 1981, grew only by some 58 per cent a quarter later, and since then their growth has moderated further to around 38 per cent by January 1983.

The velocity of circulation of broad money with respect to nominal GDP has shown pronounced changes over the last several years. Following a sharp increase in the period 1975-78, which was marked by a high and accelerating rate of inflation, by negative real interest rates and by political uncertainties, velocity in 1979 began a sustained decline. The decline was especially marked in 1980 in reflection of the deceleration of inflation and attendant rise in real interest rates and of the strengthening of confidence. However, the build up of liquidity in the economy contributed to the acceleration of inflation in the following two years, as well as to the maintenance of a sustained rate of growth of domestic demand and imports. The rate of decline of velocity decelerated markedly in 1981 and it fell below its long-term trend value in 1982, partly in reflection of the decline in real interest rates and of the adverse impact of exchange rate expectations on the willingness of economic agents to hold domestic financial assets, such as emigrants' deposits.

Portugal: Monetary Expansion and Inflation, 1976-82

(Per cent changes)

	Money <u>1/</u> (1)	Real GDP (2)	Velocity <u>2/</u> (3)	GDP Deflator (4)
1976	15.0	6.9	8.1	16.3
1977	16.9	5.6	14.2	26.7
1978	19.0	3.2	5.1	21.9
1979	37.4	4.5	-7.2	22.0
1980	41.3	5.5	-14.1	15.7
1981	31.3	1.8	-8.3	18.3
1982	27.0	3.0	-4.7	23.8

Sources: Bank of Portugal; and Ministry of Finance and Planning.

1/ Money is defined as M2, centered at mid-year.

2/ Velocity is defined as nominal GDP divided by M2, appropriately centered.

Table 21. Portugal: Selected Monetary Indicators, 1976-83

(Per cent change over previous year end-period)

	Monetary Aggregates			Credit Aggregates		
	M1	M2	Emigrants' Deposits	Total Domestic Credit <u>1/</u>	Credit to Public Sector <u>1/</u>	Credit to Private Sector and Public Enterprises
1976	8.4	16.8	...	37.4	120.3	29.1
1977	11.6	23.1	...	35.5	63.2	30.8
1978	14.6	28.0	135.8	24.5	39.3	21.4
1979	25.9	36.5	66.5	25.8	44.8	21.2
1980	22.1	34.8	72.2	28.2	35.5	26.1
1981	8.3	28.6	53.2	28.7	39.3	25.4
1980						
March	28.5	36.6	62.6	29.2	42.3	25.7
June	24.3	34.4	62.2	28.2	42.3	23.7
September	24.0	35.2	71.5	27.7	34.5	24.8
December	22.1	34.8	72.2	28.2	35.5	26.0
1981						
March	21.1	36.5	69.3	29.6	39.7	26.5
June	22.4	37.5	71.1	30.2	32.3	29.6
September	18.4	35.0	58.4	32.6	43.6	29.3
December	8.3	28.6	53.2	28.7	39.3	25.4
1982						
March	13.3	28.8	46.4	27.9	42.7	23.0
June	11.7	26.6	40.2	26.1	40.4	21.5
September	13.2	26.1	39.0	27.8	40.8	23.5
November	14.7	27.1	38.7	27.8	37.9	24.7
December	15.9	26.3	38.5	26.4	29.7	25.2
1983						
January	14.7	25.7	38.2	25.7	28.9	24.5

Source: Bank of Portugal.

1/ As of January 1980 comparison includes Esc 168.7 billion as counterpart of the cancellation of public debt resulting from revaluation of gold reserves.

Table 22. Portugal: Monetary Survey, 1980-83

	1980	1981	1982					1983
			March	June	Sept.	Nov.	Dec.	Jan.
(In billions of escudos; end of period)								
Net foreign assets	339.4	411.7	432.6	523.3	563.5	562.6	569.1	572.0
Bank of Portugal	276.3	336.8	360.1	430.4	468.4	466.8	468.6	471.0
Other banks	63.1	74.8	72.5	92.9	95.1	95.8	100.5	101.0
Net domestic credit	1,245.9	1,651.6	1,786.4	1,860.4	1,997.3	2,076.4	2,131.7	2,190.6
Public sector	170.8	304.6	373.7	373.6	424.9	443.4	445.0	488.7
Private sector	1,075.1	1,347.0	1,412.7	1,486.8	1,572.4	1,633.0	1,686.7	1,701.9
Of which:								
Public sector enterprises	282.7	320.4	332.6	348.3	370.4	377.1	384.6	
Monetary liabilities	1,340.3	1,723.6	1,814.7	1,924.1	2,053.7	2,120.2	2,177.7	2,203.0
Currency and demand deposits	477.4	517.2	501.2	526.9	556.1	563.3	599.2	583.6
Quasi-money								
Of which:								
Emigrants' deposits	229.9	352.2	381.0	411.0	452.2	474.3	487.8	499.5
Other items, net	245.0	339.7	404.3	459.6	507.1	518.9	523.1	559.6

Source: Bank of Portugal

Table 23. Portugal: Monetary Base, 1980-82

(In billions of escudos; end of period)

	1980	1981	1982			
			I	II	III	IV
Net foreign assets <u>1/</u>	276.3	336.8	360.1	430.4	468.4	469.5
Net domestic assets	134.1	224.6	241.4	269.4	281.2	338.6
Public sector	100.9	175.8	196.0	225.0	236.3	293.1
Credit <u>1/</u>	134.0	224.7	199.1	248.2	239.2	330.6
Deposits	-33.2	-48.9	-3.1	-23.2	-2.9	-37.5
Private sector	--	--	--	--	--	--
Nonmonetary financial institutions	10.8	7.5	15.6	17.8	18.7	...
Banking system	13.6	28.1	21.2	18.1	17.6	...
Uncollectable debts	8.9	13.2	8.6	8.6	8.6	...
Liabilities	410.4	561.4	601.5	699.8	749.6	808.1
Base money	272.1	369.6	355.5	399.0	426.5	477.2
Currency in circulation	165.2	188.4	179.9	189.2	197.9	219.4
Reserves	105.5	178.4	173.1	209.8	228.6	...
Legal	82.1	153.2	163.2	192.2	205.1	...
Excess	23.4	25.2	9.9	12.5	18.2	...
Supplementary	--	... <u>2/</u>	... <u>2/</u>	1.9	1.7	...
Other monetary liabilities	1.4	2.8	2.5	3.2	3.6	4.4
Net unclassified assets	138.3	191.8	246.0	300.8	323.1	330.9
<u>Memorandum item:</u>						
Base money growth	22.0	35.9	41.9	48.1	30.2	29.1

Source: Bank of Portugal.

1/ From January 1980 the Bank of Portugal's gold stock is valued at US\$254.92 per ounce. As of that date Esc 168.7 billion of the credit extended to the public sector was cancelled as counterpart of the revaluation of the gold stock.

Table 24. Portugal: Authorized and Actual Bank Credit, 1981-83  
(continued)

(In billions of escudos; end of period)

	Credit Subject to Ceilings			Credit not Subject to Ceilings			Authorized Credit		
	Commercial banks (1)	Special Credit Inst. (2)	Total (3)	Commercial banks (4)	Special Credit Inst. (5)	Total (6)	Commercial banks (7)	Special Credit Inst. (8)	Total (9)
1981									
Sept.	772.50	470.80	1,243.30	--	--	--	772.50	470.80	1,243.50
Oct.	781.95	478.50	1,260.45	--	--	--	781.95	478.50	1,260.45
Nov.	799.10	487.65	1,286.75	--	--	--	799.10	487.65	1,286.75
Dec.	819.90	496.60	1,316.50	--	--	--	819.90	496.60	1,316.50
1982									
Jan.	830.00	506.30	1,336.30	0.10	0.01	0.11	830.10	506.31	1,336.41
Feb.	835.55	516.10	1,351.65	4.99	2.81	7.80	840.54	518.91	1,359.45
Mar.	846.51	525.90	1,372.41	6.07	3.26	9.33	852.58	529.16	1,381.74
Apr.	846.51	535.70	1,382.21	9.19	3.10	12.29	855.70	538.80	1,394.50
May	849.85	545.20	1,395.05	12.21	3.48	15.69	862.06	548.68	1,410.74
June	868.62	556.30	1,424.92	18.96	8.38	27.34	887.58	564.68	1,452.26
July	885.36	567.95	1,453.31	19.46	9.58	29.04	904.82	577.53	1,482.35
Aug.	885.36	579.20	1,464.56	20.84	14.68	35.52	906.20	593.88	1,500.08
Sept.	1,013.60	628.80	1,642.40	27.64	11.06	38.69	1,041.24	639.86	1,681.09
Oct.	1,027.32	639.50	1,666.82	28.31	13.88	42.19	1,055.63	653.38	1,709.01
Nov.	1,039.14	650.30	1,689.44	30.79	17.26	48.06	1,069.93	667.56	1,737.50
Dec.	1,069.69	659.80	1,729.49	31.74	18.89	50.62	1,101.43	678.69	1,780.11
1983									
Jan.	1,060.24	668.80	1,729.04	33.86	21.15	55.00	1,094.10	689.95	1,784.04

Source: Bank of Portugal.

Table 24. Portugal: Authorized and Actual Bank Credit, 1982-83 (concluded)

(In billions of escudos; end of period)

	Actual Credit			Tolerance Margin for Special Credit Institutions (13)	Excess of Actual over Authorized Credit		
	Commercial banks (10)	Special Credit Inst. (11)	Total (12)		Commercial banks (14)	Special Credit Inst. (15)	Total (16)
1981							
Sept.	779.76	478.97	1,258.72	2.01	7.26	6.16	13.42
Oct.	786.81	487.98	1,274.70	3.00	4.86	6.48	11.34
Nov.	803.10	496.37	1,299.46	2.70	4.00	6.02	10.02
Dec.	823.98	504.69	1,328.67	3.00	4.08	5.09	9.17
1982							
Jan.	832.44	513.90	1,346.34	3.00	2.34	4.58	6.93
Feb.	839.37	524.27	1,363.64	2.70	-1.18	2.66	1.48
Mar.	850.73	536.16	1,386.89	2.99	-1.86	4.01	2.15
Apr.	859.66	545.59	1,405.26	3.00	3.97	3.79	7.76
May	866.82	555.66	1,422.48	3.00	4.76	3.98	8.74
June	889.02	572.90	1,461.92	3.00	1.44	5.22	6.66
July	914.45	585.92	1,500.37	2.91	9.64	5.48	15.12
Aug.	923.51	600.79	1,524.30	2.81	17.31	4.10	21.41
Sept.	1,053.11	645.73	1,698.84	2.96	11.87	2.91	14.78
Oct.	1,062.93	659.65	1,722.59	2.38	7.30	3.89	11.19
Nov.	1,084.35	675.31	1,759.66	2.50	14.42	5.25	19.67
Dec.	1,125.78	690.84	1,816.62	3.00	24.35	9.15	33.51
1983							
Jan.	1,128.63	702.56	1,831.19	3.00	34.54	9.61	44.15

Source: Bank of Portugal.

Table 25. Portugal: Overall Financing of Economic Activity, 1980-82 <sup>1/</sup>

	1980	1981	1982
(In billions of escudos; end of period)			
Total financing <sup>1/</sup>	1,784.3	2,336.6	3,008.8
Domestic bank credit	1,414.8	1,820.3	2,300.4
External financing <sup>2/</sup>	369.5	516.3	708.4
Public sector <sup>1/</sup>	424.7	592.9	784.7
Domestic bank credit	339.7	473.3	613.7
External financing <sup>2/</sup>	85.0	119.6	171.0
Private sector and public enterprises	1,359.6	1,743.7	2,224.0
Domestic bank credit	1,075.1	1,347.0	1,686.6
External financing <sup>2/</sup>	284.5	396.7	537.4
Of which:			
Public enterprises	517.2	651.8	859.0
Domestic bank credit	282.7	320.4	384.6
External financing	234.5	331.4	474.4
(Percentage change)			
Total financing	30.8	31.0	28.8
Domestic bank credit	28.2	28.7	26.4
External financing	41.7	39.7	37.2
Public sector	35.2	39.6	32.3
Domestic bank credit	35.5	39.3	29.7
External financing	33.8	40.7	43.0
Private sector and public enterprises	29.5	28.3	27.5
Domestic bank credit	26.1	25.3	25.2
External financing	44.2	39.4	35.5
Of which:			
Public enterprises	23.9	26.0	31.8
Domestic bank credit	13.7	13.3	20.0
External financing	38.8	41.3	43.2

Sources: Bank of Portugal.

<sup>1/</sup> Includes Esc 168.7 billion as counterpart of the cancelation of public debt resulting from revaluation of gold reserves.

<sup>2/</sup> The stock figures for external debt are calculated by adding the flow of borrowing at average exchange rates to the stock at the end of each year beginning with December 1978.

Table 26. Portugal: Maximum Interest Rates, 1976-83

	1976	1977		1978	1981	1982	1983
		As of Feb. 28	As of Aug. 26	As of May 6	As of July 16	As of Apr. 19	As of Mar. 25
Rediscount rate	6.5	8-12	13-18	18-23	18-23	19-24	23-28
Deposit rates							
Sight deposits <u>1/</u>	1-4	1-4	1-4	1-4	1-4	1-4	1-4
Time deposits							
15-90 days	4.5	5.0	6.0	8.0	10.0	11.0	15.5
90-180 days	6.5	7.5	9.0	12.0	14.0	15.0	19.5
180 days-1 year	9.5	11.0	15.0	19.0	19.5	21.5	26.0
Over 1 year	10.5	12.0	16.0	20.0	21.0	23.0	28.0
Savings deposits <u>2/</u>							
1st year	10.5	12.0	16.0	20.0	21.0	23.0	...
2nd year	10.75	12.25	16.25	20.25	21.25	23.25	...
3rd year	11.0	12.5	16.5	20.5	21.5	23.5	...
4th year	11.25	12.75	16.75	20.75	21.75	23.75	...
Over 4 years	11.5	13.0	17.0	21.0	22.0	24.0	...
Standard lending rates <u>3/</u>							
Up to 90 days	8.75	10.25	14.75	18.25	19-21	23.0	27.0
90-180 days	9.25	10.75	15.25	18.75	19.5-21.5	23.5	27.5
180 days-1 year	10.5	12.0	16.5	20.0	20.22	24.0	28.0
1-2 years	11.25	12.75	17.0	20.5	20.5-22.5	24.5	28.5
2-5 years	12.25	13.75	17.75	21.25	21-23	25.0	29.0
Over 5 years	12.75-13.25	14.25-14.75	18.75	22.25	22-24	26.0	30.0

Source: Bank of Portugal, Annual Report.

1/ Payable to individuals only.

2/ These savings deposits have special conditions. They can be fed regularly according to a previous plan, their future use being tied to specific purposes (see Port. 747/72, de 18 de Dezembro). They represent just above 0.01 per cent of  $M_2$ .

3/ Lower rates prevail for preferred types of credit such as for agriculture, exports, housing, and labor-intensive and export-oriented investments. The types of projects which receive subsidies have changed through time. An interest rate surcharge is applied on loans for the purchase of consumer durables.

Table 27. Portugal: Interest Rate Term Structure, 1975-83

(In per cent)

	Dec. 19 1975	July 1 1976	Feb. 28 1977	Aug. 26 1977	May 6 1978	July 16 1981	Apr. 20 1982	Mar. 25 1983
<u>Time deposit rates</u>								
1. Up to 3 months	4.5	4.5	5.0	6.0	8.0	10.0	11.0	15.5
2. 3 to 6 months	6.5	6.5	7.5	9.0	12.0	14.0	15.0	19.5
3. 6 months to 1 year	9.5	9.5	11.0	15.0	19.0	19.5	21.5	26.0
4. Over 1 year	10.5	10.5	12.0	16.0	20.0	21.0	23.0	28.0
<u>Lending rates</u>								
1. Up to 3 months	7.75	8.75	10.25	14.75	18.25	20.0	23.0	27.0
2. 3 to 6 months	8.25	9.25	10.75	15.25	18.75	20.5	23.5	27.5
3. 6 months to 1 year	9.5	10.5	12.0	16.5	20.0	21.0	24.0	28.0
4. 1 to 2 years	10.75	11.25	12.75	17.0	20.5	21.5	24.5	28.5
5. 2 to 5 years	11.75	12.25	13.75	17.75	21.25	22.0	25.0	29.0
6. Over 5 years	12.5	13.0	14.5	18.75	22.25	23.0	26.0	30.0
<u>Differential lending rate- deposit rate</u>								
1. Up to 3 months	3.25	4.25	5.25	8.75	10.25	10.0	12.0	11.5
2. 3 to 6 months	1.75	2.75	3.25	6.25	6.75	6.5	8.5	8.0
3. 6 months to 1 year	0	1.0	1.0	1.5	1.0	1.5	2.5	2.0
4. 1 to 2 years	0.25	0.75	0.75	1.00	0.5	0.5	1.5	0.5
5. 2 to 5 years	1.25	1.75	1.75	1.75	1.25	1.0	2.0	1.0
6. Over 5 years	2.0	2.5	2.5	2.75	2.25	2.0	3.0	2.0

Source: Bank of Portugal.

Table 28. Portugal: Banking System Credit to the Public Sector Enterprises and the Private Sector, 1979-82

	1979 Dec.	1980 Dec.	1981				1982		
			March	June	Sept.	Dec.	March	June	Sept.
(Balance in billions of escudos)									
Total credit	806.2	1,201.5	1,092.4	1,165.8	1,218.8	1,284.8	1,342.1	1,414.6	1,496.2
Preferential credit	163.5	329.1	386.2	416.8	446.8	478.0	510.5	538.2	570.2
Agriculture	(16.6)	(28.2)	(29.3)	(29.2)	(29.7)	(33.1)	(33.6)	(32.6)	(32.2)
Export	(29.1)	(37.5)	(43.6)	(48.3)	(51.5)	(51.0)	(56.4)	(57.8)	(61.0)
Investment	(51.9)	(139.7)	(149.6)	(159.3)	(168.3)	(180.3)	(191.0)	(202.2)	(211.5)
Housing	(54.6)	(109.2)	(119.0)	(134.2)	(150.1)	(165.6)	(179.3)	(193.7)	(208.3)
Other	(11.3)	(14.2)	(44.7)	(45.8)	(47.3)	(47.8)	(50.2)	(51.9)	(57.2)
Nonpreferential credit	642.7	692.4	706.2	749.0	772.0	806.9	831.6	876.4	926.0
(As per cent of total)									
Total credit	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Preferential credit	20.2	32.2	35.4	35.8	36.7	37.3	38.0	38.0	38.1
Agriculture	(2.1)	(2.8)	(2.7)	(2.5)	(2.4)	(2.6)	(2.5)	(2.3)	(2.2)
Export	(3.6)	(3.7)	(4.0)	(4.1)	(4.2)	(4.0)	(4.2)	(4.1)	(4.1)
Investment	(6.4)	(13.7)	(13.7)	(13.7)	(13.8)	(14.0)	(14.2)	(14.3)	(14.1)
Housing	(6.8)	(10.7)	(10.9)	(11.5)	(12.3)	(12.9)	(13.4)	(13.7)	(13.9)
Other	(1.4)	(1.4)	(4.1)	(3.9)	(3.9)	(3.7)	(3.7)	(3.7)	(3.8)
Nonpreferential credit	79.8	67.8	64.6	64.2	63.3	62.8	62.0	62.0	61.9

Source: Bank of Portugal, Boletim Trimestral.

Table 29. Portugal: Preferential Credits as a Proportion of  
Total Credit Granted by Commercial Banks and by  
Special Credit Institutions, 1979-82

(In per cent)

	Overall Banking System	Commercial Banks	Special Credit Institutions
1979			
December	20.2	14.1	33.5
1980			
March	20.9	14.4	34.1
June	23.3	14.3	40.9
September	24.7	15.5	42.4
December	32.2	16.6	61.8
1981			
March	35.4	17.0	70.0
June	35.8	17.4	69.3
September	36.7	18.0	69.3
December	37.3	18.7	69.5
1982			
March	38.0	19.7	69.1
June	38.0	20.0	67.9
September	38.1	20.4	66.6

Source: Bank of Portugal, Annual Report and Boletim Trimestral.

Table 30. Portugal: Margins of Subsidy Granted  
by the Bank of Portugal, 1979-82

(In percentage points)

	1979	1980	1981	1982
	At end of period			
Agricultural credits <u>1/</u>	6.5	6.5	6.5	3.5-5.5
Credits for construction of houses	2.0	2.0	2.0	2.0
Exports	2.5-6.75	2.5-6.75	2.5-6.75	3-7.5
Investments		1.5 <u>2/</u>	1.5 <u>2/</u>	2.8 <u>2/</u>
Type I	1.5-10.5			
Type II	1.5-5.5			
Companies in financial difficulties	5.5-10.5	5.5-13.25	5.5-13.25	5.5-10.5
Housing	2.5-4.5	2.5-4.5	1.5-3.75	1.5-3.75

Source: Bank of Portugal.

1/ Short-term only.

2/ According to the general scheme of the new incentive system, for new investments in Industry and Fishing, entered into force in 1980, the margins of subsidies may vary theoretically between 2.8 and 16.0 considering the specific characterization of the projects.

Table 31. Portugal: Interest Rate Subsidies Granted  
by the Bank of Portugal, 1978-82

(In millions of escudos)

	1978	1979	1980	1981	1982
Total interest rate subsidies	2,024	5,609	8,102	10,627	12,272
Agriculture <u>1/</u>	641	1,233	1,317	1,305	1,739
Investment	357	2,285	1,865	2,910	2,970
Export	718	1,552	2,693	2,787	3,202
Housing	...	420	1,696	3,022	3,778

Source: Bank of Portugal.

1/ Short-term credits only.

#### IV. Balance of Payments

##### 1. Overview

Over the past three years, there was a marked deterioration in Portugal's external position. The current account balance which had been in approximate equilibrium in 1979 shifted to deficits of US\$1,250 million or 5 1/4 per cent of GDP in 1980, US\$2,710 million or 11 1/2 per cent of GDP in 1981 and \$3,315 million or 14 1/2 per cent of GDP in 1982 (Table 32). These deficits were financed primarily through a sharp increase in external borrowing of which a large part was contracted at short-term maturities by the public sector enterprises (Table 33). As a result, Portugal's external debt is estimated to have increased from US\$7.3 billion at the end of 1979 to US\$13.5 billion by the end of 1982, of which US\$4.0 billion was at maturities of less than one year. The debt service ratio, excluding the rollover of the short-term debt, reached 27 per cent of total foreign exchange earnings by 1982 (Table 34).

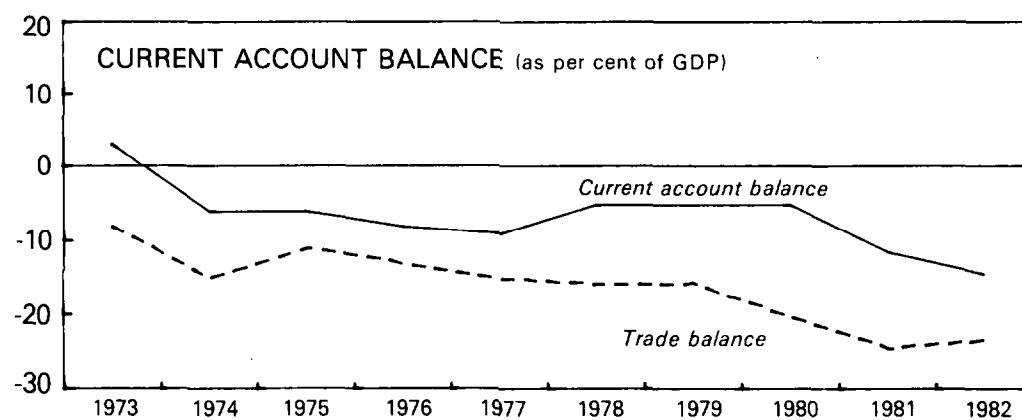
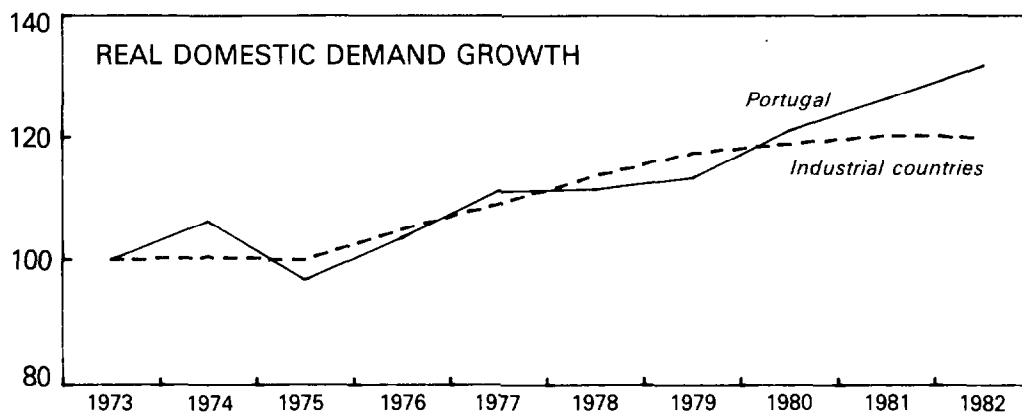
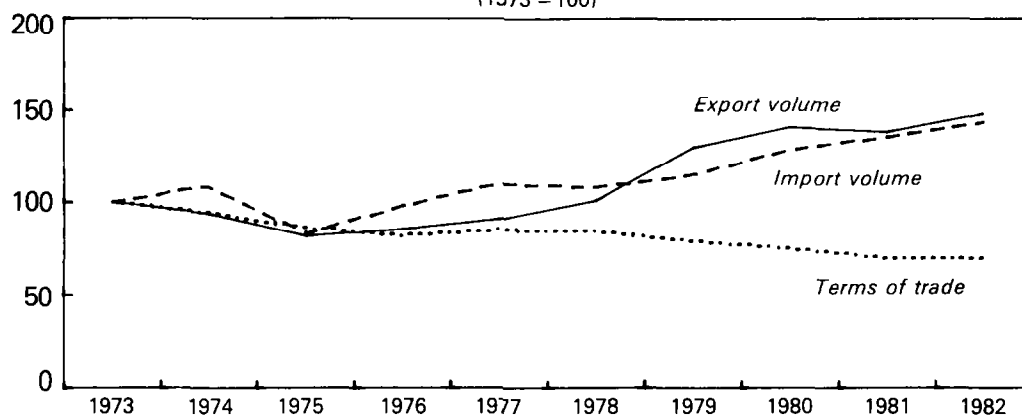
The deterioration in Portugal's external accounts has to a certain degree reflected factors beyond the control of the authorities. These include the terms of trade loss associated with the second oil shock, the prolonged recession in the industrialized countries, the high level of international interest rates and drought conditions which necessitated increased imports of food and energy. However, a major part in Portugal's poor external performance was played by the maintenance of a rate of growth of domestic demand substantially above that of its main trade partners (Chart 5). On a cumulative basis, between 1979 and 1982 real domestic demand in Portugal exceeded that in the OECD by 15 percentage points. The effect of this on Portugal's external performance was compounded through the middle of 1982 by a significant deterioration in Portugal's external competitiveness. In addition there appears to have been a significant degree of disguised capital flight in 1982 prompted by expectations as to the exchange rate and by real interest rates in Portugal appreciably below those prevailing abroad. These capital outflows would explain part of the unfavorable performance of export unit values in 1982 as well as the decline recorded in emigrants' remittances and tourist receipts.

##### 2. Exchange rate policy

In 1981 and 1982 the Portuguese authorities continued the policy introduced in 1977 of a gradual monthly depreciation of the escudo at a preannounced rate vis-à-vis a basket of currencies of its major trade partners. The basket of 14 currencies used for this purpose was redefined in March 1981 in order to reflect more accurately Portugal's trade patterns. The redefinition of the basket had the effect of significantly reducing the weight of the U.S. dollar, to 16 per cent, and of increasing the weight assigned to the European currencies.

CHART 5  
PORTUGAL  
SELECTED INDICATORS OF TRADE PERFORMANCE

(1973 = 100)





Although the basic objective of the crawling peg exchange rate policy was to maintain international competitiveness, through much of the past two years the pace of the crawl was maintained at a rate well below that required to offset the differential rate of inflation between Portugal and its trade partners. This led to prolonged periods of losses in competitiveness which then had to be corrected by discrete changes in the exchange rate. Thus, in 1981 the monthly rate of depreciation was maintained at 0.5 per cent until December in spite of a marked acceleration in inflation. The crawl was then raised to 0.75 per cent which was still insufficient to offset the inflation differential. Against the background of a large loss of competitiveness, the Portuguese authorities took advantage of the realignment in the EMS in June 1982 to devalue the escudo in effective terms by 9.4 per cent, thereby broadly restoring Portugal's competitive position to the level prevailing at the end of 1979 (Table 35). However, the pace of the crawl was maintained at 0.75 per cent which led to a further erosion in competitiveness particularly in the first quarter of 1983. The authorities again took advantage of the EMS realignment at the end of March 1983 to depreciate the exchange rate by 2 per cent in effective terms and step up the pace of the monthly crawl to 1 per cent.

In reflection of the exchange rate policy described above, the escudo depreciated against the dollar by 23 per cent in 1981 and by 36 per cent in 1982 while in effective terms the exchange rate depreciated by 7 per cent in 1981 and by 22 per cent in 1982 (Table 35). The real effective exchange rate, as measured by relative increases in consumer prices adjusted for exchange rate changes, steadily appreciated by over 10 per cent between the end of 1980 and the beginning of June 1982. The subsequent depreciation of the exchange rate restored the overall competitive position to the level prevailing at the end of 1979 although with respect to the European Community there was still some loss in competitiveness (Chart 6). Competitiveness was maintained at this level through the remainder of 1982 before deteriorating by approximately 5 percentage points in the first quarter of 1983 in response to a sharp pick up in domestic inflation. The movements described above in the real exchange rate as measured by relative consumer prices were broadly paralleled by those as measured by relative unit labor costs (Table 36). The latter indicates that on average the loss in competitiveness recorded in 1981 was broadly restored in 1982.

### 3. Merchandise trade

Portugal's trade balance improved markedly in response to the 1977-78 stabilization program with the deficit narrowing to US\$2.6 billion or the equivalent of 15 3/4 per cent of GDP by 1979. Thereafter there was a substantial rise in the deficit which by 1981 had approximately doubled to almost US\$5.2 billion or the equivalent of 24 1/2 per cent of GDP, before declining somewhat in 1982 to US\$4.9 billion or 23 1/4 per cent of GDP (Table 37). A significant part of the deterioration in the trade balance since 1979 reflects the cumulative loss of around 10 1/2 percentage points in Portugal's terms of trade largely due

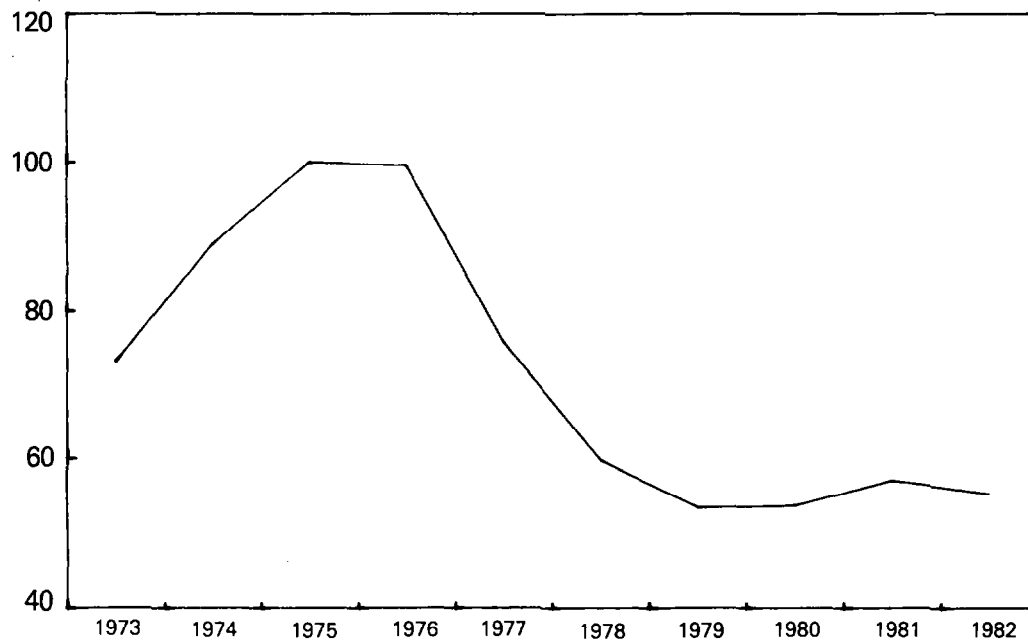
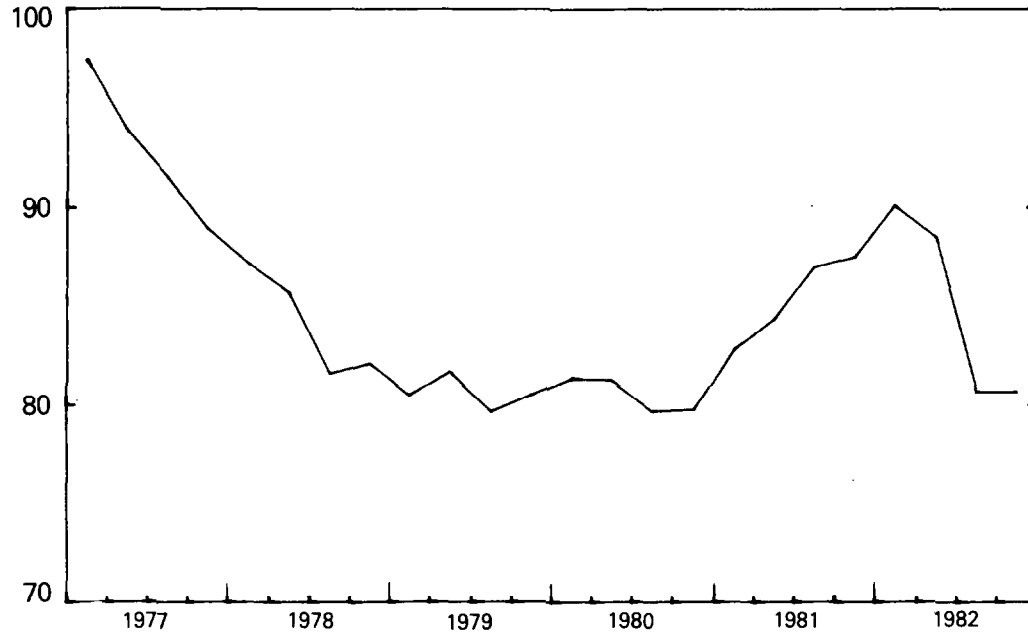
to the increase in international oil prices and the strengthening of the U.S. dollar. However, an even larger part was played by the rapid increase in import volumes associated with the buoyancy in domestic demand. Between 1979 and 1982 import volumes increased by a cumulative 24 1/2 per cent which well exceeded the corresponding 14 1/2 per cent increase in export volumes.

On the basis of provisional data, exports in dollar terms are estimated to have declined by 8.7 per cent in 1981 and by a further 1.3 per cent in 1982. However, in real terms it appears that following a 2 per cent decline in volumes in 1981 there was an approximate 8 per cent rebound in 1982. The implicit decline of around 9 percentage points in export unit values in 1982 can only in part be explained by the estimated 4 per cent decline in dollar prices in Portugal's main trade partners and by the fact that Portugal's export trade is more concentrated on those products subject to a greater degree of price competition at a time of recession (Table 38). This would suggest an intensification of the underinvoicing that already began in 1981 in response to the relatively unfavorable interest rates in Portugal as well as to exchange rate speculation.

The relatively favorable performance in export volumes in 1982 reflected in part the substantial increase in exports of "new" products. These included the marked stepping-up of refined petroleum product exports following the coming on stream of a large petrochemical plant at Sines, and the increase in exports of automobile parts stemming from the beginning of production at a Renault plant. However, even excluding these new exports, export volumes in 1982 increased by 5 1/2 per cent or well above the 1 per cent increase in market growth. In part this reflected some regaining of market shares lost in 1981 (Table 39). Of more importance, however, was the estimated 15 per cent increase in textile exports which currently represent around 29 per cent of total exports. Whereas in 1981 the growth in textile exports had been constrained by voluntary export arrangements, in 1982 Portugal's quota allocations in Europe were increased as part of the EEC preaccession arrangements. On the other hand, in reflection of depressed market conditions as well as of a loss in export competitiveness, significant declines were experienced in the export of metal products, ceramics and glass, while in view of the continued drought agricultural export performance remained weak.

The heavy concentration of the structure and destination of Portugal's exports has made export earnings particularly vulnerable to the weakening in external demand and to losses in competitiveness (Tables 38 and 40). With a view to redressing this situation, the framework of export promotion was reformed in 1981 so as to increase the selectivity of promoting nontraditional products and markets. The main instrument in this regard was the introduction of letters of credit which complement the system of interest rate subsidies granted by the Bank of Portugal. These letters are granted selectively depending on the amount of domestic value added, the sector concerned, and the market to which the exports are directed with higher incentives granted to exports destined for the United States

CHART 6  
PORTUGAL  
REAL EFFECTIVE EXCHANGE RATE INDICES  
(1975 = 100)





and the Middle East. The letters of credit granted could raise the percentage of exports qualifying for the 7 1/2 percentage point interest rate subsidy granted by the Bank of Portugal, which covers 25 per cent of the export's value, by between a further 2 1/2 to 10 percentage points. In addition efforts are being made to provide small- and medium-sized enterprises with commercial, technical, and marketing support. The export sectors on which the Ministry of Exports is focusing particular attention include transport equipment, electric and electronic products, optical equipment, ceramics and metal mechanics.

Import volume which had increased by around 12 per cent in 1980, primarily in reflection of the buoyancy of domestic economic activity and investment, grew by 5.2 per cent in 1981 and by a further 5.6 per cent in 1982 (Table 37). In addition to the continued buoyancy of domestic demand and to the loss of international competitiveness, the relatively rapid growth of Portugal's import volumes over the past two years has in part been due to special factors affecting agricultural and energy imports. This is particularly true for 1982, where excluding these products, import volumes grew by around 3 1/2 per cent (Table 41). Thus, as a result of a prolonged drought and the consequent poor agricultural harvests, food imports grew by almost 12 per cent in 1981 and by a further 6 3/4 per cent in 1982. At the same time, the drought necessitated net electricity imports of around US\$150 million in both 1981 and 1982. During 1982 there was also the effect of the coming onto full operation of Portugal's petrochemical production which resulted in an almost doubling of refined petroleum product imports. The growth in crude oil imports on the other hand slowed to 1 per cent in 1981 in reflection of higher domestic energy prices.

As regards the terms of trade, Portugal is estimated to have suffered a loss of around 5 percentage points in 1980 and a further 6 3/4 percentage points in 1981 (Table 42). This primarily reflected the sharp increase in international petroleum prices and the marked appreciation of the U.S. dollar. During 1982 despite the general decline in commodity prices and the weakening of oil prices, there was only a modest recovery of less than 1 per cent in the terms of trade. This mainly reflected the widespread underinvoicing of exports which as described above had a depressive effect on recorded export unit values.

#### 4. The service account and emigrants' remittances

Since 1979 there has been a substantial deterioration in Portugal's net earnings from invisibles which accounts for somewhat more than one third of the widening in the current account deficit over this period. Thus, due to the weakness in almost all of its components, the service account deficit increased from US\$45 million in 1980 to an estimated US\$1,305 million by 1982 (Table 32). At the same time, the receipts from emigrants' remittances which had almost doubled between 1978 and 1980, declined thereafter from around US\$3,000 million in 1980 to US\$2,650 million by 1982.

A primary factor in the weakening of Portugal's service account was the sharp rise in the deficit on the investment income account from US\$435 million in 1979 to US\$1,215 million in 1982. This reflected both the more than doubling of Portugal's external debt over this period as well as the rise in international interest rates. In 1982 there was some decline in interest rates but this was not sufficient to prevent interest payments from rising to US\$1,350 million. A further element in the weakening of the service account was the poor performance of tourism with net receipts declining from US\$860 million in 1980 to an estimated US\$630 million in 1982 (Tables 43 and 44). In part this was due to the effects of the international recession, the appreciation of the dollar, and the loss of competitiveness with respect to Greece, Spain and Italy. However, beyond these factors there appears to have been significant underreporting, especially in 1982, as suggested by the sharp drop in tourist expenditure per night (Table 44). Additional factors underlying the weakening in the service account were the increase in freight payments associated with the expansion in import volumes and the sharp decline in the receipts from ship repairing related to the decline in world trade in oil.

Over the past two years, emigrants' remittances were adversely affected by the depth of the economic recession particularly in the European countries from which Portugal currently derives 67 per cent of its remittances. The lower growth of labor income in these countries coupled with the strong appreciation of the dollar resulted in an approximate 10 per cent decline in emigrants' wages in dollars over this period (Table 45). Remittances in the United States and Canada which account for 16 per cent of overall remittances were the only major areas from which remittances continued to display any dynamism. It is also possible that there has been a change in the long run trend in remittances from the European countries in reflection of the fact that there has been no appreciable new emigration to these countries over the past ten years. In addition it would appear that, despite some raising of interest rates on emigrants' deposits and some modification in the various credit saving schemes for emigrants, the sharp rise in real interest rates abroad has reduced the incentive for Portuguese workers to remit their earnings as is suggested by the decline in the ratio of remittances to earnings (Table 45).

5. Developments in the capital account, reserves,  
and external debt

a. The capital account and reserves

The marked widening in the current account deficit since 1979 was accompanied by a parallel sharp rise in the inflow of nonmonetary capital (including errors and omissions). This primarily reflected the large scale short- and medium-term borrowing of the public sector enterprises, frequently at the request of the Government, as well as the direct borrowing operations of the Treasury. As a result, despite the appreciable

widening in the current account deficit, the overall balance recorded only a modest deficit of around US\$140 million in 1981 and a surplus of some US\$95 million in 1982 (Table 32).

The strengthening of the medium- and long-term capital account balance in 1981 and 1982, reflected mainly the borrowing operations of the Government and the public sector enterprises. Thus, on a net basis the Government raised US\$500 million in 1981 and US\$660 million in 1982, while the public sector enterprises net borrowing totaled US\$1,555 million and US\$860 million over these same two years, respectively. A large part of the public sector enterprises borrowing over this period was contracted by EDP, the electricity company, to finance its long-term investment program. As regards the remaining medium- and long-term capital flows, private sector borrowing and direct investment into Portugal remained modest (Table 46). In both 1981 and 1982 net direct investment was in the region of only US\$110 million. The relatively poor performance in this area was not a reflection of the regulations covering foreign investment which were appreciably streamlined in 1980 in anticipation of Portugal's approaching accession to the European Community. Rather, it appears that foreign investment was inhibited by the rigidities in the domestic labor market and the deepening of the world recession.

As regards short-term capital flows, the primary element has been the large scale borrowing by the public sector enterprises to finance imports of basic goods, such as cereals and petroleum products. The net short-term borrowing of these enterprises totaled US\$1,815 million in 1981 and a further US\$864 million in 1982. The main borrowers in this regard were EPAC, Petrogal, and IAP0 which were required by the Government to finance their respective imports of cereals, oil, and agricultural products with 180-day supplier credits.

During both 1981 and 1982 there was a significant reduction in Portugal's gross official foreign exchange holdings in part reflecting the repayment of IMF credits as well as of short-term credits of the Bank of Portugal (Tables 47 and 48). By the end of 1982 official foreign exchange holdings amounted to around US\$395 million or approximately two weeks' import payments. However, including Portugal's holdings of 22 million ounces of gold valued at current market prices, gross official reserves totaled US\$10.2 billion or over one year's import payments. In addition, the gross international reserves of the commercial and savings banks totaled an estimated US\$1.2 billion at that date.

#### b. External debt developments

In reflection of the current and capital account developments described above, Portugal's external debt rose considerably over the past three years. Thus, the total debt outstanding increased from US\$7.3 billion at the end of 1979 to US\$13.5 billion by the end of 1982 (Table 33). Of the outstanding debt at the end of 1982, almost 60 per cent was that of the public sector enterprises with a further 20 per cent owed by the Government. Despite the rapid increase in the debt, the terms on which

the Government and the public sector enterprises were able to raise funds in the international capital market remained favorable. Thus, during 1982 the Treasury borrowed medium- and long-term funds at between  $1\frac{1}{2}$  per cent and  $5\frac{1}{8}$  per cent over LIBOR, with similar terms prevailing for the public sector enterprises. As regards the currency denomination of Portugal's external borrowing, an attempt is underway to diversify borrowing away from the U.S. dollar in which the overwhelming part of Portugal's debt is currently denominated. Of the US\$650 million borrowed by the Government in 1982, only US\$300 million was U.S. dollar denominated, with the remainder raised largely in deutsche marks and Japanese yen.

Although there was some deceleration in 1982, the fastest growing component of Portugal's debt has been that contracted at less than one year maturity. This short-term debt rose from US\$1.7 billion or around 23 per cent of total debt at the end of 1979 to US\$4.0 billion or about 30 per cent of the total by the end of 1982. The steady increase in the short-term debt over the past three years reflects to a large extent the increase in the imports of crude oil and other essential commodities which, under current guidelines established by the Bank of Portugal, must be financed by short-term external credits. Thus, four public sector enterprises involved in the import of basic goods and of electricity (EPAC, Petrogal, IAP0 and EDP) account for around 90 per cent of short-term debt outstanding. External borrowing operations are authorized and recorded for statistical purposes by the Bank of Portugal, and borrowing by nonfinancial public enterprises is scrutinized by the Ministry of Finance and by the relevant supervising ministries, ministerios de tutela, before authorization by the Bank of Portugal. However, in recent years these mechanisms of control have not been used to restrain external borrowing, which has rather been viewed as necessary to finance the increasingly large current account deficits.

The steady rise in Portugal's external debt coupled with a weakening in the growth of foreign exchange earnings, has resulted in a considerable deterioration in the various debt service indicators. The broadly defined debt service ratio (including debt service to the IMF and interest payments but not amortization on short-term debt) rose from  $14\frac{1}{2}$  per cent in 1980 to  $22\frac{1}{2}$  per cent in 1981 and to  $27\frac{1}{4}$  per cent in 1982 (Table 39). Similarly, there was an approximate doubling in the debt service ratio on medium- and long-term debt from  $11\frac{1}{2}$  per cent in 1980 to  $22\frac{3}{4}$  per cent in 1982. In addition to the rapid growth in Portugal's external debt, the recent deterioration in the debt service ratio has also been the result of large amortization payments falling due on the medium-term debt contracted in the late 1970s. For 1983, it is estimated that if interest rates remain at the levels prevailing at the end of 1982, debt service payments excluding the rollover of the US\$4 billion outstanding in short-term debt, will exceed US\$2.6 billion (or around 29 per cent of foreign exchange earnings).

6. Negotiations toward EC membership

During 1982 further progress was made in Portugal's negotiations with the European Commission for accession to the European Community. Agreement in substance was reached at the beginning of the year on five broad chapters of the Treaty of Rome including those relating to the transport sector, regional policy, Euratom, and financial and economic issues. In addition an arrangement was reached for the textiles industry whereby a pre-accession agreement with respect to an increase in quotas was linked to a post-accession agreement on the derogation of EC principles in this respect. The post accession arrangement would restrict the increase in Portugal's exports of sensitive textile commodities to 7 per cent in real terms in the first year after accession and to 12 per cent after three years. In the fiscal area Portugal has agreed to have the value added tax in place three years after accession while with regard to the banking system a seven-year transition period has been agreed.

Negotiations of those issues on which agreement had not yet been reached are proceeding under four broad headings. These include the question of agriculture where the whole issue of agricultural price and subsidy policy as well as the arrangements with respect to cereal imports from third countries are still to be negotiated. In addition, agreement still has to be reached on arrangements for the fishing industry, on labor mobility, on external relations particularly in so far as it affects preferential treatment for the Mediterranean Countries, and on the treatment of Portugal in the EC budget. The negotiation of these issues, together with the ratification process that would be required by the individual members' Parliaments, is expected to delay Portugal's entry into the Community to the beginning of 1985 at the earliest. Moreover, the question as to whether the European Community would permit Portugal to join prior to Spain is yet to be addressed.

Table 32. Portugal: Summary Balance of Payments, 1978-82

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982 <sup>1/</sup>
Exports, f.o.b.	2,379	3,550	4,575	4,089	3,997
Imports, f.o.b.	<u>4,787</u>	<u>6,182</u>	<u>8,781</u>	<u>9,251</u>	<u>8,927</u>
Trade balance	-2,408	-2,632	-4,206	-5,162	-4,930
Services, net	-53	104	-45	-441	-1,305
Of which:					
Tourism	431	695	859	778	634
Investment income	-329	-435	-612	-960	-1,215
Transfers, net	1,635	2,476	3,000	2,893	2,650
Of which:					
Emigrants' remittances	1,671	2,445	2,931	2,834	2,581
Current account balance	-826	-52	-1,251	-2,710	-3,315
Medium-term and long-term capital	758	813	718	1,282	2,186
Basic balance	-68	761	-533	-1,428	-1,129
Short-term capital and errors and omissions	228	594	1,391	1,268	1,224
Allocation of SDRs	--	23	24	22	--
Overall balance	160	1,378	882	-138	95
Change in net foreign asset position of commercial banks (increase -)	-201	-995	-498	48	18
External credits to the Bank of Portugal	197	-274	-358	-28	-211
Use of IMF credit and reserve position in the Fund	-53	-41	-146	-72	-59
Change in official reserves (increase -)	-103	-68	120	190	157

Source: Data provided by the Portuguese authorities.

<sup>1/</sup> Estimates.

Table 33. Portugal: External Debt Outstanding, Disbursed, 1979-82

(In millions of U.S. dollars, end of period)

	1979		1980		1981		1982 (Prov.)	
	Total	Of which: Short-term	Total	Of which: Short-term	Total	Of which: Short-term	Total	Of which: Short-term
General Government	1,276	--	1,691	--	2,195	--	2,856	--
Bank of Portugal	1,617	582	1,116	220	962	250	670	120
Other monetary institutions and nonmonetary financial sector <u>1/</u>	532	--	736	2	882	23	1,331	50
Public enterprises	3,395	1,010	4,603	1,939	5,974	2,754	7,702	3,618
Nonfinancial private sector	447	59	831	235	1,002	262	905	169
Total	<u>7,267</u>	<u>1,651</u>	<u>8,978</u>	<u>2,397</u>	<u>11,015</u>	<u>3,289</u>	<u>13,464</u>	<u>3,957</u>
Of which:								
Public and publicly guaranteed	3,891	582	3,785	220	4,120	251	4,666	120
Bank-guaranteed	1,587	678	1,076	59	926	13	799	6
Memorandum items: (in per cent)								
Share of short-term debt	22.7		26.7		29.9		29.4	
Ratio of debt to GDP	35.8		37.3		49.7		66.2	
Ratio of debt to foreign exchange earnings	92.4		90.7		120.5		161.6	
Ratio of debt to gross official reserves <u>2/</u>	372.5		61.1		111.8		130.9	

Sources: Bank of Portugal; and staff estimates.

1/ Including EFTA Fund with government guarantee.2/ With gold valued at the official price of SDR 35 per ounce until December 31, 1979 and at the quarterly average London market price thereafter.

Table 34. Portugal: External Debt Service Payments, 1978-82

	1978	1979	1980	1981	1982
<u>(In millions of dollars)</u>					
I. Service payments					
Amortization on medium-term and long-term debt	<u>507</u>	<u>89</u>	<u>713</u>	<u>1,004</u>	<u>981</u>
Of which:					
Repurchases from the Fund	37	41	120	72	59
Interest <sup>1/</sup>	<u>387</u>	<u>536</u>	<u>733</u>	<u>1,099</u>	<u>1,337</u>
Of which:					
Interest on short-term debt	158	156	179	278	388
Charges on use of Fund resources	18	17	13	7	2
Debt service	<u>894</u>	<u>1,325</u>	<u>1,446</u>	<u>2,103</u>	<u>2,318</u>
<u>(As a percentage of foreign exchange earnings)</u>					
II. Ratios					
Debt service	16.9	16.8	14.6	22.5	27.3
Debt service excluding the Fund	15.8	16.1	13.3	21.7	26.8
Debt service on medium-term and long-term debt	12.8	14.1	11.5	18.7	22.7

Sources: Data provided by the Portuguese authorities; and Fund staff estimates.

<sup>1/</sup> Based on the debit of investment income in the balance of payments.

Table 35. Portugal: Exchange Rate Developments, 1977-82 <sup>1/</sup>

(1979 = 100)

	Dollar/ Escudo Rate	Nominal Effective Exchange Rate	Portuguese Consumer Prices	Portuguese Consumer Prices in Relation to Partners	Real Effective Exchange Rate <sup>2/</sup>
1977	78.2	66.8	65.9	75.6	113.4
1978	89.8	85.3	80.8	87.2	102.5
1979	100.0	100.0	100.0	100.0	100.0
1980	102.3	103.0	116.6	105.4	102.3
1981	125.8	106.8	140.0	115.0	107.7
1982	162.4	124.0	171.8	130.7	105.8
1979					
March	98.6	97.2	93.1	95.9	98.6
June	100.2	99.4	99.3	99.9	100.6
Sept.	99.8	102.4	105.1	103.1	100.7
Dec.	101.8	104.8	109.6	105.3	100.4
1980					
March	104.5	99.8	113.9	105.8	106.0
June	100.0	102.9	115.9	105.0	102.0
Sept.	102.7	104.2	118.4	105.1	100.9
Dec.	108.4	104.2	123.9	107.7	103.4
1981					
March	116.0	104.5	131.0	110.6	105.9
June	129.5	105.6	136.3	112.5	106.6
Sept.	132.9	108.4	146.5	118.0	108.9
Dec.	133.4	111.7	154.9	122.9	110.1
1982					
March	145.7	113.7	166.5	129.6	113.9
June	171.0	124.0	171.6	130.4	105.2
Sept.	180.4	131.7	176.8	132.6	100.7
Dec.	182.0	136.4	184.1	136.6	100.2

Sources: Bank of Portugal; and IMF, International Financial Statistics.

<sup>1/</sup> Based on average 1979-80 export and import weights.

<sup>2/</sup> A decline in the index indicates a depreciation.

Table 36. Portugal: Real Effective Exchange Rate as Measured  
by Relative Unit Labor Costs Adjusted  
for Exchange Rate Changes, 1977-82

	Portugal				Nominal effective exchange rate 1/	Real effective exchange rate 1/
	Increase in wages in industry	Increase in industrial productivity	Index of Unit labor costs	Partner coun- tries unit labor costs		
	In per cent			Indices with 1979 = 100		
1977	15.2	10.6	82.3	89.7	149.7	137.3
1978	15.3	7.6	88.2	95.0	117.2	108.8
1979	19.9	5.7	100.0	100.0	100.0	100.0
1980	23.5	5.6	116.9	109.5	97.1	103.6
1981	19.8	2.0	137.4	118.2	93.6	108.8
1982 (est.)	23.0	4.0	162.7	126.8	80.6	103.5

Sources: Data provided by the Portuguese authorities; and Fund staff estimates.

1/ Exchange rates expressed as units of foreign currency per escudo. A decline in the index indicates a depreciation.

Table 37. Portugal: Merchandise Trade, 1978-82

(Customs basis)

	1978	1979	1980	1981	1982
Exports, f.o.b. (in billions of escudos)	106.5	176.0	231.6	256.7	324.9
Per cent change in unit value	23.3	28.0	21.6	13.1	17.4
Per cent change in volume	11.1	29.2	8.2	-2.0	7.8
Imports, c.i.f. (in billions of escudos)	230.1	331.9	475.5	608.9	749.7
Per cent change in unit value	23.3	35.2	27.9	21.3	16.6
Per cent change in volume	-2.1	6.7	12.0	5.2	5.6
Trade balance (in billions of escudos)	-213.6	-155.9	-243.9	-352.2	-424.8
In per cent of GDP	-15.8	-15.7	-20.2	24.4	23.3
<u>Memorandum items:</u>					
Market growth	5.5	8.9	0.2	-1.5	1.1
Change in partner countries' export prices (in U.S. dollars, trade weighted)	11.0	19.6	20.4	-1.2	-3.8
Of which:					
Non-oil	13.0	15.3	11.7	-4.4	-4.1
Terms of trade (1970=100)	89.2	84.4	80.3	74.9	75.4

Sources: Data provided by the Portuguese authorities; and staff calculations.

Table 38. Portugal: Composition of Exports, 1979-82

(Customs basis; in escudos)

	1979	1982	1979		1980		1981		1982 1/	
	Share in total exports		Volume	Prices	Volume	Prices	Volume	Prices	Volume	Prices
Agricultural products	13.8	11.5	15.3	25.3	3.3	13.9	-8.8	14.9	1.8	22.0
Mineral products, including ceramic, glass, etc.	6.9	8.4	48.3	27.5	29.7	38.7	10.5	18.6	-19.2	17.6
Products of chemical industry	5.6	5.8	19.9	37.1	9.1	28.4	-14.4	22.2	13.0	18.9
Wood, cork, paper, and pulp products	16.1	15.7	28.3	31.5	7.2	27.8	-6.6	15.2	4.7	16.7
Textiles and clothing	29.2	28.6	26.2	31.2	-1.0	21.0	4.4	8.0	14.9	16.7
Hides, leather, and footwear	4.3	4.1	48.7	27.7	10.5	17.1	6.6	4.9	4.0	16.7
Products of metal industry	6.0	4.2	62.6	22.4	-5.3	14.4	-7.0	14.8	-4.0	16.7
Machinery	8.3	9.9	15.0	18.6	23.0	12.9	3.3	16.0	14.7	16.8
Land transport equipment	2.7	2.8	29.6	26.9	24.3	20.9	-13.9	13.2	14.4	16.6
Other (including diamonds, airplanes, ships, and new chemical exports)	7.1	9.0	...	...	...	...	...	...	...	...
Total	100.0	100.0	29.2	28.0	8.2	21.6	-2.0	13.1	7.8	17.4

Source: Data provided by the Portuguese authorities.

1/ Provisional.

Table 39. Portugal: Market Shares, 1978-81

	1978	1979	1980	1981	1978	1979	1980	1981	1978	1979	1980	1981
	Imports from Industrial Countries and other European Countries 1/				Imports from Portugal				Portugal's Market Shares			
	(In billions of U.S. dollars)								(Per thousand)			
World	907.1	1,108.8	1,310.7	1,301.6	2.6	3.8	4.7	4.3	2.8	3.5	3.6	3.3
Industrial countries	614.2	773.2	891.2	840.0	2.1	3.2	3.9	3.4	3.5	4.1	4.4	4.0
EC excluding United Kingdom	327.4	421.9	486.2	424.0	1.0	1.5	2.0	1.7	3.1	3.6	4.1	4.0
United Kingdom	56.8	77.5	88.1	76.2	0.5	1.7	0.8	0.7	8.7	9.3	8.8	8.8

Source: IMF, Direction of Trade.

1/ Excluding Portugal.

Table 40. Portugal: Geographic Structure of Trade, 1979-82

(In per cent)

	1979	1980	1981	1982	1/	1979	1980	1981	1982
	Exports					Imports			
EC	57.3	54.9	53.8	56.9		41.8	39.5	38.1	38.5
Of which:									
United Kingdom	18.1	14.8	14.5	14.8		9.1	8.7	8.1	7.0
Other European countries	17.5	18.3	17.1	17.4		14.1	13.4	14.1	13.2
Of which:									
Spain	2.9	3.7	2.9	3.5		5.7	5.5	6.6	6.5
United States, Canada, and Japan	8.4	7.6	7.1	7.5		15.3	14.8	16.1	14.4
Former colonies <u>2/</u>	4.5	5.0	6.6	3.1		0.9	0.4	0.4	0.4
East European countries	2.3	1.8	1.9	2.0		3.3	2.6	3.3	1.9
Rest of world	10.1	12.5	13.5	13.1		24.6	29.3	28.1	31.5
Total	100.0	100.0	100.0	100.0		100.0	100.0	100.0	100.0

Sources: Data provided by Portuguese authorities; and IMF, Direction of Trade.

1/ January-August.

2/ Angola, Mozambique and Guinea-Bissau.

Table 41. Portugal: Composition of Imports, 1979-82

(Customs basis; in escudos)

	1979 Share in total imports	1982 1/ Share in total imports	1979		1980		1981		1982 1/	
			Volume	Prices	Volume	Per cent Prices	Volume	Prices	Volume	Prices
Agricultural products	16.8	14.3	12.9	26.9	0.3	18.4	11.8	31.4	6.7	1.0
Mineral products	20.3	28.6	14.7	48.7	2.2	74.3	-7.0	39.5	13.1	17.8
Chemicals and related products	13.8	10.8	-0.1	41.4	7.6	20.2	7.0	8.6	-3.4	18.8
Hides, skins, wood, and paper	3.2	3.1	14.9	47.9	31.1	11.7	18.4	8.1	-3.7	21.7
Textiles and clothing	7.5	6.1	22.2	26.5	25.8	13.5	-7.9	16.9	1.4	14.5
Metals and metal products	8.3	7.4	-14.4	38.7	21.1	16.4	4.9	3.8	13.4	16.6
Machinery and appliances	17.7	17.2	4.6	26.8	19.0	18.5	8.8	13.9	5.8	19.3
Transport equipment (excluding airplanes and ships)	7.4	8.1	1.7	37.4	16.9	17.7	26.2	20.5	1.9	15.8
Miscellaneous	3.6	3.8	12.5	25.7	26.1	8.8	17.1	11.1	10.0	20.0
Total (excluding airplanes ships, and diamonds)	98.6	99.4	6.8	35.2	12.0	27.8	5.2	21.3	6.3	16.6
Airplanes and ships	0.6	0.2	--	--	--	--	--	--	--	--
Diamonds	0.8	0.4	--	--	--	--	--	--	--	--
Total	100.0	100.0	6.7	35.2	12.0	27.9	5.2	21.3	5.6	16.6

Source: Data provided by the Portuguese authorities.

1/ Provisional. Estimates based on actual data for the first ten months of 1982.

Table 42. Portugal: Terms of Trade, 1976-82 1/

(1970 = 100)

	Index of Unit Export Values	Index of Unit Import Values	Terms of Trade	Percentage Change
1976	178.8	210.2	85.1	-3.7
1977	242.2	271.6	89.2	4.8
1978	298.7	334.9	89.2	--
1979	382.3	452.8	84.4	-5.4
1980	464.9	579.1	80.3	-4.9
1981	525.8	702.4	74.9	-6.7
1982 <u>2/</u>	617.3	819.1	75.4	0.7

Sources: Data provided by the Portuguese authorities; and staff estimates.

1/ Revised series published in Ministry of Industry, Energy and Exports, Comercio Externo - Estatisticas para o Planeamento - Series Anuais - Decada de 70.

2/ Provisional.

Table 43. Portugal: Nonfactor Services Account, 1977-82

(In millions of U.S. dollars)

	1977	1978	1979	1980	1981	1982 <sup>1/</sup>
Nonfactor service receipts	893	1,142	1,684	2,131	2,162	1,683
Tourism	403	592	942	1,149	1,024	883
Freight	37	53	73	81	86	69
Other transportation	230	229	344	475	547	370
Insurance	10	16	20	24	26	17
State transactions	53	53	115	113	177	44
Other	160	199	190	289	302	300
Nonfactor service payments	811	866	1,143	1,563	1,643	1,503
Tourism	135	161	247	289	246	249
Freight	282	297	382	539	564	540
Other transportation	89	114	149	211	200	187
Insurance	47	46	54	78	82	91
State transactions	91	84	116	163	270	119
Other	167	165	195	283	281	317
Nonfactor service balance	82	276	541	567	519	180
Tourism	268	431	695	859	778	634
Freight	-245	-244	-309	-458	-478	-471
Other transportation	141	115	195	264	347	183
Insurance	-37	-29	-34	-54	-56	-74
State transactions	-38	-31	-1	-50	-93	-75
Other	-7	34	-5	6	21	-17

Sources: Bank of Portugal, Annual Report; and data provided by the Portuguese authorities.

<sup>1/</sup> Provisional.

Table 44. Portugal: Tourism Receipts, 1973-82

	<u>Tourist Nights</u> In thousands	<u>Receipts per night</u> In U.S.    In escudos at dollars    current prices		<u>Portuguese Tourist Receipts</u>  In millions of U.S. dollars	<u>OECD (European Countries) Tourist Receipts</u>  In millions of U.S. dollars	<u>Market Share 1/</u>
1973	5,653	97	2,392	550	19,443	2.8
1974	4,443	115	2,922	514	20,475	2.5
1975	3,329	108	2,760	360	24,506	1.5
1976	3,676	89	2,690	328	25,635	1.3
1977	5,988	67	2,565	403	33,065	1.2
1978	6,658	89	3,911	592	41,896	1.4
1979	7,835	120	5,896	942	50,794	1.9
1980	8,230	139	6,984	1,148	56,983	2.0
1981	7,843	131	8,132	1,026	52,545	1.9
1982 <u>2/</u>	6,040	109	3,575	883	49,600	1.8

Source: Data provided by the Portuguese authorities.

1/ Ratio of tourist receipts in Portugal to tourist receipts in European OECD countries.

2/ January-September.





Table 45. Portugal: Emigrant Workers' Remittances, 1970-82

	In Millions of U.S. Dollars (1)	Number of Emi- grant Workers In thousands (2)	Remittance Per Worker		Index of Emi- grant Wages 1/ In U.S. dollars 100=1970 (5)	Remittances/ Earnings Ratio (4)/(5)	Quasi-Money Held by Emigrant Workers End of period; in billions of escudos (6)
			In U.S. Dollars (3)	Index 100=1970 (4)			
1970	452	1,350	335	100	100	100	...
1971	602	1,500	401	120	111	108	...
1972	747	1,605	465	139	133	105	...
1973	972	1,725	564	168	170	99	...
1974	949	1,795	529	158	187	84	...
1975	821	1,840	446	133	236	56	...
1976	907	1,873	484	144	241	60	4.6
1977	1,174	1,902	617	184	263	70	34.0
1978	1,671	1,927	867	259	321	81	80.2
1979	2,455	1,951	1,258	376	384	98	133.5
1980	2,928	1,972	1,485	443	440	101	229.9
1981	2,832	1,990	1,423	425	401	102	352.2
1982 <sup>2/</sup>	2,688	2,000	1,344	401	398 <sup>3/</sup>	99	486.3

Sources: Data provided by the Portuguese authorities; and Fund staff estimates.

<sup>1/</sup> Weighted index of developments in the wage bill per man in France and Germany (weights 0.8 for France and 0.2 for Germany).

<sup>2/</sup> Provisional.

<sup>3/</sup> Estimates based on first three quarters.

Table 46. Portugal: Private, Medium-Term and Long-Term Capital Flows, 1977-82 <sup>1/</sup>

(In millions of U.S. dollars)

	1977	1978	1979	1980	1981	1982 Prel.
From abroad to Portugal, net	9	245	434	326	890	1,653
Direct investment	52	56	49	119	135	108
Portfolio investment	10	2	-1	1	1 )	
Trade credits	38	31	-103	-251	-1 )	
Financial loans	-121	144	444	403	718 )	1,410
Of which:					)	
Drawings	220	340	584	457	928 )	
Amortizations	341	196	140	54	210 )	
Other	30	12	45	54	37	35
From Portugal to abroad, net	10	4	28	-10	4	11
Direct investment	-2	-7	11	-14	-21	-9
Portfolio investment	--	--	2	1	--	--
Trade credits	21	16	23	11	18	9
Financial loans	--	5	2	1	4	7
Other	-9	-10	-11	-9	3	4
Total net	19	249	462	316	894	1,664

Sources: Bank of Portugal; Annual Report 1980; and data provided by the Portuguese authorities.

<sup>1/</sup> Including public enterprises.

Table 47. Portugal: Gross International Reserves, 1973-82

(In millions of U.S. dollars, end of period)

	Official Reserves (Bank of Portugal and Treasury)				Commercial and Savings Banks (5)	Total (6)=(4)+(5)
	Total reserves minus gold (1)	Of which: Foreign exchange (2)	Gold 1/ (3)	Subtotal (4)		
1973	1,676	1,641	1,163	2,839	304	3,143
1974	1,161	1,125	1,193	2,354	412	2,766
1975	398	390	1,136	1,534	347	1,881
1976	176	166	1,125	1,301	702	2,003
1977	366	361	1,025	1,391	881	2,272
1978	871	871	1,009	1,880	996	2,876
1979						
1st qtr.	659	640	996	1,655	1,019	2,674
2nd qtr.	624	619	1,000	1,624	1,203	2,827
3rd qtr.	1,071	1,070	1,020	2,091	1,386	3,477
4th qtr.	931	930	1,020	1,951	1,508	3,459
1980						
1st qtr.	607	587	13,988	14,595	1,324	15,919
2nd qtr.	448	420	12,053	12,501	1,427	13,928
3rd qtr.	1,101	1,077	14,364	15,465	1,667	17,132
4th qtr.	795	751	13,903	14,698	1,739	16,437
1981						
1st qtr.	569	500	11,508	11,567	1,519	13,086
2nd qtr.	576	516	10,617	11,193	1,418	12,611
3rd qtr.	814	756	9,329	10,143	1,502	11,645
4th qtr.	544	477	9,308	9,852	1,553	11,405
1982						
1st qtr.	319	256	8,028	8,603	1,365	9,968
2nd qtr.	488	431	7,366	8,285	1,444	9,729
3rd qtr.	588	533	8,402	9,523	...	...
4th qtr.	449	393	9,440	10,282	...	...

Sources: Bank of Portugal; IMF, International Financial Statistics, and staff estimates.

1/ With gold valued at the official price of SDR 35 per ounce until December 31, 1979 and at the quarterly average London market price thereafter.

Table 48. Portugal: Net External Assets, 1973-82

(In millions of U.S. dollars)

Stocks at end of period	Total	Bank of Portugal <u>1/</u>	Treasury	Other Banks
1973	3,012	2,789	55	168
1976	285	130	93	62
1977	-720	-307	92	-505
1978	-249	-103	157	-303
1979				
I	-192	-237	140	-95
II	-26	-185	121	38
III	877	65	416	396
IV	1,138	155	291	692
1980				
I	5,276	4,727	137	412
II	5,435	4,653	150	632
III	6,677	5,338	261	1,078
IV	6,615	5,221	204	1,190
1981				
I	6,085	5,029	105	951
II	6,386	5,307	112	967
III	6,752	5,546	140	1,066
IV	6,414	5,178	94	1,142
1982				
I	6,123	5,067	39	1,017
II	6,316	5,155	50	1,111
III	6,450	5,319	53	1,078
IV	6,441	5,273	39	1,129

Source: Bank of Portugal.

1/ With gold stock valued at the official price of SDR 35 per ounce until December 31, 1979 and a US\$254.92 per ounce thereafter.

Energy

Portugal is relatively poorly endowed with energy resources and is highly dependent on petroleum imports to satisfy its energy requirements. In 1982 oil imports accounted for over 75 per cent of Portugal's energy consumption, which at a cost of over US\$2.6 billion placed a serious strain on the balance of payments (Table 49). Whereas Portugal was slow to adjust to the first oil shock, prices of petroleum products in the domestic market have been raised significantly in real terms since 1979 (Table 50). As a result, the intensity of energy consumption, as measured by energy demand in relation to GDP, declined by an estimated 13 1/2 per cent between 1979-82, after having increased by 2 1/2 per cent between 1973-76. In view of Portugal's high dependence on oil imports for its energy needs, the authorities' recently released draft National Energy Plan places primary emphasis on measures to promote energy conservation. In addition the diversification of Portugal's sources of energy imports is to be encouraged as is the development of Portugal's hydroelectric production and its nuclear capability. The Energy Plan envisages overall investment in the energy sector of at least Esc 300 billion between 1983-90 or approximately 12 per cent of total investment expected over that period. Almost 66 per cent of this investment would be directed at increasing electricity production and improving the distribution network in the electricity sector.

1. Energy demand

Portugal's energy demand per capita is approximately one quarter that of the OECD average and with the exception of Turkey the lowest in the OECD. In part this reflects Portugal's favorable climate as a result of which only around 8 per cent of overall energy consumption is directed toward residential usage. The principal uses of energy in Portugal are for transportation and industry which account for 40 per cent and 30 per cent of overall petroleum consumption, respectively. In reflection of the structure of final energy demand, Portugal's imports of petroleum are heavily weighted toward fuel oil which accounts for over 45 per cent of total petroleum imports.

Since the first oil shock in 1973, Portugal has reduced the level of its energy usage in relation to GDP by very much less than other OECD members, although since 1979 there has been a changed pattern of energy usage in response to higher prices. Albeit declining, the income elasticity of demand for energy averaged around 1.5 between 1973-82. The income elasticity of demand for electricity has been significantly higher in recent years partly as a result of the lesser adjustment in electricity prices. The share of electricity in total energy usage has increased from 9 per cent in 1974 to over 12 per cent by 1982.

A basic objective of the authorities' draft National Energy Plan is to reduce the income elasticity of demand for energy to below one over the longer term. In this regard, the authorities are committed to maintaining realistic prices for energy products. Since 1973 petroleum product

prices have been adjusted on numerous occasions resulting in real increases in the price of gasoline by 48 per cent, diesel by 109 per cent and fuel oil by 300 per cent (Table 50). As a result of these adjustments, gasoline prices in Portugal are among the highest in Europe, while the prices of diesel and of fuel oil are now around the average prevailing in other European countries (Table 51). Currently, indirect taxes account for almost 60 per cent of the retail price of gasoline, while the subsidy element to fuel oil prices has been progressively reduced from 34 per cent of total cost in 1980 to 17 per cent by 1982 (Table 52). Consequently, the contribution of petroleum taxes net of fuel subsidies to the budget has increased from Esc 4.5 billion in 1980 to Esc 10.4 billion in 1981 and to Esc 29.0 billion in 1982 (Table 53).

In addition to a realistic pricing policy, the draft National Energy Plan lays stress on policies to promote energy conservation. This effort is to be mainly concentrated in the industrial sector through investments that will reduce energy usage. Between 1983 and 1990 a total of Esc 63 billion is to be devoted to these efforts or approximately 13 per cent of the total investment envisaged under the Plan. The programs to be financed will be undertaken together with the World Bank and energy audits will be required of the public enterprises.

## 2. Energy supply

An overriding objective of the authorities' draft Energy Plan is to reduce Portugal's dependence on imported petroleum from the current 75 per cent of total energy consumption to around 60 per cent by 1990. This is to be achieved through investments aimed at maintaining the proportion of overall energy needs supplied by domestic sources, principally hydroelectric power and biomass production, and by increasing the proportion of energy needs supplied by coal imports from the current 2 per cent to 17 per cent by 1990. Beyond 1990, the Plan envisages a possible increased role for domestic nuclear energy production although the necessary decisions in this respect are yet to be taken.

As regards the domestic sources of energy, hydroelectricity accounted for around 19 per cent of Portugal's primary energy requirements over the past five years (Table 49). Production from this source is, however, highly dependent on climatic conditions and during 1981 and 1982 production was reduced to around two thirds of normal levels by severe drought conditions. The Energy Plan envisages that through a series of small hydroelectricity projects, capacity could be raised by over 20 per cent by 1990.

Nuclear energy production offers Portugal the possibility of significantly reducing its dependence on imported sources of energy in the 1990s. Portugal has an estimated 8,200 tons of uranium reserves which would suffice to provide fuel for three 1,000 m.w. reactors for 25 years. In addition Portugal has the necessary trained personnel for operating nuclear plants. However, the political decision as to whether to proceed along this route is still to be taken and delays are to be expected in the process of selecting a site.

The National Energy Plan's objective of raising the proportion of total energy needs to be met from coal to 17 per cent by 1990 is to be attained primarily through increased coal imports. This would be done mainly for reasons of cost effectiveness but it would at the same time allow a diversification of Portugal's energy supplies. The increase in coal imports that is envisaged would require large scale infrastructural investment in port and transport facilities for which feasibility studies are currently being undertaken.

Table 49. Portugal: Energy Balance Sheet, 1978-82

(In millions of tons of petroleum equivalent, TPE)

	Stocks	Consumption		Domestic Production		Imports	
		As percentage		As percentage		As percentage	
	TPE	TPE	of total consumption	TPE	of total consumption	TPE	of total consumption
1978							
Coal and other solid	--	1.17	10.94	0.81	7.58	0.36	3.37
Crude oil	-0.24	6.58	61.55	--	--	6.34	59.31
Petroleum products	0.16	0.41	3.84	--	--	0.57	5.33
Hydroelectric power	--	2.53	23.67	2.55	23.85	-0.02	-0.19
Total	-0.08	10.69	100.00	3.36	31.43	7.25	67.82
1979							
Coal and other solid	-0.02	1.21	10.62	0.85	7.46	0.34	2.98
Crude oil	0.18	8.36	73.33	--	--	8.54	74.91
Petroleum products	0.85	-0.79	06.93	--	--	0.06	0.53
Hydroelectric power	--	2.62	22.98	2.64	23.16	-0.02	-0.18
Total	1.01	11.40	100.00	3.49	30.62	8.92	78.24
1980							
Coal and other solid	-0.01	1.25	10.85	0.90	7.81	0.34	2.95
Crude oil	0.71	7.63	66.23	--	--	8.34	72.40
Petroleum products	0.07	0.58	5.04	--	--	0.65	5.64
Hydroelectric power	--	2.06	17.88	1.90	16.49	0.16	1.39
Total	0.77	11.52	100.00	2.80	24.30	9.49	82.38
1981							
Coal and other solid	-0.04	1.22	10.76	0.93	8.20	0.25	2.20
Crude oil	-0.42	7.94	70.02	--	--	7.52	66.31
Petroleum products	-0.07	0.70	6.17	--	--	0.63	5.56
Hydroelectric power	--	1.48	13.05	1.22	10.76	0.26	2.29
Total	-0.53	11.34	100.00	2.15	18.96	8.66	76.36
1982							
Coal and other solid	0.02	1.20	10.52	0.93	8.15	0.29	2.54
Crude oil	-0.14	7.81	68.45	--	--	7.67	67.22
Petroleum products	0.68	0.53	4.64	--	--	1.21	10.61
Hydroelectric power	--	1.87	16.39	1.61	14.11	0.26	2.28
Total	0.56	11.41	100.00	2.54	22.26	9.43	82.65

Source: Data supplied by the Portuguese authorities.

Table 50. Portugal: Real Prices of Petroleum Products, 1973-82 1/  
(1972 = 100)

	Imported Price of Crude Oil	Super Gasoline	Diesel	Fuel Oil
1973	101.7	91.9	90.5	92.4
1974	224.3	118.3	106.2	122.5
1975	225.8	109.6	97.9	131.8
1976	240.6	129.8	103.5	170.4
1977	255.2	131.1	105.7	174.3
1978	243.9	128.9	106.6	184.0
1979	305.5	128.8	118.0	190.1
1980	476.2	147.4	159.2	283.5
1981	567.3	143.8	178.9	308.7
1982 <u>2/</u>	562.2	136.4	188.9	369.2

Sources: Bank of Portugal; and Department of Energy.

1/ Deflated by the Consumer Price Index.

2/ Provisional estimates.

Table 51. Portugal: Comparative Prices of  
Petroleum Products 1/

(In escudos per litre)

	Super Gasoline	Diesel	Fuel Oil <u>2/</u>
Portugal	74.0	40.0	17.5
Germany	53.6/60.8	49.8/54.7	16.0
Belgium	60.0	44.8	18.8
France	60.6/63.2	48.1/50.1	18.1
Greece	53.4	26.2	12.2
Netherlands	59.4/60.7	39.7/40.1	18.2
United Kingdom	54.4	52.9	24.5
Italy	77.0	37.0	21.0

Source: Ministry of Industry, Energy and Exports.

1/ As of January 13, 1983.

2/ In escudos per kilogram.

Table 52. Portugal: Structure of Fuel Prices, 1980-82

(In escudos per litre)

	Petrol <u>1/</u>	Diesel	Fuel Oil <u>2/</u>	Naphtha/ Chemicals
1980				
Crude oil, c.i.f.	14.7	13.6	9.9	14.7
Refining costs	1.3	1.2	0.9	1.3
Marketing costs	2.0	1.5	0.4	--
Excise taxes and royalties	<u>4.6</u>	<u>0.2</u>	<u>0.2</u>	<u>0.2</u>
Total cost	22.7	16.5	11.4	16.2
Sale price	43.9	17.5	7.5	3.6
Tax (+) or subsidy (-) <u>3/</u>	21.3	1.0	-3.9	-12.6
1981				
Crude oil, c.i.f.	19.4	17.3	14.8	18.2
Refining costs <u>4/</u>	2.4	1.6	0.5	1.2
Marketing costs	<u>4.6</u>	<u>0.3</u>	<u>0.3</u>	<u>0.2</u>
Excise taxes and royalties				
Total cost	26.4	19.2	15.6	19.6
Sale price	51.4	23.6	9.8	12.5
Tax (+) or subsidy (-)	25.0	4.4	-5.8	-7.1
1982				
Crude oil, c.i.f.	23.1	22.9	16.6	22.9
Refining costs <u>4/</u>	2.4	1.9	0.5	1.4
Marketing costs	<u>4.3</u>	<u>0.3</u>	<u>0.2</u>	<u>0.2</u>
Excise taxes and royalties				
Total cost	29.8	25.1	17.3	24.5
Sale price	59.5	30.4	14.3	16.7
Tax (+) or subsidy (-) <u>3/</u>	29.7	5.3	-3.0	-7.8

Source: Ministry of Industry, Energy and Exports.

1/ An average of premium and standard prices.2/ In escudos per kilogram.3/ Not net of distribution costs, freight adjustments, financial charges, etc.4/ Included in c.i.f.

Table 53. Portugal: Budgetary Outlays for Fuel  
Subsidies and Taxes, 1980-82

	<u>Total Consumption</u> In millions of liters	<u>Subsidy 1/</u> In escudos per liter	<u>Total Subsidies 1/</u> In billions of escudos
1980			
Petrol	955	21.30	20.3
Diesel	1,955	1.00	2.0
Fuel oil	3,700 <u>2/</u>	-3.85 <u>3/</u>	-14.3
Naphtha/chemicals	280 <u>2/</u>	-12.60 <u>3/</u>	-3.6
Aggregate balance	...	...	4.5
1981			
Petrol	969	25.0	24.2
Diesel	2,078	4.4	9.1
Fuel oil	3,758	-5.8 <u>3/</u>	-21.8
Naphtha/chemicals	158	-7.1 <u>3/</u>	-1.1
Aggregate balance	...	...	10.4
1982			
Petrol	1,012	29.7	30.1
Diesel	2,167	5.3	11.5
Fuel oil	3,770	-3.0 <u>3/</u>	-11.3
Naphtha/chemicals	161 <u>2/</u>	-7.8 <u>3/</u>	-1.3
Aggregate balance	...	...	29.0

Source: Ministry of Industry, Energy and Exports.

1/ Tax (+) or subsidy (-).

2/ In millions of kilograms.

3/ Escudos per kilogram.

### The Social Security System in Portugal

The current system of social security in Portugal is the outgrowth of a series of socioeconomic changes that took place in the country after the 1974 revolution. The expansion and improvement of the social security system was a reflection of the greater priority given to social concerns after the revolution of 1974-75. Not surprisingly, the financial support of the new system became one of the major responsibilities of the public sector.

#### 1. Structure of the Social Security System

Until 1974 social security comprised two independent branches: "Assistance" and "Providence". Under the new, unified system, the Social Security Administration belongs to the Ministry of Social Affairs and is headed by a Secretary of State. The system follows all of the provisions of Convention 102 of the International Labor Office and comprises Old Age, Survivors and Disability Insurance, Unemployment Insurance, Family Allowances and Sickness and Maternity Insurance. The system also includes a special, noncontributive pension, named "Social Pension", which is extended to people in need that do not qualify under other criteria.

The coverage of social security, as defined for budgetary purposes, includes employees in industry and commerce, wage and salary earners in agricultural enterprises, domestic servants, and self-employed in industry. Fishermen, seamen, farm laborers, railway employees and civil servants are covered by special systems.

The current minimum pension is Esc 7,000 per month for 13 months a year, i.e., 12 calendar months plus the Christmas bonus, and represents approximately 50 per cent of the minimum wage. About 85 per cent of all pensioners receive the minimum pension. The entitlement is a function of the employment history of the beneficiary but the calculation is based only on the highest wages of the last five years of a pensioner's insurance. At present the contributions are 8 per cent of earnings for the employee and 20 per cent of payroll for the employer. There is a ceiling on taxable wages which is rather high and is also periodically adjusted. The contributions include a portion allocated to the noncontributive "social pension". They also finance sickness and maternity benefits. <sup>1/</sup> For the old-age pension the retirement age is 65 for men and 62 for women with some minor exceptions. The qualifying conditions also include five years of insurance, including 60 months of continuous contribution. For the disability pension the qualifying conditions are loss of two thirds of earning capacity and three years of insurance, including 24 months of continuous contribution.

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<sup>1/</sup> These are only cash benefits. In 1977 the administration of in-kind medical benefits was transferred to the National Health Service, which was established as an independent agency under the Ministry of Social Affairs.

Unlike retirement and disability programs, which have a broad coverage, unemployment insurance covers only 35 per cent of the unemployed, mainly due to the high number of first-time entrants in the labor force. The eligibility criteria are twofold: the person must have, first, been previously employed and insured for at least six months and, second, been involuntarily laid off. If a beneficiary is over 60, then after two years of unemployment insurance he/she is obliged to move to the old-age coverage. Unemployment benefits are 100 per cent of the minimum wage for heads of households and 70 per cent for single beneficiaries. The benefits normally last for one year but, if circumstances warrant, may be extended for up to a maximum of two years. This system was established in 1977.

Family allowances are extended to employees in industry and commerce, liberal professions, domestic servants and fishermen with one or more children. Civil servants and agricultural wage earners are covered by special systems. There is no government contribution to the family allowance scheme and no means test, except in the case of noncontributors. The benefits include child allowance (with special supplements for handicapped children), nursing allowance, a birth grant and a marriage grant.

## 2. Trends in the finances of the Social Security System

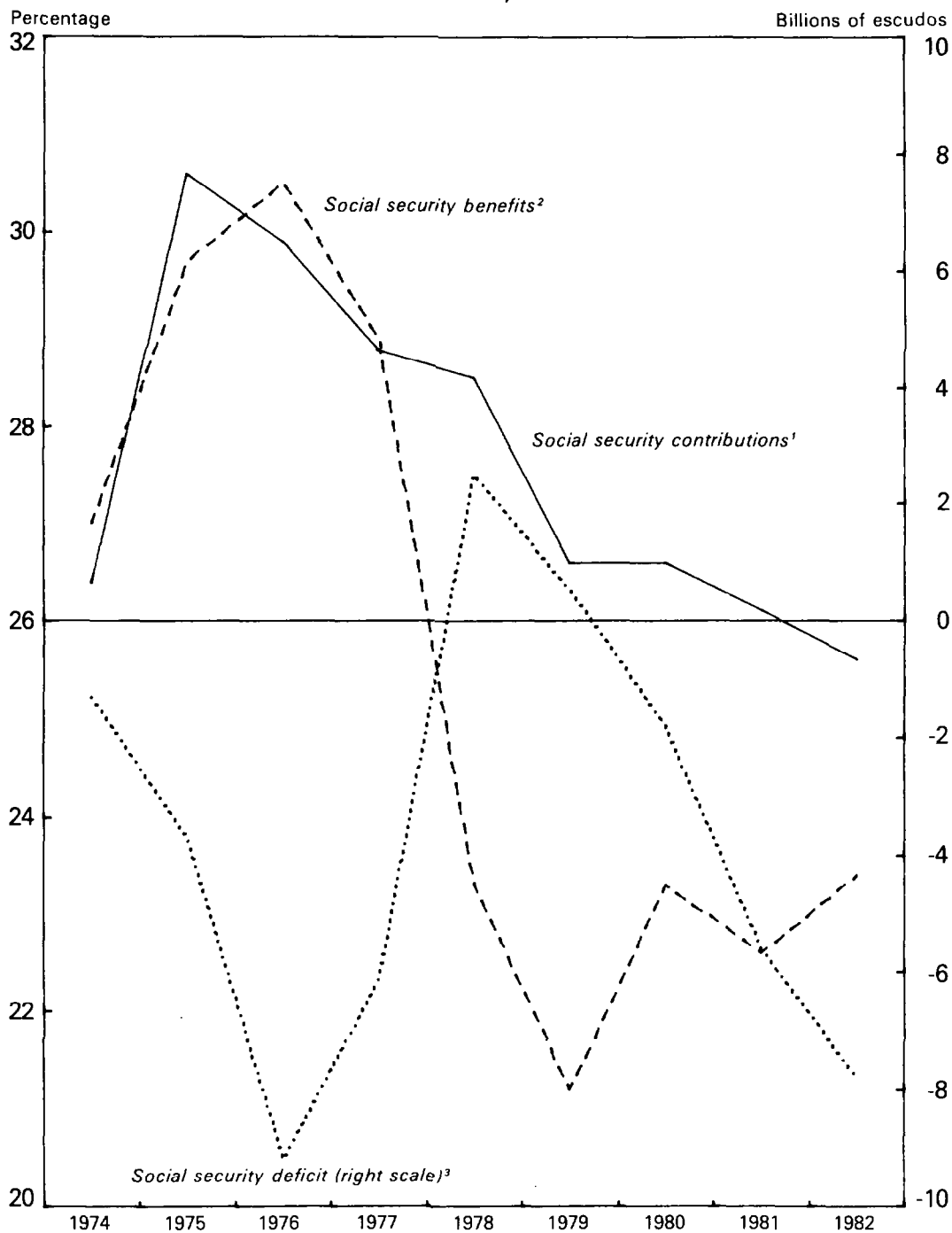
Next to State, the Social Security Administration ranks as the most important subsector of general government both in terms of revenue collected and expenditure disbursed. In 1981 and 1982 current receipts of social security averaged 27 per cent of general government current revenue and social security current expenditure 25 per cent of general government current outlays. <sup>1/</sup> The principal source of revenue is the contributions by employers and employees, but the social security budget also receives transfers from the State budget and the Unemployment Fund. On the expenditure side, over 90 per cent of current outlays represent social security benefits (Table 54).

Social security operations over the period 1974-82 clearly point to the trends that have caused the emerging fiscal difficulties of the last few years (Table 54 and Chart 7). After reaching a peak within the first two years of the introduction of the new system, both receipts and expenditures moved along a decelerating trend until 1979, at which point there was a split in their trajectories. Specifically, as a per cent of general government current receipts, social security contributions reached a peak of 30.6 in 1975 and consistently declined to 25.6 in 1982. On the other hand, social security benefits as per cent of general government current outlays reached a peak of 20.5 in 1976 declining monotonically to 21.2 by 1979. Their downward trend was sharper than that of contributions, but was reversed in 1980 following the expansion of unemployment insurance

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<sup>1/</sup> The analysis is conducted in terms of the current account because the capital account represents a very small component in the system and, in any event, it does not reflect policy decisions.

CHART 7  
PORTUGAL  
TRENDS IN SOCIAL SECURITY CONTRIBUTIONS  
AND BENEFITS, 1974-1982



<sup>1</sup>Social security contributions as per cent of general government current tax receipts.

<sup>2</sup>Social security benefits as per cent of general government current expenditure.

<sup>3</sup>Social security current balance.



and a general improvement in old-age pensions. <sup>1/</sup> Despite a temporary decline in 1981, the share of social security benefits in public expenditure rose again in 1982, thus sustaining the divergence from the trend of receipts that began in 1979.

The balance of the system has followed a pattern consistent with the developments on the expenditure side, as the nearly perfect mirror-image of the two series in Chart 7 demonstrates. It is worthwhile noting at this juncture that, in terms of absolute magnitude, the rates of growth of benefits and contributions have been almost equal over the long run. Chart 8 presents their rates of growth between 1974 and 1982. The rate of growth of GDP is also shown for comparison. As the chart indicates, 1976 was the year with the greatest divergence in the rates of growth between receipts and outlays, 1978 the year when the trends were reversed, and 1980 the year when the gap began to close. Correspondingly, in 1976 the budget registered the highest deficit, in 1978 the deficit turned into a surplus and in 1980 the surplus shifted back to a deficit.

The growing deficit of the social security system, at least since 1979, reflects two reinforcing factors: first, the Government has followed a policy of keeping benefits constant in real terms. There is no automatic indexation built into the system, but benefits have been de facto adjusted annually on the basis of past inflation. Second, evasion of the payroll tax has apparently been growing in recent years and the authorities have often accepted the accumulation of arrears in the payments of social security contributions by firms experiencing financial difficulties. The social security budget revenue projections for 1983 assume some reduction in arrears, but such estimates have proved rather optimistic in the recent past.

The composition of benefits has changed dramatically during the post-1974 evolution of the social security system (Table 55). Contributive pensions (old-age, survivors, disability) rose substantially from 36 per cent of total benefits in 1974 to 71 per cent in 1982. On the other hand, the importance of sickness and maternity allowances declined sharply and their share dropped from 39 per cent in 1974 to 9 per cent in 1982; similarly, the share of family allowances declined steeply from 25 per cent in 1974 to 10 per cent in 1982. Between these two extremes, the shares of the social pension and of the unemployment insurance have stabilized at 5 per cent in the past few years; the former gained importance after 1979, whereas the latter was introduced in 1977.

### 3. Some international comparisons and conclusions

Table 56 and Chart 9 provide information on the position of Portugal's social security system in reference with EC countries. As

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<sup>1/</sup> In the same year revenues were also stabilized as a per cent of general government receipts, thanks to the marginal increase of contributions from 7.5 to 8 per cent for employees and from 19 to 20 per cent for employers.

Table 56 indicates, Portugal ranks second in terms of the share of employees' contributions and third in terms of employers' contributions to total receipts, which highlights the degree of independence of the system. Although international comparisons of this sort must be made with caution, this information suggests that the finances of Portugal's social security system are more vulnerable to adverse socio-demographic developments than that of other countries. There is currently little available information on this potential problem from a global perspective, but it is known that at least one sector, namely agriculture, is faced with a growing imbalance of its social security accounts, due to the rapidly diminishing employment in the sector that is necessary for the support of the system.

On the other hand, Chart 9 illustrates that social security expenditures in Portugal are not out of line with its per capita income. The implication of the combined information contained in Table 56 and Chart 9 is that the problem with the Portuguese social security system is not so much that of the level of outlays in relation to income, as it is one of revenue composition. The basic inference is that in the future it may be necessary to finance the social security system with a growing share of general revenue, which, in turn, would imply a changing ranking of national priorities as expressed through the general government budget.

CHART 8  
PORTUGAL  
GROWTH OF SOCIAL SECURITY COMPONENTS

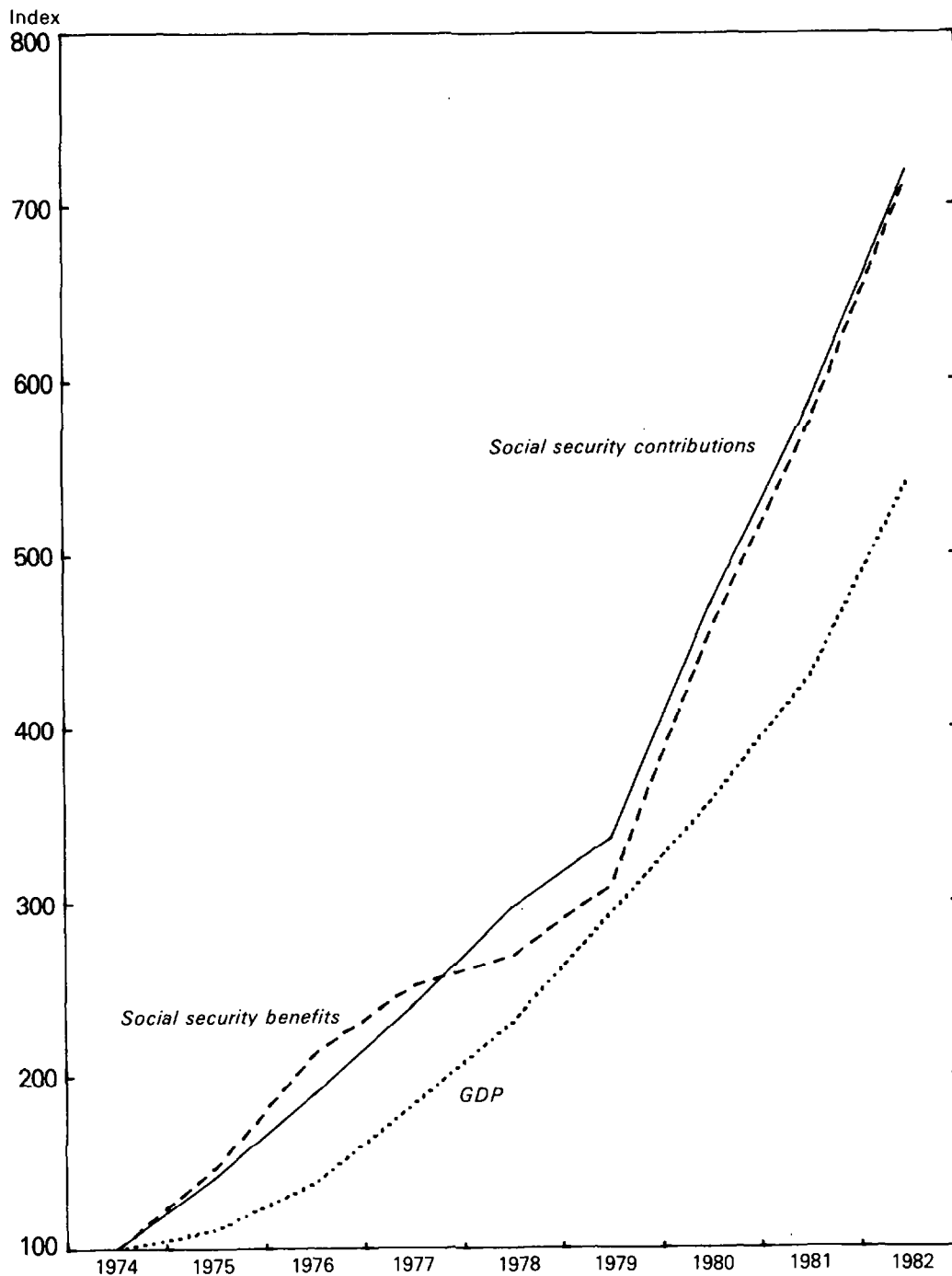




CHART 9  
PORTUGAL  
EEC AND PORTUGAL: SOCIAL SECURITY  
EXPENDITURES, 1980

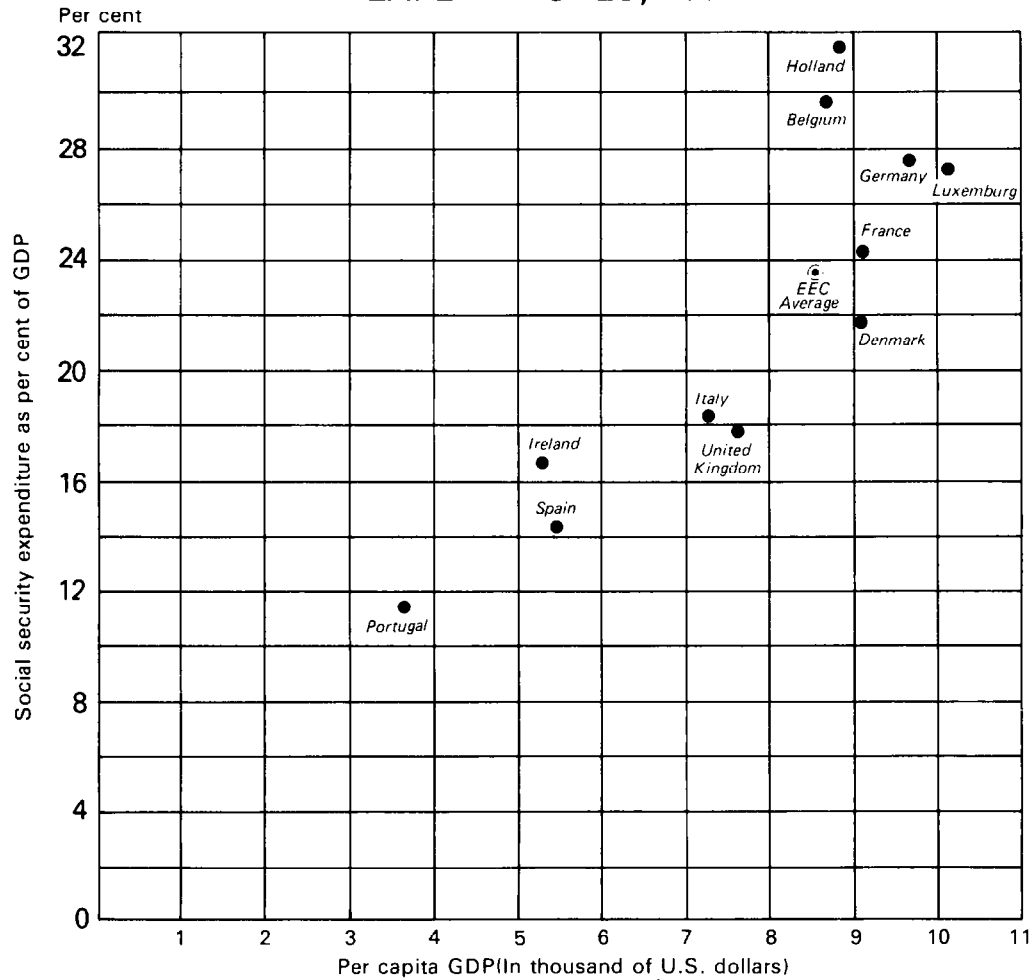




Table 54. Portugal: Social Security Budget, 1974-82

	1974	1975	1976	1977	1978	1979	1980	1981	1982
Current receipts	<u>22.0</u>	<u>29.5</u>	<u>39.3</u>	<u>50.0</u>	<u>65.3</u>	<u>71.2</u>	<u>100.8</u>	<u>122.5</u>	<u>151.1</u>
Social security contributions	19.3	27.2	36.6	46.2	57.3	65.1	90.7	112.9	139.0
Transfers from other general government sectors	--	0.8	1.3	2.8	6.9	4.6	6.5	8.2	10.3
Other receipts	2.7	1.5	1.4	1.0	1.1	1.5	3.6	1.4	1.8
Current outlays	<u>23.3</u>	<u>33.2</u>	<u>48.5</u>	<u>56.1</u>	<u>62.8</u>	<u>71.0</u>	<u>102.6</u>	<u>128.1</u>	<u>158.9</u>
Social security benefits	20.7	30.4	44.1	52.2	55.7	64.2	94.1	119.0	148.0
Other expenditures	2.6	2.8	4.4	3.9	7.1	6.8	8.5	9.1	10.9
Current balance	<u>-1.3</u>	<u>-3.7</u>	<u>-9.2</u>	<u>-6.1</u>	<u>2.5</u>	<u>0.5</u>	<u>-1.8</u>	<u>-5.6</u>	<u>-7.8</u>
Memorandum items:									
(In per cent)									
Social security contributions as per cent of general government current tax revenue	26.4	30.6	29.9	28.8	28.5	26.6	26.6	26.1	25.6
Social security benefits as per cent of general government current outlays	27.0	29.7	30.5	28.9	23.3	21.2	23.3	22.6	23.4

Sources: Social Security Administration; and staff estimates.

Table 55. Portugal: Distribution of Social Security Benefits, 1974-82

(In per cent)

	1974	1975	1976	1977	1978	1979	1980	1981	1982
Illness and maternity allowance	39	38	39	35	20	12	10	10	9
Family allowances	25	23	17	15	14	12	11	10	10
Unemployment insurance	...	...	...	2	7	5	5	5	5
Contributive pensions	36	39	41	48	59	66	69	70	71
Social pension	--	--	--	--	--	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>
Total	100	100	100	100	100	100	100	100	100

Sources: Social Security Administration; Ministry of Finance; and staff estimates.

Table 56. EEC and Portugal: Composition of Social Security Receipts, 1980

(In per cent)

	Employers' Contributions	Employees' Contributions	Transfers	Other Receipts	Total
Netherlands	37.1	25.8	20.4	16.7	100.0
Portugal	47.3	24.8	26.8	1.1	100.0
France	56.0	23.7	17.7	2.6	100.0
Luxemburg	36.2	22.6	31.6	9.6	100.0
Germany	42.7	22.1	26.7	8.5	100.0
Belgium	41.0	20.1	34.7	4.2	100.0
United Kingdom	33.3	14.6	43.6	8.5	100.0
Italy	58.8	13.6	24.9	2.7	100.0
Ireland	25.1	11.4	62.5	1.0	100.0
Denmark	9.6	1.8	84.9	3.7	100.0

Source: Social Security Administration.

## The Public Enterprises

### 1. Background

Following a wave of nationalizations after the 1974 revolution, the public enterprises in Portugal have acquired a substantial weight in the economy. Some sectors are reserved by law to public enterprises. These include the utilities, banking and insurance, public transport, some industrial activities (such as petroleum imports, refinery and distribution, mining, cement, petrochemicals and steel production) as well as the import of some essential foodstuffs. The Government made repeated attempts in 1980 and 1981 to open some sectors, such as banking and insurance, to private initiative but was hampered in its efforts by the opposition of the Council of the Revolution. Following the approval of the constitutional revision in late 1982 and the abolition of the Council, political obstacles to progress in this area have been removed.

On the basis of national accounts data, which unfortunately are only available through 1979, nonfinancial public enterprise accounted for 14 per cent of value added, 17 per cent of the wage bill and 30 per cent of fixed capital formation in the economy as a whole, on average during the period 1977-79. The corresponding ratios with respect to the nonfinancial corporate sector amounted to 31 per cent, 29 per cent, and 59 per cent in the same period. <sup>1/</sup> The weight of public enterprises in value added was, not surprisingly, especially high in the sectors of utilities (100 per cent) and of transport and communications (75 per cent). In industry the weight of the public enterprises averaged about 25 per cent. The public enterprises sector is highly concentrated, with four main activities (chemical industries, electricity and gas, transport and communications) accounting for 80 per cent of its gross fixed capital formation, 70 per cent of value added and two thirds of employment.

The financial position of the public enterprises over the last several years has been characterized by significant weakness, as is apparent from the aggregate data presented in Table 57, which refer to a sample of enterprises accounting for over 90 per cent of value added of the sector. These indicators point to a relatively tight liquidity position, a high debt/equity ratio and a high proportion of short-term debt in total indebtedness. They also indicate a significant shift in the composition of the enterprises' debt toward external financing. Disaggregated data by sectors suggest a fairly wide dispersion around the averages presented in Table 57, only partly related to the technical nature of the activity pursued by the enterprise. Economic factors, including the relative profit performance of the various enterprises and the varying degrees of budgetary support, have played an important role in determining this dispersion. The highest debt/equity ratios were recorded in enterprises in the sectors of fishing, machinery and equipment, water

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<sup>1/</sup> See A.J. Mendonça Pinto and V. Bento, "Empresas Publicas nao Financeiras", Bank of Portugal, Quarterly Bulletin, June 1982.





supply, construction and transport and communications. The highest ratios of short-term debt to total indebtedness, on the other hand, were recorded in the sectors of food distribution and processing, fishing, metallurgic industries and pulp and paper. Negative rates of return on own capital were registered in most sectors with the exception of some industrial activities, wholesale trade and communications (Table 58).

Although comparable data are not available beyond 1980, aggregate information from the monetary and external debt statistics points to a further deterioration in the position of the public enterprises in 1981 and 1982 (see Table 3 of the Staff Report, SM/83/88, 5/18/83). During those two years the growing financing requirements of the public enterprises were met primarily through a sharp increase in the foreign indebtedness, as budgetary transfers were virtually frozen and credit from the domestic banking system rose at rates significantly lower than for the private sector.

A more detailed analysis of the position of public enterprises in the sectors of industry and energy, on the one hand, and transport and communications, on the other, has been made in the last two years by the Central Planning Department of the Ministry of Finance, and its main results are reported in the two sections below.

## 2. Public enterprises in the industrial and energy sectors

The public enterprises in the industrial sector are concentrated in basic industries (mining, steel, chemical and petrochemical products, cement, pulp and paper and shipbuilding). In the energy sector the electricity company (EDP) has the monopoly of production, import and distribution of electricity and gas. The public enterprises in these sectors are generally characterized by high capital intensity, as evidenced by the relatively low share (less than 40 per cent) of expenditure on personnel in value added. Investment by these enterprises grew on average at considerably faster rates than in the economy as a whole (Table 59). Investment was, however, largely concentrated in a few enterprises, namely the electricity company and the chemical sector. On the basis of recent developments in the finances of the chemical companies, it appears that a number of large scale investment projects undertaken in the late 1970s, notably in the area of petrochemicals, were ill-advised as they resulted in an expansion of capacity in lines of production for which international demand and prices have substantially weakened.

Employment in these enterprises rose rapidly during the period 1977-80 but continued to account for a very small share of total employment in the economy. Labor costs per employee rose on average at a faster rate than in the rest of the economy. In absolute terms labor costs in industrial public enterprises remained substantially higher than in the manufacturing sector, partly reflecting the relatively higher

level of technical qualifications and productivity of workers in these enterprises. The financial position of the enterprises remained relatively weak during the second half of the 1970s partly in reflection of pricing policies which generally did not adequately affect increases in costs, particularly of imported raw materials and energy. As a result, the share of self-financing, albeit improving, remained on average relatively low (Table 60) and the resort by industrial public enterprises to indebtedness continued to rise, as reflected in the sharp increase in financial charges, which absorbed a very large and growing share of gross operating profits. There was, however, some improvement in the structure of indebtedness, with the share of short-term debt declining significantly between 1977 and 1980.

The aggregate data conceal a considerable degree of variation as between individual enterprises, with some (notably in the shipbuilding sector) affected by chronic financial disequilibria, others having seen their position deteriorate, e.g. the chemical companies, while in yet others (the steel and pulp and paper companies) some improvement was recorded during the period under consideration.

3. Public enterprises in the transport and communication sectors

The public enterprises in the transport sector account for a smaller share in value added and in investment but for a larger share in employment in the economy than the public enterprises in the industrial sector (Table 61). Investment by these public enterprises grew on average by 7.5 per cent a year, more rapidly than in the rest of the economy, during the period 1977-81. The increases were largely concentrated in three subsectors: air transport, communications and urban transport. Investment in shipping grew modestly and that in interurban transport experienced a significant decline, largely in reflection of the poor financial position of the enterprises in these sectors.

Employment, on the other hand, virtually stagnated during the period. While a substantial increase was recorded in the air transport sector (especially in the workforce in the national airline--TAP--and in the airport authority--ANA) and to a lesser degree in urban transport enterprises, employment declined significantly in the other subsectors, particularly in the railway company (CP). The share of value added of public enterprises in the transport sector in total value added of the economy declined slightly over the period; this decline is, however, partly a reflection of the pricing policies followed by the authorities, which have resulted in a decline in relative prices for some services provided by enterprises in this sector.

Pricing policies have also been largely responsible for a significant deterioration in the finances of several enterprises in the transport sector, as prices have frequently not been adjusted promptly and adequately in line with cost developments. As regards the latter, the most dynamic component has been expenditure on fuel (included under

"other" in Table 62). Amortizations and financial charges also have been rising rapidly, while the share of personnel expenditure in total costs has declined during the period, partly reflecting the above mentioned trends in employment.

Budgetary subsidies to the sector have decelerated markedly over the period, in reflection of the effort to moderate the growth of public expenditure and to contain the budget deficit. The decline in subsidies was partly compensated by increased capital transfers (Table 63) which, however, were not sufficient to prevent a significant growth of indebtedness, at an average annual rate in excess of 17 per cent between 1977 and 1981. On the whole, the financial structure of public enterprises in the transport sector remained characterized during the last several years by a high debt to equity ratio, tight liquidity position and a very high, albeit declining, share of short-term debt in total indebtedness.

As in the industrial sector, there was a wide dispersion in the economic and financial performance of enterprises in the sector, largely related to variations in pricing, budgetary support and other policies. The worst results were recorded in the interurban transport and air transport sectors while the sector of communications showed a strong performance. In the long distance transport sector, factors contributing to the deteriorating performance especially of the railway company were the maintenance of low traffic lines, the competition by alternative carriers on routes with high traffic density, inadequate compensation by the state for the imposition on the company of special tariffs for certain users, as well as delays in adjustments of prices. In the air transport sector, sharp increases in costs for personnel and fuel, not fully reflected in prices, have played an important role in the deterioration of the finances of the enterprises of the sector. The position of the national airline has also been weakened by questionable investment decisions, which have resulted in an expansion of capacity in long-haul routes, in which demand has been relatively depressed.

Table 57. Portugal: Indicators of the Financial  
Position in the Nonfinancial Public  
Enterprises Sector, 1978-80

	1978	1979	1980
Working capital/Short-term debt	0.86	0.92	0.92
Average stock x 12/Sales	6.00	5.40	4.80
Short-term debt/Total debt	0.24	0.25	0.28
Own capital/Total debt	0.31	0.39	0.34
Own capital/Debt toward banks <u>1/</u>	0.56	0.66	0.55
External debt/Domestic bank debt <u>2/</u>	...	0.68	0.83

Source: Bank of Portugal.

1/ Includes external debt toward banks.

2/ The corresponding values for this ratio in 1981 and 1982 are:  
1.03 and 1.23.

Table 58. Portugal: Economic Indicators for Nonfinancial  
Public Enterprises, 1977-80

(In per cent)

	1977	1978	1979	<u>1977-79</u> Average
On the basis of national accounts data:				
Fixed investment/Value added				
at factor costs	66.5	67.9	53.2	62.5
Wages/Value added	74.7	70.4	60.9	68.7
Gross profits/Value added	25.3	29.6	39.1	31.3
Rates of growth of:				
Value added (current prices)	...	27.4	40.6	...
Fixed investment (current prices)	...	30.1	10.0	...
Fixed investment (constant prices)	...	8.4	-8.7	...
	<u>1978</u>	<u>1979</u>	<u>1980</u>	
On the basis of sample <u>1</u> / data:				
Personnel expenditure/Sales	23.1	20.0	18.3	
Financial charges/Sales	13.9	14.6	11.0	
Subsidies/Sales	4.9	6.7	6.1	
Profits/Own capital	-4.6	-3.3	-6.1	

Source: Bank of Portugal.

1/ The sample covers enterprises accounting for about 85 per cent of total.

Table 59. Portugal: Public Enterprises in the Industrial and Energy Sectors--Main Economic Indicators, 1977-80

(In per cent)

	1977	1978	1979	1980
Shares in overall national:				
Value added (current prices)	4.9	6.2	7.6	7.8
Fixed investment	17.7	20.1	18.1	19.6
Employment	1.7	1.8	1.8	1.9
Rates of growth of:				
Value added (current prices)	...	58.1	59.3	22.8
Fixed investment (constant prices)	...	17.5	-12.3	19.9
Employment	...	6.8	5.5	4.9
Labor cost per employee	...	26.3	19.2	25.5
Financial charges (industrial sector)	...	285.7	33.1	45.0
Financial charges (energy sector)	...	101.5	63.1	41.7
Gross operating profits <u>1/</u> (industry)	-934	-1,778	2,632	-534
Gross operating profits <u>1/</u> (energy)	-119	-1,507	-2,488	-2,058

Source: Central Planning Department.

1/ In millions of escudos - A negative sign indicates a loss.

Table 60. Portugal: Public Enterprises in the Transport and Communications Sectors--Main Financial Indicators, 1978-81

(In per cent)

	1978	1979	1980	1981
Own capital/Medium- and long-term debt	84.0	51.2	46.1	68.1
Own capital/Total debt	27.5	17.1	14.6	25.1
Working capital/Short-term debt	51.4	59.1	57.4	56.1
Structure of indebtedness				
Short-term debt	67.2	66.2	68.2	63.2
Medium- and long-term debt	<u>32.8</u>	<u>33.8</u>	<u>31.8</u>	<u>36.8</u>
Total	100.0	100.0	100.0	100.0
Structure of budgetary support				
Subsidies	76.0	75.2	62.3	66.1
Capital transfers	<u>24.0</u>	<u>24.8</u>	<u>37.3</u>	<u>33.9</u>
Total	100.0	100.0	100.0	100.0

Source: Central Planning Department.

Table 61. Portugal: Public Enterprises in the Transport and  
Communications Sectors--Indicators of Their  
Weight in the Economy, 1977-81  
(In per cent)

	1977	1978	1979	1980	1981
Shares in total national:					
Value added (current prices)	5.2	5.1	5.0	4.5	4.7
Fixed investment (current prices)	...	...	...	6.6	7.8
Employment	3.1	3.1	3.0	3.0	2.9
Domestic credit to private sector and public enterprises	...	3.1	...	...	3.1
Share of subsidies and capital transfers to sector in total expenditure of state budget	5.1	5.9	4.9	4.7	3.4

Sources: Central Planning Department; and Bank of Portugal, Annual Reports.

Table 62. Portugal: Public Enterprises in Transport and Communications Sectors--Main Economic Indicators, 1978-81

(Percentage changes)

	1978	1979	1980	1981	<u>1977-81</u> Average
Value added (current prices)	24.8	23.6	8.9	26.8	20.8
Value added (constant prices)	3.7	4.3	-7.0	6.6	1.8
Investment (constant prices)	4.2	24.2	-15.6	33.7	7.5
Employment	1.7	-0.8	-0.1	-0.4	0.1
Receipts	31.7	34.7	19.7	24.7	27.4
Of which:					
From subsidies	19.4	7.4	4.3	1.1	7.8
Costs	32.1	34.2	24.2	17.0	26.7
Of which:					
Personnel expenditure	22.0	24.0	21.9	21.3	22.3
Financial charges	39.1	21.4	23.0	17.6	25.0
Amortizations	55.3	26.3	7.4	29.6	28.5
Other	37.5	51.5	29.8	11.4	31.7
Net losses	30.8	10.1	46.3	-14.5	15.8
Net losses after subsidies	63.4	15.7	127.9	-28.4	32.8

Source: Central Planning Department.

Table 63. Portugal: Public Enterprises in Industrial and Energy Sectors--Main Financial Indicators, 1977-80

(In per cent)

	1977	1978	1979	1980
Own capital/Total debt	27.8	30.9	30.1	24.4
Working capital/Short-term debt	92.7	88.5	99.5	100.0
Cash and liquid assets/Short-term debt	92.7	61.8	99.6	100.0
Structure of indebtedness:				
Short-term debt	52.9	50.5	49.6	46.5
Medium- and long-term debt	<u>47.1</u>	<u>49.5</u>	<u>50.4</u>	<u>53.5</u>
Total	100.0	100.0	100.0	100.0
Structure of financing:				
Self-financing	...	7.7	24.4	15.9
Capital transfers from state	...	4.6	6.0	3.2
Subsidies	...	0.3	0.2	0.1
Change in indebtedness	...	82.8	66.6	75.7
Others	<u>...</u>	<u>4.6</u>	<u>2.8</u>	<u>5.1</u>
Total	...	100.0	100.0	100.0

Source: Central Planning Department.

### Exchange and Trade System 1/

There have been only few changes in Portugal's exchange and trade system since the last consultation. The exchange rate policy of gradual monthly depreciation of the escudo vis-à-vis a basket of currencies of major trading partners at a preannounced rate, which was introduced in 1977, continues to operate. The monthly rate of depreciation which was 0.75 per cent throughout 1982 was raised to 1.0 per cent in March 1983. In March 1981 the weights of the currencies in the exchange rate basket which hitherto reflected their importance in Portugal's international transactions in merchandise, tourism, and private transfers, were altered to reflect only their importance in Portugal's merchandise trade. The basket weights were further changed in April 1982 involving a significant reduction in the weight of the U.S. dollar and an increase in the weight of European currencies. On December 31, 1982 the authorized banks' buying and selling rates for the U.S. dollar were Esc 88.891 and Esc 89.237, respectively. Other recent developments in exchange rate policy are discussed in Chapter IV above.

Phasing requirements which had been imposed on the transfer of profits and dividends under the enabling provisions of the Foreign Investment Code, when individual remittances in excess of US\$250,000 were involved, were lifted in January 1980. Limits on foreign exchange allowances for tourist travel per person per year were increased in July 1980 as follows: for persons 18 years of age or over, from the equivalent of Esc 20,000 to the equivalent of Esc 30,000; for persons between 12 and 18, from the equivalent of Esc 15,000 to the equivalent of Esc 22,500; and for children under 12, from the equivalent of Esc 10,000 to the equivalent of Esc 15,000. In April 1980 the value of the Bank of Portugal's holdings of 689 tons of gold was revalued retroactively to January 1, from SDR 35 per ounce to US\$254.92 per ounce. In April 1982, the period for settlement of export transactions was reduced from 180 to 120 days.

The only major change in trade restrictions over the past two years was the raising in February 1983 of the import surcharge from 10 per cent to 30 per cent. Many items are currently subject to a temporary import surcharge of 30 per cent or 60 per cent of the customs value, irrespective of origin, and the list of products currently subject to the 60 per cent surcharge consists mainly of nonessential goods. The proportion of total imports subject to duty surcharges has declined from 24 per cent in 1977 to under 20 per cent in recent years, the bulk of which being items subject to the 30 per cent surcharge. Imports of certain items, such as unassembled automobiles, household appliances, and fruits are subject temporarily to quota limitations in value terms. The escudo values of import quotas of certain nonessential consumer goods for the period April 1982-March 1983 were increased to take into account the effects of inflation and of the devaluation of the escudo. On the other hand, the ratio of actual imports of these items to total imports, which

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1/ A more detailed description is contained in the Fund's Annual Report on Exchange Arrangements and Exchange Restrictions.

had declined from 3 per cent in 1977 to 1 per cent in 1979, is estimated to have remained in this region over the past two years. The escudo value of annual import quotas for completely knocked down vehicles has also been increased in each of the recent years, and the transition period for restructuring of the Portuguese automotive industry, by the end of which there will be a total liberalization of imports of vehicles and parts originating from the EC and EFTA, has now been shortened to the end of 1984. Minimum proportions of foreign financing of imports of basic goods and minimum repayment terms are prescribed by the Bank of Portugal. Under current guidelines, all imports of crude oil, as well as imports of essential food products exceeding Esc 65 million and imports of other essential current goods exceeding Esc 50 million, must be financed by external credits with minimum maturities of six months, subject to specified proportions of rollover. Moreover, 70 per cent of the value of imports of capital goods must be financed by external credits in maturities of at least two years.

1. Changes during 1982

a. Exchange arrangements

March 23. The tax on the sale of foreign exchange was raised from 0.3 per cent to 0.5 per cent.

April 12. The weights in the currency basket used for determining the exchange rate of the escudo were modified, such that the weight of the U.S. dollar was reduced and the weight of specified European currencies was increased.

June 16. The escudo was devalued in effective terms by 9.4 per cent following the realignment of parities of EMS currencies.

b. Imports and import payments

March 1. Import quota limitations in value terms were established for certain nonessential consumer goods for the period through March 31, 1983.

October 1. The limit for exemption from prior registration of imports of newspapers and technical, scientific, or cultural periodicals was raised from Esc 40,000 to Esc 60,000 (Decision No. 37/82 of the Secretary of State for Exports).

c. Payments/proceeds for invisibles

November 4. A regulation was introduced that invoices for current invisible transactions should be denominated only in the foreign currencies quoted by the Bank of Portugal, except for tourism transactions and for transactions specified in Portaria No. 453/77 of July 22, 1977 or other specific legislation, which could be invoiced in escudos (Portaria No. 1018/82).

d. Exports and export proceeds

April 20. It was announced that in cases where settlement for exports occurred later than four months after customs clearance, the exchange rate prevailing on the last day of the four-month period from the date of customs clearance would be applied (Portaria No. 397-A/82).

e. Capital

May 12. The transfer abroad of the proceeds from the liquidation of foreign investment, which hitherto was authorized after five years of the initial investment, would henceforth be freely permitted, on condition of compliance with the conditions established under the investment authorization (Decree-Law No. 174/82).

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