THE TIMING AND SEQUENCING OF TRADE
LIBERALIZATION POLICIES: PORTUGAL
1948 - 1986
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Summary

This study covers the major economic and trade policy developments in Portugal since World War II: 1948-86 (chapters I and II). It identifies the most near-to-liberalisation episodes in Portugal: 1970-74 and 1977-80. We describe the economic and political environment, trade policies and accompanying policies which impinge on the sustainability of the episodes (chapters III and IV). The volume ends by drawing ten comparative inferences and four lessons from the Portuguese experience on the timing and sequencing of trade policies.

We defend the lack of political commitment and often, outright contradictory policies before Portugal’s entry into the EC in 1986. The closer-to-liberalisation, but short-lived episodes are those identified with the “Caetano’s spring” and its aftermath before the revolution and the period coinciding with the first liberalisation-cum-stabilisation package and its aftermath, after the revolution. In both episodes there was no clear political commitment to trade liberalisation, which was not a first objective and never fully designed. Thus trade and domestic policies were generally inconsistent.

Our ten inferences and four lessons from these episodes are directly relevant to the third episode starting in 1986. However, EC entry and the 1992 market implies not only more profound changes than EFTA implied in the sixties and seventies, but also a greater policy interdependence with the other European countries, with the inherent costs of inappropriate policies. Only a non-defensive, active response to increased structural interdependence may prove the new episode sustainable.
Acknowledgments

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Ever since the research described in this paper began, over four years ago, the enthusiasm of Martha de Melo, and her familiarity with Portuguese economic ambiguities, kept us going through the successive versions presented.

Unfailing computer assistance on both sides of the Atlantic was provided by Manuel Gonçalves and by Debby Nicholson. Too many people at Princeton, Lisbon, Coimbra, Washington and Cambridge were involved in processing the numerous versions of this work to be thanked individually.

Further results can be found in the Special Study, "Trade Liberalization and Macroeconomic Stabilization in Portugal: Implications for the Pattern of Competitiveness 1970-85", supplementing this country manuscript. The trade agreements between Portugal and its European partners from 1948 to 1985 are analysed in an "Annex on Trade Agreements", henceforth refered to as ATA.
Similarly, all of the data collected for this project is in a Statistical Annex, henceforth referred to as SA, whose contents are summarized at the end of the text, together with the list of tables in the ATA. Both Annexes are available from the authors on request. Tables numbered with single numerals, e.g. Table 1, refer to the Tables in the text.
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INTRODUCTION

During the forty years since Portugal's participation in the Marshall plan in 1948, trade policy has been a reflection of the movements of European economic integration, rather than of a political commitment to economic liberalization. When a clear political commitment did emerge, shortly after the April 25th, 1974 revolution, it led instead to a temporary reversal of this gradual trade liberalization process.

Portugal joined the Organization of European Economic Cooperation (OEEC) in 1948, the European Free Trade Association (EFTA) since its inception in 1959 and it signed a free trade agreement with the European Community (EC) in 1972. However, the application to membership came only in 1977, as direct result of the political changes in 1974, and Portugal joined the EC in 1986. In the mid-nineties, Portugal will be a full member of the EC. In some sense this is the longest transition to the European Community.

Portuguese participation in the European movement involved gradual nominal tariff reductions from 19 percent in 1964 to 13 percent in 1970 and to 4 percent in 1974. While the reversal of 1975-77 was due to the revolutionary policies pursued, the consequences were aggravated by external shocks, such as the oil crisis. From 1977 to 1980, significant non-tariff barriers remained but the average tariff fell from 14 percent to 5 percent.

We argue that trade policy in Portugal has involved a very gradual liberalization because it reflects an ambiguous commitment to free trade as a development strategy on the part of the Portuguese authorities. As a consequence of this ambiguity, other objectives of policy were pursued even when they were found to reverse the effects of liberalization.

As a consequence, we consider that within the 1948 to 1985 period, there are two short episodes during which the government came close to a credible commitment to trade liberalization: from 1970 to 1974 and from 1977 to 1980.

The first episode (1970-74) was followed by the revolution of 1974 and the second episode (1977-80) was followed by a partial and temporary reversal due to external imbalances and resistance to expenditure-switching policies, which were again used in 1983-85. With membership in the EC in 1986, and a more stable macroeconomic environment, another trade liberalization episode might have begun in 1983, or more likely in 1986. We do not analyze the current episode but refer to it for comparison.
The recurrence of trade liberalization policies shows that the lack of sustainability of the two experiences cannot be attributed to trade liberalization.

The ambiguity of trade liberalization was unquestionable before 1974. The international isolationism of Salazar's regime and colonial policy were more consistent with the British ambivalence about European integration than with the federalist enthusiasm of the original Six.

Thus, Portugal joined EFTA rather than accepting a more demanding EC. In practice EFTA meant a privileged and expanding market for exports while the combination of a Portuguese economic union encompassing the colonies and a policy of import substituting industrialization could be pursued. The reason is that the inward-looking policy was not only based on a trade policy but rather on a mix of trade policy and domestic controls, investment licensing and extensive subsidization.

The ambiguity of trade policy during the 60's accommodated tariff reductions but maintained a discriminatory protective structure by region and by product, supplemented by domestic controls. This ambiguous liberalization neglected agriculture and did not apply to trade with the neighboring Spanish economy.

The neglect of agriculture has deep historical roots, despite the success of port wine as an export product following the Methuen treaty with England in 1703.

Similarly, while other attributes of the economy, changed considerably since the Second World War, traditional fears of Spanish domination remained until the joint access of the two Iberian countries to the EC. Indeed, the two neighboring economies left their mutual integration as a paradoxical by-product of the quest for membership.

Some elements of ambiguity towards trade policy were eliminated during the rule of Salazar's heir, Marcelo Caetano between 1968 to 1974. The first episode of liberalization spans this period.

Following English application for EC membership, Portugal signed a free trade agreement with the EC in 1972. The new authorities also liberalized several domestic controls and regulations in both the real and the financial sphere. However, they maintained the African policy and they attempted to satisfy the powerful lobby groups formed previously. As a result the social and political consensus broke down and the new government was seen as weak, paving the way to the revolution of 1974.
The Socialist Party (PS) won the 1976 elections and was therefore responsible for the first government to be appointed under the Constitution. Fulfilling a promise made during the electoral campaign, Prime Minister Mario Soares presented the Portuguese application for EC membership in March 1977.

The announcement of the desire to join the EC was followed by a stabilization program arranged with the International Monetary Fund (IMF) and defines the second trade liberalization episode (1977–80), partly reversed after 1980.

In some way this reversal was the price to pay for constitutional socialism just as the reversal of the first trade liberalization episode was the price to pay for the colonial rule.

Thus the democratic regime shared the same ambiguity about trade liberalization. The application for EC membership in 1977, was seen essentially as a political option. The new authorities continued to pursue policy objectives which conflicted with liberalization and they lengthened the duration of the transition to European free trade. For instance, the design in the 1976 Constitution, with respect to the economic system, explicitly prevents the reversal of the extensive nationalizations without compensation of 1975, and this may not be changed without another Amendment, probably to be voted in 1989.

Moreover, domestic controls as well as tariff and non-tariff barriers were strengthened from 1974 onwards. Tariffs ceased to be the main trade policy instrument so that the average tariff became yet a poorer indicator of trade liberalization.

In this manuscript we characterize the two liberalization episodes, pointing out those effects attributable to trade policies. The emphasis is on the interdependence of trade policies and domestic policies and market structure before 1974 and the significanceliberalization - cum - stabilization packages (LCSPs) in 1977 and in 1983, in an environment of an inconsistent commitment to trade liberalization.

The main inferences to be made are linked to the timing and sequencing of trade policy, its effects and its sustainability. The experience of gradual liberalization in a favorable environment during the first episode and the experience of a LCSP subject to international trade agreements during the second episode - let alone the third -, provide a distinct framework for trade liberalization in Portugal.

The body of the text is divided into five Chapters.
In Chapter I we summarize the economic attributes relevant to trade liberalization: migration movements, market structure and macroeconomic balance.

Chapter II presents the policy pattern of the longest transition to the EC, emphasizing that trade policy was constrained by political preferences. The chapter describes trade policies and the motivations for entering into international trade agreements. It ends with an Annex explaining the construction of a scale-arbitrary liberalization index from 1948 to 1986.

Chapter III analyses the first liberalization episode (1970-74) and Chapter IV analyses the second episode (1977-80). We describe in detail the instruments of trade policy, the circumstances during which the policy was introduced, the accompanying policies and its effects.

Chapter V summarizes the lessons from the timing and sequencing of policies in Portugal during the two episodes. The inferences were drawn in spite of the lack of transparency of political decisions before 1974 and lack of transparency of trade barriers after 1974. In fact, some answers are well grounded but others stem from our perception and statements by policy-makers. Chapter V also describes some lessons of prospective interest given the changes facing Portugal in the years ahead.

The study ends in 1986 at a time of accelerated trade, domestic and financial liberalization. The majority vote for one party in the July 1987 elections, with the election of Prime Minister Cavaco Silva, brought expectations of political stability. If they are realized, the change in the institutional arrangements inherited from unstable times may turn out to be fairly smooth. But even with a minority government of the Social Democratic Party (PSD) the economic system is still essentially dictated by the socialist 1976 Constitution.

Nevertheless, the challenges of transition to full EC membership are immense since a trade liberalization episode involving agriculture, financial markets and Spain is inevitable.

The episode beginning in 1986 will not be restricted to trade in manufactures with relative distant trade partners: it will imply a much greater mobility of capital with neighboring financial centers. Yet, the bilateral agreement between Portugal and Spain for the European transition was hastily negotiated and still signed after accession.

The traditional preference for multilateral solutions when it comes
to relations with Spain may now leave too much room for ambiguity. And one major lesson of the longest transition is precisely that ambiguous objectives make for a gradual yet easily reversible trade liberalization policy.
CHAPTER I

ECONOMY'S ATTRIBUTES

Portugal, with a population identical to Greece, is more densely populated than either Greece, Spain and Turkey, as shown in Table 1. The agricultural sector still absorbs one quarter of the labor force but contributes only to 10 percent of GDP. With a low GDP per capita more similar to Turkey than either Spain or Greece, it achieved a surprising degree of industrialization. Industrial GDP represents 48 percent of total. Being a small, dependent economy it also achieved a higher level of trade integration than either the also small Greece economy and the larger neighbour Spain.

Table 1

The present economic situation corresponds to a high economic growth up to the early 1970s (the highest in Europe in 1968-73) and a relatively faster decline since then (the fastest in the OECD after Iceland in the period 1982-84): the annual growth rate was 4 percent in the fifties and over 6 percent in the sixties. After that the rates became very volatile (9.1 in 1970-73, -1.5 in 1973-75, 5.5 in 1975-80 and 1.2 in 1980-81. As shown also in Table 1, the rate of growth fell substantially below other peripheral European economies in the early 1980s to pick up again at mid-decade.

This chapter describes major attributes of the economy. Despite a sustained growth process during the period following the Second World War, Portugal continues to be a country that is relatively poorer than its neighbors. Therefore, in some ways, the attributes resisted to the changing circumstances at home and abroad whereas, in other ways, they were affected by economic performance. We chose the attributes most relevant for the assessment of trade liberalization effects.

We first emphasize labor migration and its contribution to the liberalization pace and sectoral labor allocation, as well as the changing circumstances in the labor market, income distribution and social environment before and after 1974.

The composition and structural imbalances of production as well as
<table>
<thead>
<tr>
<th></th>
<th>Portugal</th>
<th>Greece</th>
<th>Spain</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Population</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (Thousand)</td>
<td>10129</td>
<td>9900</td>
<td>38387</td>
<td>48825</td>
</tr>
<tr>
<td>Density (persq.km)</td>
<td>110</td>
<td>75</td>
<td>76</td>
<td>63</td>
</tr>
<tr>
<td><strong>Employment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (Thousand)</td>
<td>4068</td>
<td>3501</td>
<td>10422</td>
<td>14912</td>
</tr>
<tr>
<td>Agriculture (%)</td>
<td>25</td>
<td>29</td>
<td>17</td>
<td>58</td>
</tr>
<tr>
<td>Industry (%)</td>
<td>35</td>
<td>28</td>
<td>32</td>
<td>17</td>
</tr>
<tr>
<td>Services (%)</td>
<td>41</td>
<td>43</td>
<td>51</td>
<td>25</td>
</tr>
<tr>
<td><strong>Production</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP (Billion US$)</td>
<td>19</td>
<td>34</td>
<td>161</td>
<td>50</td>
</tr>
<tr>
<td>GDP per capita (US$)</td>
<td>1905</td>
<td>3380</td>
<td>4192</td>
<td>1018</td>
</tr>
<tr>
<td><strong>Trade (1985)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imports/GDP (%)</td>
<td>42</td>
<td>31</td>
<td>19</td>
<td>22</td>
</tr>
<tr>
<td>Exports/GDP (%)</td>
<td>31</td>
<td>14</td>
<td>15</td>
<td>14</td>
</tr>
<tr>
<td><strong>Growth Rates</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973/82</td>
<td>3.9</td>
<td>3.1</td>
<td>2.6</td>
<td>4.5</td>
</tr>
<tr>
<td>1980/82</td>
<td>2.7</td>
<td>4.1</td>
<td>4.4</td>
<td>7.6</td>
</tr>
<tr>
<td>1982/84</td>
<td>-1.2</td>
<td>1.5</td>
<td>2.2</td>
<td>4.6</td>
</tr>
<tr>
<td>1984/86</td>
<td>2.5</td>
<td>0.5</td>
<td>2.1</td>
<td>4.3</td>
</tr>
</tbody>
</table>

Sources: SA-Table 4.1, 4.9, 2.9, 3.1 and OECD, Country Surveys, Portugal, 1985.
the imperfect market structure are described next. We underline the dualistic structure of production and define an industrial structure with two segments: 1) private, traditional, labor-intensive industry oriented for the domestic and foreign market; and 2) capital-intensive, import-substituting non-competitive industry, which became state-owned after 1975. Non-traditional, significantly foreign-ownership of oligopolist type firms exist in both segments.

To underscore the autonomy of the first segment relative to government regulations, including export promotion measures, we call it an export "enclave".

We also deal here with long run macroeconomic constraints, external and internal balance and their differences before and after 1974. The gap between income and expenditures large as it was up to 1974 narrow since then due to the decline of non-export sources of foreign exchange earnings and increased expenditures particularly by the public sector and state-owned entreprises.

Migrations and the Labor Market

Portugal has traditionally been a labor-exporting country. Emigration, traditionally directed to Brasil and Africa, turned in the early sixties towards the fast-growing countries of the European community, thus contributing to bringing Portugal economically closer to Western Europe than to its African colonies.

The liberalization of trade with Europe can indeed be seen as an attempt of keeping Africa closer to Portugal by political means when economic forces were pointing the other way.

Internal and International Migrations

During the 1960s and early 1970s, resident population in all the territory was practically the same. The average natural rate of increase of 1.1 per thousand per annum was offset by emigration at about the same rate, mostly directed towards the fast-growing Western European countries.

Since 1974, emigration to Europe slowed down substantially due to the economic recession. This compounded the labor absorption problem posed by the immigration from Portugal's former colonies of 8 percent of total population (700,000 people in the period 1975-77 according to the OECD).[1]
Migration movements had an important role in determining aggregate and sectoral regional labor supply and production. Because emigration decisions were closely connected with wage differentials and remittances by migrants with a high propensity to save, it allowed a sustained difference between income and production which collapsed in 1974-1977 under the pressure of excess public and private spending [2].

Between 1960 and 1970, both emigration and increasing military involvement (since the start of the 1961 Africa war) led to virtual elimination of open unemployment. In fact, overall employment stagnated between these years; in agriculture it declined by 31 percent also because of the existence of disguised unemployment in the sector.

Unemployment remained around 2 percent from 1960 to 1970 and did not reach over 10 percent until the mid-seventies. Thus, emigration (and disguised unemployment in agriculture) led to a sustainable lower unemployment rate and probably allowed a rather capital-intensive pattern of industrial development during the 1950 and 1960s. Conversely, immigration contributed for an increase of the unemployment rate after 1974. Despite the expansion of 1976 and 1977, unemployment increased again after 1978.

At the sectoral and regional level the effects of migration on labor supply and production is best seen over regions as in Table 2.

### Table 2

International migration movements were unequally distributed over the territory. During the period of high emigration, three-quarters of the emigrants left from the densely populated north and center of the country, and one-quarter left from the sparsely populated south and the industrialized Lisbon-Setubal area. Similarly, from 1975-1977, immigration was initially directed to the urban areas of Lisbon and Porto. Unfortunately, no data are readily available on the subsequent movements of the returnees.

The foreign or domestic destination of emigrants varied by place of origin. While most migrants from the north and center went abroad (domestic migration was about one half of net foreign migration), the population from Alentejo migrated to the coast, particularly to the Lisbon area (domestic migration from the south was three times larger than net foreign migration). In the Lisbon area, domestic immigration was four times larger than net foreign emigration. This
### Table 2

**Regional Characteristics of the Original Migrant Labor**

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Interior</th>
<th>Litoral</th>
<th>Lisbon</th>
<th>South</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>North</td>
<td>North</td>
<td>South</td>
<td>North</td>
</tr>
<tr>
<td></td>
<td>and Center</td>
<td>and Center</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pop. Density</td>
<td>Medium</td>
<td>High</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Internat.</td>
<td>Emigr.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production Bias</td>
<td>Agricult.</td>
<td>Agricult/</td>
<td>Indust/</td>
<td>Agricult.</td>
</tr>
<tr>
<td></td>
<td>Indust/</td>
<td>Services</td>
<td></td>
<td>Services</td>
</tr>
<tr>
<td>Land Tenure</td>
<td>Minifund.</td>
<td>Minifundia</td>
<td>--</td>
<td>Large Farms</td>
</tr>
<tr>
<td>Industrial Bias **</td>
<td>--</td>
<td>Labor Inten.</td>
<td>Cap.Inten</td>
<td>--</td>
</tr>
<tr>
<td>Indust. Concentrat.</td>
<td>--</td>
<td>Low</td>
<td>High</td>
<td>--</td>
</tr>
<tr>
<td>Market Orientation</td>
<td>--</td>
<td>Exporting and Import Competing</td>
<td>Import</td>
<td>Substitut</td>
</tr>
</tbody>
</table>

* Regions are based on districts of SA-Table 4.4.
Migration patterns are those of the 1961-1974 period in SA-Table 4.4.
Characteristics of industrial production from SA-Table 3.6.
Characteristics of agricultural land tenure and production from SA-Table 3.10.

** The litoral north and center produces 54% of total manuf. production; mainly textiles and wood products, pulp and paper and non-metallic mineral products.
The Lisbon and Setubal area produces 39% of manuf. production; mainly capital goods, base metals, chemical and petrochemical products and food processing.
is of course consistent with a substantial reallocation of the resident labor force from agriculture to other activities.

Before the 1960s, there were some migratory movements from the rural to the coastal urban areas, particularly to the Lisbon area. As the importance of the agricultural sector declined and the incidence of Lisbon and Porto as centers for industry and services increased, so did their population (by 13 percent over the decade).

During the 1960s, the pace of industrialization picked up and internal migration movements accelerated. Unlike international emigration, internal migration was larger in the south than it was in the north, with flows running from the impoverished interior to the progressively more industrialized coast. Altogether, between 1961 and 1974, emigration and internal migration corresponded to a decline in population in the north, center, and south of 1.2 million while in the Lisbon area there was an increase of 0.4 million.

Therefore, on the one hand, international migration was particularly important in the densely populated regions of the north and center, where agriculture is intensive and farms small and where the bias of industry is towards exporting industry made up by labor intensive production, oriented to foreign and domestic market (mainly textiles, clothing and wood products).

On the other hand, the Lisbon, Setubal area absorbed labor from the extensive farming of the south. The industrial bias in this area is towards more capital intensive, import substituting production.

Trade Unions and Wage Policy

Under the political regime prevailing until 1974, there were no trade unions. Real wages in manufacturing increased slowly by 2% during the 1960s. Wages in agriculture in 1965 were 78 percent of those in manufacturing industry but slightly higher than in construction.[3]

Between 1965 and 1973, real wages in construction and in industry increased much more than in the agricultural sector. By 1973, a worker in agriculture was receiving 64 percent of the wage in manufacturing and 85 percent of the wage of the construction worker. Like wages, social security benefits were small and had been increasing slowly [4].

In the early 1970s, they were paid both to rural as well as to
urban workers. Social security benefits accounted for 27 percent of the current outlays of the general government in 1974. Thus average (real) labor costs rose 5 percent during the sixties.

Despite the slow rise in real wages, income distribution was very uneven in 1973: the poorest 50 percent of households were receiving only 14 percent of personal income while the top 5 percent received 40 percent of income.[5] Indeed, it substantially worsened in relative terms during the early seventies, due to an increase in inflation and a stock market boom.

After 1974, there was a profound change in the management style of companies as workers demanded and obtained a great deal more influence on corporate policies. In 1975, Intersindical was formed (CGTP, dominated by the Communist Party which wanted to be the sole representative of labor) followed in 1977 by the Uniao Geral de Trabalhadores (UGT, jointly backed by Socialists and Social Democrats) [6].

Union concentration and increasing power, together with workers' takeovers in a few private enterprises and with legislation prohibiting layoffs, created a vastly different setting for labor-management relationships. In October 1976, the government issued legislation to fight absenteeism, limit fringe benefits, and establish a 40-45 hour legal work week. During this period, several measures regarding social security and wages including minimum wage provisions and high wages freeze were introduced.

However, at the same time an element of labor flexibility was introduced: the alternative to life contracts in the form of short time contracts for hired labor. Time contracts have been increasing in importance since then. They represented 12 percent of total employment in 1985.

The social and economic changes were also felt in the rural areas. However the 1974-76 agrarian reform was concentrated in the large estates of the south, which were claimed by workers' cooperatives during the so-called "hot summer" of 1975, while the minuscule farms of the north were left untouched.

These events, wage policies together with active trade unions, changed income distribution substantially. Real wages increased steeply in 1974 and 1975, but less in 1976, as inflation accelerated and unemployment grew. The disequilibrium, both domestic and foreign, aggravated by the world recession and then by the second oil shock, led to the introduction of contractionary policies. These were delayed until they became essential to obtain external credit. Wages declined substantially in 1977 and less in
subsequent years. Unemployment has been rising since 1977, even though wages are, in 1985, below their 1973 level.

Real wages after 1977 have been more flexible than before 1974 although the degree of flexibility respond slower to the pattern of economic shocks after that date than before 1974. The higher flexibility of wages is probably due to an imperfect labor mobility across sectors and regions and also interact with the exchange rate policy.

Labor laws which limit layoffs are still operating, even though governments have unsuccessfully attempted to introduce more flexibility since 1984. The current régime has been a constraint on labor mobility and is likely to have aggravated unemployment. Labor mobility is still impaired by a freeze on house rents for the last 10 years, severely limiting the supply of house leasing in the urban areas. In spite of repeated but unsuccessful efforts to change the law since 1984, the freeze on rents is likely to have contributed also to accelerated urban unemployment.

By 1977, social security benefits increased to 29 percent of general current government outlays but declined to 23 percent in 1982, as the government tried to balance its budget. Until 1982, attributable pensions had increased to 71 percent of total benefits. Unemployment insurance also increased to 5 percent of total benefits from 1977 to 1982. However, even now and in the aggregate, total social benefits are low compared with other countries in Europe.

Alternative measures of the difference between actual and warranted real wages show that, after increasing moderately in the 1960s, the wage gap rose somewhat in the early 1970s due to an increase in the domestic prices relative to import prices (as the terms of trade deteriorate). However, after 1974, and particularly in 1975, there was a substantial fall in the terms of trade and an increase in the labor force. As an offset to wage increases, the Portuguese escudo was on a crawling peg devaluation after 1977, leading to the decline in the wage gap. The rise of the wage gap between 1980 to 1982 was also partially due to a slowdown in devaluation between these years.[7]

Growth and Productive Structure

The economic structure of production, was formed in the period starting in the 1950s up to the early 1970s, during which the economy grew very fast.
This fast growth may be attributed to high rates of growth of industrial production (6 percent during the fifties, 9 percent during the sixties and 11% in the early 1970s) and exports (at slightly higher rate in the same periods), offsetting a dramatic relative decline in agriculture [8].

The rate of growth picked up in the late 1970s, despite the external and internal shocks of 1974-75, largely because of an expansion of the public sector, financed by foreign savings. In the 1980s, Portugal is a semi-industrialized country where a serious strutural imbalance stems from the excessive weight of the public sector.

Decline of Agriculture

In the 1950s, Portugal had essentially an agricultural economy. Still, by 1960, the agricultural sector represented 25 percent of GDP, but absorbed 44 percent of total employment, whereas manufacturing (mainly labor intensive textiles and food processing, some machinery and metal products) accounted for 32 percent of GDP and 21 percent of employment. By 1980, the agricultural sector shares were down to 10 percent of GDP and a quarter of the labor force. It generated 20 percent of merchandise exports (mostly wine and forestry products) down from 48 percent in 1956.[9]

Portugal, a country which was self sufficient in food in the 1950s, became a heavy net importer of agricultural products by the 1980s [10]. While such facts are shared by other middle-income countries in Portugal they were dramatized by an almost stagnant agricultural output during the last thirty years.[11]

The decline of agriculture began in the early 1950s and can be explained by several factors: (1) the outflow of people from farms mentioned above; (2) the dualistic structure of small farms in the north and larger monoculture farms in the south, with the associated institutional problems; (3) the decline in land productivity and incomes; (4) the slow pace of investment and innovation (and lack of government sponsorship of research and development); and (5) price intervention favoring industrial development via a relatively lower price of food in terms of wages in manufacturing. The cheap food policy came to dominate policy up to the end of the 1970s as government policy to promote industrialization.

Regulation, Trade Policy and Industrial Structure
The industrial development was remarkable during the quarter of a century ending in 1974. In 1980 the share of industry in GDP was 48 percent, whereas the share of employment was 36 percent. Consumer goods industry still dominates manufacturing GDP (17 percent of total) but the faster growth was observed in the chemical and capital goods industry during the 1960s.

Industrial development was carried out in an environment marked by investment licensing which restricted entry in large segments of industry and gave high protection to domestic production, particularly in new industries and new products. These policies were implemented through the 1960s and led to the formation of a dualistic structure of production.

On the other hand, large and relatively more capital-intensive firms could be found in the licensed sectors such as steel, cement, petrochemical products, and ship construction and repair. In these industries foreign investment was not allowed or was insignificant.

On the one hand, there were small firms in more traditional, labor-intensive industries such as food products, textiles, footwear, wood and cork products, metal products, and small machinery industries. In these industries as well as in electrical machinery and transport equipment, foreign investment was significant [12].

Whereas firms in the first segment were able to compete internationally, the second segment included mainly import-substituting industries.

In the 1960s, domestic and foreign demand was expanding. Domestic demand had increased because of higher wages, significant emigrant remittances, and the defense effort. Foreign demand had increased because of increasing trade and foreign exchange liberalization and overall growth in Europe. Between 1959 and 1972, total Portuguese exports grew by 10 percent (16 percent to EFTA) in volume every year following an annual rate of increase of 4 percent in 1954-59. Manufactured exports grew even faster: 12 percent in volume (22 percent to EFTA) between 1959-72. Textiles, clothing and footwear represented 29 percent of total manufacturing exports in 1977 [13].

The larger firms, with monopoly power and an import-substituting strategy, had little to do with the small family-owned or larger firms open to foreign investment sectors where competition was brisk and the export drive strong. One can therefore describe the latter as forming an exporting industry. In any event, by the early 1970s Portugal had reached the end of the "easy" stages of
import substitution.

This bias of the protective system in favor of import-substituting sectors and against exports is shown in Table 3. This table lists the level of protection given to sectors according to the share of production exported and the share of imports in consumption for the year taken to be closest to free trade, 1974.

Exporting sectors are those which export more than 10 percent of domestic production, while imports are less than 10 percent of domestic consumption. Export- and import-competing sectors are those exporting more than 10 percent of production but also importing more than 10 percent of domestic consumption. Finally, sectors for which exports are less than 10 percent are either import-competing or non-import-competing according to whether the import share is larger or smaller than 10 percent of consumption, respectively.

Table 3

The bias against manufactured exports is larger in 1964 and 1970. In these years, effective (and nominal) protection was substantially lower for exporting and export and import competing sectors (exporting more than 10 percent of production) than for import- and nonimport-competing sectors (exporting less than 10 percent of production).

Following the 1974 revolution, and running parallel with a land reform in the southern part of the country, a series of nationalizations in manufacturing and services took place. In manufacturing, 16 firms covering 18 percent of production and 10 percent of exports were nationalized: steel, cement, petroleum and petrochemicals, beer, tobacco, and a large pulp firm (Portucel). [14] Unfortunately, these firms belonged to the large conglomerate groups largely devoted to import substitution in the 1960s.

The banking system, insurance companies, and public services, including most of public transportation and communications, were also nationalized. As banks held substantial equity in the industrial sector, the nationalization of the banking system implied very widespread government participation therein. In 1976, state-owned enterprises (both by nationalization and major state participation) accounted for 27 percent of GDP, 20 percent of employment and 50 percent of gross fixed capital formation.

This situation has been maintained until the mid-eighties in spite
of the financial burden it has represented for the state and
consequent efforts to limit domestic and foreign borrowing by
state-owned enterprises. In 1985, new foreign banks and domestic
private banks were authorized, but their share is still very small.

Table 4 shows industrial structure by type of ownership. The
largest share of exports is found in traditional, privately-owned
industries. While the highest share of imports is found in
nontraditional, privately-owned industries, it includes transport
equipment where public ownership is significant. Excluding it would
let state-owned enterprises account for almost half of imports.
This category is also the most capital-intensive [15].

Table 4

Traditional industries, often based on natural resources (food,
wood, cork, and beverages), produced 57 percent of total output,
while nontraditional industries have larger and more
capital-intensive firms, accounting for 17 percent of production.
The latter group is more oriented toward the domestic market than
the former. The industries where public ownership is significant
cover 26 percent of output and are also oriented toward the
domestic market, except for the chemical and pulp industries.
Finally, sectors with significant foreign penetration cover 35
percent of the total manufacturing output.

Aggregate investment was high through the 1960s (18 percent of GDP
on average and 21 percent from 1970 to 1973) and grew since the
1960s at a rate of over 10 percent per year. By 1973, the
manufacturing industry was over 3 times more capital intensive than
in 1960 [16]. In the wake of EFTA agreement, foreign investment was
particularly attractive to the exporting industries. It also
occurred in vertically integrated production for the domestic
market.

From 1974 to 1977, investment declined yearly by 7 percent.
Agricultural investments stagnated and manufacturing investment
dropped by 8 percent and construction by 14 percent. Even though
investment recovered between 1977 and 1981 - growing at 7 percent
yearly - it did not rise to the level observed before 1974. The
reason was that output growth has been using existing capacity
rather than being based on new capacity. With the usual
difficulties in comparing full capacity in industries with capital
of different vintages, capacity utilization seems to be lower for
consumer goods than for intermediate and capital goods.
<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
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<tbody>
<tr>
<td>Export Competing</td>
<td>29</td>
<td>71</td>
<td>36</td>
<td>173</td>
<td>24</td>
</tr>
<tr>
<td>Export and Import Competing</td>
<td>26</td>
<td>26</td>
<td>14</td>
<td>52</td>
<td>9</td>
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<tr>
<td>Import Competing</td>
<td>70</td>
<td>88</td>
<td>9</td>
<td>20</td>
<td>4</td>
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<tr>
<td>Non-Import Competing</td>
<td>74</td>
<td>102</td>
<td>35</td>
<td>82</td>
<td>22</td>
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<tr>
<td>Economy</td>
<td>25</td>
<td>28</td>
<td>12</td>
<td>37</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: SA-Table 6.7.
Table 4

Industrial Structure by Ownership (1977)

<table>
<thead>
<tr>
<th></th>
<th>Output</th>
<th>Exports</th>
<th>Imports</th>
<th>Capital-Labor Ratio **</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Privately-Owned</td>
<td>74</td>
<td>70</td>
<td>64</td>
<td>0.81</td>
</tr>
<tr>
<td>1.1 Traditional</td>
<td>57</td>
<td>54</td>
<td>18</td>
<td>0.75</td>
</tr>
<tr>
<td>1.2 Non-Traditional</td>
<td>17</td>
<td>16</td>
<td>46</td>
<td>1.09</td>
</tr>
<tr>
<td>2. State-Owned</td>
<td>26</td>
<td>30</td>
<td>36</td>
<td>1.55</td>
</tr>
<tr>
<td>Memo: Foreign-Owned</td>
<td>35</td>
<td>45</td>
<td>47</td>
<td>1.15</td>
</tr>
</tbody>
</table>

* as percentage of total manufacturing
** average in manufacturing = 1

Note: Sectors from the 1977 Input-Output tables were aggregated according to dominance of ownership. There is overlapping of foreign-owned firms and privately as well as state-owned enterprises. Overlapping sectors are on SA-Table 3.7.

Source: SA-Table 3.7.
Tax Policy and Domestic Controls

Despite rising defense expenditures due to the colonial wars, the government budget was kept in balance without tax increases. The tax reform enacted between 1958 and 1965 had the stated purposes of improving tax administration, and fell short of introducing a comprehensive income tax largely because of fears about its difficult implementation. The temporary solution, a series of partial direct taxes with a supplementary income tax, turned out to last for over twenty years since comprehensive income taxation will not be implemented until 1989.

The only case where tax policy was seen as an accompanying policy to trade liberalization was the introduction of a sales tax in 1966, designed to make up for lost revenue due to EFTA tariff reductions. Even though this substitution allowed an increase in revenues, protection remained particularly high for goods with low price elasticity of imports, suggesting that the revenue motive continued to be important [17].

This is all the more likely due to the fact that direct taxes remained a small and roughly constant share of total revenue. Because government expenditures increased at a lower rate than revenues, the public sector remained a net saver, at around 2% of national income. It can then be presumed that the policy objective of maintaining a balanced budget and the favorable provisions of the EFTA trade agreement interacted in a preverse way since they generated a budget surplus and a slow pace of trade liberalization.

But low taxes did not mean low government intervention in the economy. Until the early seventies, the traditional administrative determination of prices was never seriously challenged. Aside from the investment licensing scheme, there were state monopolies for some imports, direct price controls on foodstuffs, raw materials, and public services, as well as an extensive and complex system of taxes and subsidies (including tariff and tax rebates for infant industries), including controlled wages. The main objective of these controls was industrialization.

Trade agreements such as the ones with EFTA or the EC were not seen as the best mean to achieve economic development. Rather they were seen as a mean of lessening the international isolation of Portugal's colonial policy. Therefore, they were supposed to foster rather than jeopardize domestic and African political and social priorities.

Following the 1974 revolution, in the wake of the enlargement of
the public sector and widespread nationalizations, the government budget went into deficit. This situation has been maintained until the mid-1980s in spite of the financial burden it has represented for the tax payer because the Constitution made the nationalizations enacted after 1974 "irreversible" [18].

Internal and External Macroeconomic Balance

The major difference between the period before and after 1974 refers to external balance. During most of the period before 1974, the trade deficit was more than offset by receipts from tourism and remittances, as well as by capital inflows, so that reserves increased every year from 1962 to 1973. Since then, external balance has been a recurrent constraint on macroeconomic policy, even though the overhang of gold and foreign exchange reserves allowed some smoothing between adjustment and financing throughout the 1970s [19].

As in most small open economies, external imbalances can be ascribed to a combination of an excessive level of spending, mainly by the public sector, and its inadequate composition.

Emigrants remittances and (less) tourism contributed significantly to the foreign exchange surplus throughout the first period particularly between 1967 and 1973. From 1964 to 1973 those two items were estimated at respectively 26 and 10 percent of total foreign exchange earnings, while exports were 51 percent and trade and capital movements with former colonies at an (overestimated) 12 percent.

In spite of a decline of exports, remittances and tourism during the revolutionary period of 1974 to 1976 and a slowdown of emigration since 1973, both remittances and tourism in percentage of export earnings have increased. In fact, between 1977 and 1981 remittances were 66 percent of total exports earnings up from the 44 percent share recorded from 1964 to 1973 [20].

The contrast between the period before and after 1974 with respect to external balance corresponds to sharp differences on the domestic macroeconomic balances front. Before 1974, the steady growth of exports, workers remittances and tourism allowed a sustained gap between income and production. So, there was a continuous reserve accumulation.

The public sector was essentially a saver and on the whole domestic savings exceeded gross investment. Private and public consumption grew at moderate rates, except for the beginning of the 1960s, due
to the outbreak of the war in Africa and an unusual level of public spending. After 1974, the excessive level of spending, mainly by the public sector, and its composition greatly changed the macroeconomic balance. In fact, after 1974, public consumption grew rapidly: 13 percent between 1973 and 1977 (15 percent only between 1974 and 1975, compared with half this rate in 1968-73)[21].

The composition of public consumption also changed substantially: (1) with the independence of the Africa possessions, defense expenditures fell; (2) employment expanded in the public sector, and civil servants' wages and salaries increased; (3) social considerations and the flow of immigrants from Africa led to an increase in the weight of the social security system; and (4) there was an increase in the financial burden of public enterprise, which fell substantially into debt.

The rapid growth in expenditures—especially interest payments—was not matched, despite government efforts, by increasing revenues. This was in part due to an income distribution out of higher incomes towards less taxable lower incomes. It was also because private consumption increased substantially, as did population (immigrants, de-drafting, and returnees). Since private consumption increased on goods which were not revenue raisers, via sales taxes or import duties, net borrowing by the government in the domestic and foreign markets increased continuously.

An important source of public expenditure increase was due to the nonfinancial state-owned enterprise. Between 1977 and 1980, these entreprises grew twice as fast as private firms, when they accounted for about 15 percent of gross domestic product, higher than the average of 10 percent in both industrial and developing countries.

The excess growth of these entreprises, financed by government borrowing (domestic and foreign), does not reflect market resource allocation, so that their importance and weight in total production will tend to decline with the government's ability to borrow on their behalf. This decline is not certain, however, if EC funds are sufficiently large and directed against private sector firms.

On the aggregate, between 1974-1976, investment declined but domestic savings fell even more and could not cover gross investment. On the one hand, public savings were reduced because of increased expenditures within the nationalized sector, greater welfare services, and increased employment. On the other hand,
private savings declined because of increased consumption and reduced profits. Emigrant remittances (in dollars) also fell. By 1977, savings covered about 64 percent of total investment. This forced the central bank to increase credit and money creation. Foreign borrowing increased, especially in the enlarged public sector.

After 1977, public consumption increasingly generated negative savings. The composition of savings also changed in the private sector. The increase in interest rates in 1977 and 1978 to smaller negative values in real terms led to an increase in household savings relative to corporate savings as consumption levelled off. The ratio of gross investment to gross savings improved up to 1980. It has deteriorated since then, as the public sector cut deeper in the sources of financing and as household savings declined, due to a more rapid adjustment to inflationary expectations since 1980. The evaluation of the corporate situation is more difficult to assess because it includes the nationalized sector. Before 1974, corporate savings were important. In the early 1980s, the public sector dissaving accounts for over 20 percent of private savings, whereas including state-owned enterprises, public sector dissaving accounts for about 30 percent of private savings. The corresponding share of private investment is over 45 percent.
NOTES

[1] Detailed data on growth of population and labor force are in SA-Table 4.1, and employment and unemployment in SA-Tables 4.2 and 4.9 to 4.16. International and internal migration and their regional incidence are in SA-Table 4.3 to 4.6. The occupational structure of legal emigrants, in SA-Table 4.5, suggests that most emigrants were drawn from the pool of unskilled labor force. The speed of urbanization is on SA-Table 4.7.


[3] Nominal and real wages are in SA-Table 1.2 and by sectors in SA-Tables 1.3 to 1.5. Real wages seem to be quite rigid with respect to changes in the economic structure, according to Barosa (1986). The flexibility of real wages is nevertheless a prominent feature of the Portuguese economy's adjustment in the seventies, as argued by Krugman and Macedo (1979).

[4] Social security benefits are in SA-Table 1.6. The Unemployment Fund reports its expenditures in 1973 as 47 percent for public works, 45 percent for professional training and subsidies, and 8 percent for loans and administration.

[5] This is based on a 1973 household expenditure survey carried out by the National Statistical Institute.

[6] Openthogel and Stoleroff (1984) report an estimate (based on an informal survey) of a 60-40 share for Inter and UGT, and a total membership of 1 million, or about one-fourth of the labor force.

[7] The warranted wage computed by Barosa (1984) is implied by a constant labor share and a constant natural rate of unemployment. Note also that he smooths out the increase in labor force show in SA-Table 4.1 for 1975 across 1974 and 1975. Calculations are summarized on SA-Table 1.7.

[8] These figures are from National Accounts at 1963 prices(see
SA-Table 3.2).

[9] See SA-Table 4.9 for sectoral employment, and for agricultural trade SA-Tables 2.35 and 2.36.

[10] Portugal was a net exporter of agricultural goods in the 1950s of around 400 million escudos (average of 1956-59) while overall trade balance was negative (-5300 million escudos). In 1980-81, the agricultural trade deficit reached 14 percent of overall trade deficit (see SA-Table 2.35).

[11] Demand pressures increased dramatically due to the economy's rising incomes, earnings from tourism and workers remittances. Meat consumption and other food consumption grew also and demand pressures were not translated in higher prices and productivity but in higher imports.

[12] Data on foreign investment is on SA-Tables 3.8 and 3.9.

[13] Exports growth rate by destination is on SA-Table 2.14. Trade orientation by industrial ownership is on SA-Table 3.7.


[15] See SA-Table 3.7 on industrial structure by ownership. The (overlapping) list of industries where foreign ownership is significant can be found in SA-Table 3.8.

[16] Aggregated capital and investment is on SA-Tables 5.1 and 5.3. SA-Tables 5.5 and 5.6 show investment and capital stock at sectoral level. Factor intensities are in SA-Table 5.7. Detailed growth of sectoral investment is on SA-Table 5.8. Capacity utilization in manufactures is on SA-Table 5.9.

[18] Efforts to limit domestic and foreign borrowing by state-owned enterprises are very difficult politically. The same can be said about attempts to open some of these sectors to private investment and participation. Even though law no. 11/83 of July 1983 and Decree Law no. 406/83, of November 19th, reduced the restricted sectors to defense, petroleum refining, basic petrochemicals and steel (thereby liberalizing banking, insurance, cement and fertilizers which were restricted by Law 46/74 of July 8th), and the new legal framework for private commercial and investment banks was approved by Decree-Law no. 51/84 of February 11st, they did not begin operating until the spring of 1986. By then, however, some of the nationalized banks were in such difficult situation that policy measures to favor the new banks could generate a collapse of the banking system. See Macedo (1987).

[19] Balance of payments data is on SA-Tables 2.1 and 2.3 and debt on SA-Table 2.7. Data on the budget, public receipts and expenditures is on SA-Tables 6.12 to 6.18.

[20] According to Chaney (1986), Portugal's remittances as source of earnings particularly in recent years is higher than they are in other labor exporting countries such as Greece, Turkey or Pakistan.

[21] See SA-Table 5.20.
CHAPTER II

THE LONGEST TRANSITION TO THE EC

With the benefit of hindsight, Portuguese trade policy from 1948 to 1985 can be described as a long transition to membership in the European Community, since it was, to a large extent, the result of European multilateral agreements and of membership in regional organizations. The hesitations and the obstacles are, however, an important component of this long transition.

Thus, Salazar's government had reservations about the ideals of European integration underlying the agreements establishing a European Economic Community and European governments had reservations about Portugal's authoritarian regime, which were exacerbated by its stance against self-determination in Africa.

Despite the ambiguity of the government's desire to liberalize, partaking of European integration since the beginning of the European Payments Union (EPU) and of the Organization for European Economic Cooperation (OEEC), in the late forties, did generate channels of structural interdependence. During the period of ambiguous liberalization (1948-74), these can be seen as the exchange of manufactures and labor for capital goods and gold.

The neglect of agriculture and the lack of energy resources made this pattern of growth quite vulnerable to external shocks of the early seventies. At the time, though, the April revolution induced the mutual political responsiveness which was lacking during the colonial transition.

The qualitative index of trade liberalization, presented in Chart 1 and constructed in the Annex to this Chapter illustrates that the long transition to EC membership in 1986, was marked by hesitations, which differ across periods. We define three periods: 1948-74, a period of ambiguous liberalization, 1974-77 the revolutionary reversal and 1977-85, a transition to EC membership. Policies in these periods are described below. Trade and domestic policies implied variable levels of structural interdependence with the rest of the world both on trade and factors movements.

The major reason for the hesitation during the 1948-74 period had to do with the alternative objective of "self-reliance" and domestic controls. Since both of these objectives became
Chart 1

Index of Trade Liberalization: 1948-1985
controversial during the first liberalization episode (1970-74) — because popular support for the colonial objective disappeared whereas domestic liberalization was seen as unfair to labor — they were strongly reversed after the revolution.

The major reason for the hesitation during the transition to EC membership had to do with the Constitutional freeze on the sprawling public sector inherited from the revolutionary nationalizations. This surely exacerbated the structural imbalances of the Portuguese economy, particularly in manufacturing, thus generating the partial reversal of the second episode and undermining some of the effects of expected membership in the EC until 1986.

Thus, external trade policies have been far from the forefront of the economic policy design in these forty years. In the years of 1948 to 1974, economic policy was aimed at industrialization based on ambitious large import-substituting projects while after 1974 external payments difficulties led to quick shifts of trade and domestic policies.

Except for a short period (1970-74), internal policies were generally inconsistent with external liberalization implied in the several regional agreements. Thus, the level and pace of liberalization was determined by external trade policies and also internal policies which in practical terms both isolated several sectors of the economy from international pricing and competition and in the second episode also led to reversals of liberalization.

Ambiguous Liberalization (1948-74)

Even though trade barriers reductions occurred gradually throughout the whole period, three phases can be identified: (1) 1948-59, the EPU-OEEC phase, when a QR and exchange control regime was in part replaced by tariffs; (2) 1960-69, the EFTA phase, when tariff reductions, coupled with increasing labor and capital mobility, were associated with higher growth as a consequence both of EC prosperity and the favorable Annex G to the EFTA agreement; and (3) 1970-73, the EC phase, a period of faster liberalization, when the level and variance of tariff protection fell substantially, the bias against export declined, factor mobility was very high and, on the domestic front, the investment licensing scheme was virtually removed.

The last phase, which qualifies as a trade liberalization episode, will be analysed in Chapter III.
For convenience, we report for the entire period the economic and political circumstances in Table 5 and the main policy shifts in Table 6.

Tables 5 and 6

In Table 6, policy patterns indicate that in spite of a progressive trade liberalization, with QRs replaced by tariffs and a slow but broadly sustained decline in the effective rate of protection, price mechanisms were not the main indicators for resource allocation in the economy. This was largely the result of strictly domestic policies, even though the exchange rate policy pursued also played a role.

Nature of Decision-making

The process of decision making in Portugal, as far as trade policy is concerned, was very secretive and continues to be poorly understood. It seems that Salazar, during the first years after he became Prime Minister in 1932, gave special attention to the budget, public works and foreign policy. The economic arrangement preferred by Salazar seems to have been an economic union with the colonies which would increase the economic power of Portugal. Actually he rooted this strategy of "collective self-reliance" on the view that discoveries epitomized the Portuguese people. Given the widespread international opposition to the colonial policy, a major arena for its discussion became the United Nations General Assembly [1].

While the position of Portugal in relation to political international organizations was a major source of concern during the sixties, international economic matters were relatively neglected. It was not realized that the role of Portugal as an intermediary between North and South required greater openness, and therefore a worldwide foreign economic policy.

The hesitation to partake of post-war European economic cooperation itself, is apparent in Portugal's attitude towards the Marshall Plan. Despite the refusal of the first disbursement of Marshall aid, after the establishment of OEEC and EPU in 1948 and the signature of the North Atlantic Treaty Organization (NATO) in 1949, Portugal was the only neutral country which received Marshall aid on the same footing as the countries who had been involved in the war [2].

The same hesitation to participate in the European movement led Portugal to opt for EFTA rather than the EC at the end of the
## Table 5
Main Economic and Political Circumstances Before 1974 Reversal

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Speed of Liberalization</strong></td>
<td>Slow</td>
<td>Slow</td>
<td>Fast</td>
</tr>
<tr>
<td><strong>Years of High Liberalism</strong></td>
<td>1950-1956</td>
<td>1963-1964</td>
<td>1973 (very high)</td>
</tr>
<tr>
<td><strong>Targets of Trade Policy</strong></td>
<td>Balance Foreign</td>
<td>Accompanying main trade partner (UK)</td>
<td></td>
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<tr>
<td><strong>Overall Target</strong></td>
<td>Defense of Sovereignty over African Territories</td>
<td>Attempt to Establish an Economic Union</td>
<td></td>
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<tr>
<td><strong>Economic Circumstances</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Current Account</td>
<td>Deficit (47-50)</td>
<td>Growing Surplus (Except 1961)</td>
<td>Large Surplus (Except 1974)</td>
</tr>
<tr>
<td>Reserves</td>
<td>Surplus (50-59)</td>
<td>Accumulation</td>
<td>Accumulation</td>
</tr>
<tr>
<td>Trade Balance with Colonies</td>
<td>Positive (50-59)</td>
<td>Positive (59-61)</td>
<td>Negative</td>
</tr>
<tr>
<td>Capital Flight</td>
<td>None</td>
<td>Increasing (after 1967)</td>
<td>Yes</td>
</tr>
<tr>
<td>Emigration</td>
<td>Low</td>
<td>Increasing (to 57)</td>
<td>Improving (68-69)</td>
</tr>
<tr>
<td>Terms of Trade</td>
<td>Deterioration Stable (60-67)</td>
<td>Improving (70-72)</td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>Nil</td>
<td>Low (4%)</td>
<td>Increasing (10%)</td>
</tr>
<tr>
<td>Output Growth</td>
<td>Moderate (4%)</td>
<td>High (6.2%)</td>
<td>High (9%)</td>
</tr>
<tr>
<td>Agricultural Growth</td>
<td>Low (-.9%)</td>
<td>Low (1.5%)</td>
<td>Low (2.1%)</td>
</tr>
<tr>
<td>Shocks</td>
<td>Minor (post-war)</td>
<td>African War</td>
<td>1st Oil Price</td>
</tr>
<tr>
<td></td>
<td>devaluations (starting 1961)</td>
<td>Increase</td>
<td></td>
</tr>
<tr>
<td><strong>Political Circumstances</strong></td>
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<tr>
<td>Stable Government</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>Government Agencies</td>
<td>- Prime Minister's Office -</td>
<td>Central Bank</td>
<td>Min. Industry</td>
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<td>Responsible for Policy</td>
<td>EPU</td>
<td>EFTA</td>
<td>Same + EC</td>
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<td>International Influence</td>
<td>OEEC</td>
<td>GATT</td>
<td>Larger</td>
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<td></td>
<td>NATO</td>
<td>IMF/IBRD</td>
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</tr>
<tr>
<td>-----------------------------------------------</td>
<td>-----------</td>
<td>-----------</td>
<td>-----------</td>
</tr>
<tr>
<td>Charges on Fgn. Exch.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tariffs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal</td>
<td>Stable</td>
<td>Moderate decline</td>
<td>Decline (48-74)</td>
</tr>
<tr>
<td>Effective (Increase - 59)</td>
<td>?</td>
<td>(19%-64; 13%-70) across the board</td>
<td></td>
</tr>
<tr>
<td>Infant Industry Protection</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Protection to Import Substitutes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Trade Monopolies on Staples</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Import Quotas</td>
<td>Yes (Progressive Removal)</td>
<td>Liberal</td>
<td>Liberal</td>
</tr>
<tr>
<td>Export Incentives</td>
<td>Negative</td>
<td>Negative until 65</td>
<td>Low</td>
</tr>
<tr>
<td>Bis Against Exports</td>
<td>Yes</td>
<td>Low thereafter</td>
<td>No</td>
</tr>
<tr>
<td>Remittances and Tourism Support</td>
<td>Modest</td>
<td>Rising</td>
<td>Rising</td>
</tr>
<tr>
<td>Foreign Investment (oth. than basic sec.)</td>
<td>Small US $ peg</td>
<td>Rising US $ peg</td>
<td>Revals</td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>effve revail</td>
<td>effve revail</td>
<td>rel. to US $</td>
</tr>
<tr>
<td>Accompanying Policies</td>
<td>Licensing</td>
<td>Licensing</td>
<td>Liscg Liberal.</td>
</tr>
<tr>
<td>Investment Policy</td>
<td>- Preference to Cap. Intensive, Import Substitutes - Surplus</td>
<td>Deficit (61,62) Surplus</td>
<td></td>
</tr>
<tr>
<td>Fiscal Policy</td>
<td>Increase (47-48)</td>
<td>Accomodating</td>
<td>Expanding</td>
</tr>
<tr>
<td>Monetary Policy</td>
<td>Accomodating</td>
<td>Stable (1%)</td>
<td>Low Increase (2%) Stable (1%)</td>
</tr>
<tr>
<td>Real Wages</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Price Controls</td>
<td>Positive</td>
<td>Decline</td>
<td>Negative</td>
</tr>
<tr>
<td>Interest Rates</td>
<td>(about 3%)</td>
<td>(about 1%)</td>
<td>(about -3%)</td>
</tr>
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</table>
fifties. The EFTA solution appeared acceptable since Portugal did not risk losing the traditional British market, which accounted for more than 12 percent of total merchandise exports, while retaining autonomy about domestic and colonial policies. This option was largely to the credit of Correia de Oliveira, Salazar's Minister of Industry.

On the other hand, because of the political resistance to Portuguese colonial policy, entry in the EC would be resisted by other members. Even within EFTA, Britain was reluctant to allow an underdeveloped country like Portugal in this more restricted arrangement. In any event Portugal was invited to participate in the negotiations which led to the Treaty of Stockholm, on January 4, 1960 [3].

Nevertheless, it soon became clear that the EFTA option was not a long-run option, because it was to be tied to the particular objectives of the United Kingdom. Thus, shortly after the EFTA period began, the UK requested membership in the EC, surprising the other members.

Portugal followed suit but the strength of the British alliance may not have been the principal reason. Bilateral relations had been damaged by the British refusal to oppose the military reclaiming of Goa, Damao and Diu by India. In any event, the opposition to British entry in the EC made Portugal's request moot.

In this context, the outbreak of guerrilla movements in Angola in 1961 made the Portuguese government seek international support for its colonial policy, especially from the United States. As a gesture of good will, the government decided to open further: Portugal joined the World Bank, the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT) and, in rapid succession, sought aid from the German Development Bank and arranged for "precautionary loans" in the London and New York financial markets [4].

Seeking international support for the colonial policy, thus meant a broadening of the number of countries with which trade and payments were liberalized in the framework of existing international agreements. This openness is a far cry from an actual foreign economic policy, which, to the extent that it was acknowledged, involved some form of collective "self reliance" with the African territories. Indeed, a dispute within Salazar's government between ministers such as Correia de Oliveira who were in favor of a faster reduction and removal of tariff protection, and others who were in favor of keeping high level of protection for a longer time was apparently won by the defenders of a slower process. This was
especially easy since EFTA partners agreed to give Portugal a slower schedule for tariff reduction.

The timing of the accession to multilateral international organizations can also be seen in the light of interagency divergences. The interest in becoming a member of GATT only arose in 1962, when it became apparent that convenient conditions could not otherwise be obtained for trade relations with the recently established EC, which purchased 42 percent of Portuguese exports.

Having already participated in the Dillon Round, Portugal was involved, from 1964 to 1967, in the reduction and consolidation of duties achieved within the Kennedy Round. Similarly, membership in the World Bank was used to promote industrialization through loans for hydroelectric dams, while membership in the IMF had also the effect of giving international recognition to the parity of the Portuguese currency [5].

In Portugal, the absence of information and of political participation contributed to the lack of perception of the public about the importance of a trade liberalization policy. When trade liberalization matters appeared in the media, they were presented as implications of international agreements, rather than as the effect of a desirable policy for a small country like Portugal to be engaged in.

The process of liberalization was also affected by different interest groups that were able to influence the authorities. This happened both relative to the arrangements leading to the agreements and relative to the tariff changes that occurred at various stages. Negotiations were conducted on product by product bases. With the secretive decision-making process followed, the motivations for trade intervention or liberalization at industry level are extremely difficult to assess. Nevertheless, econometric evidence on the first episode will be brought to bear.

EPU-OECE Phase (1948-59)

The joining of EPU-OECE in 1948, in part due to the external payments difficulties of 1947-48 initiated the period of gradual external liberalization. Tariffs gradually became the main form of protection to the incipient industry and afforded fiscal revenues rather than the previous QRs and exchange controls. At the end of the 1950s, QRs were applied to a small number of products. Exports, mainly natural resource based (wine, cork and some industrial goods) were taxed. The negative incentive to exports was particularly high up to 1955, declining since then and abolished in 1965 [6].
Within EPU, the government also showed interest from the beginning in the process of trade liberalization, which led to the removal of quantitative restrictions such as import quotas and licensing, as well as to efforts for the restoration of currency convertibility.

Doubts about the strength of the authorities' commitment to trade liberalization within EPU and OEEC arise because of the increase in the general level of the tariff that occurred during those years. Nevertheless, tariffs were already the main instrument of trade intervention in Portugal, when the 1928 tariff schedule was replaced by a new tariff in 1959, on the eve of the EFTA agreement [7].

The lack of commitment to trade liberalization during this phase is reflected in variable tariff protection, protective domestic policies and lower level of trade and factor movements than in later phases.

EFTA Phase (1960-69)

In these years, the EFTA agreement dominated trade policy. Tariffs in Portugal were reduced as scheduled in trade agreements with EFTA and GATT, except for some acceleration of tariff reductions facing Portuguese exports in OEEC and EFTA.

Taking into account the stage of development of the country, by far the lowest among the members of EFTA, Portugal managed to obtain a slower import liberalization schedule in the special trade regime included in Annex G to the Treaty of Stockholm, without having to give in exchange special advantages to the other member countries. Thus, while 87 percent of Portuguese exports to other EFTA countries could immediately benefit from the common regime of the Convention, only 23 percent of imports were subject to such regime, whereas 65 percent could benefit from the more protectionist regime of Annex G [8].

More important perhaps than the initial concessions is the fact that the subsequent acceleration of the liberalization program was much greater in relation to the common regime than to Annex G [9].

As result of this agreement, the nominal protection declined from 19 percent in 1964 to 13 percent in 1970 (or by 32%) but effective protection increased from 25 percent to 28 percent (or by 12%). The higher variance of nominal tariffs reflect a higher level of protection on consumer goods and more rapid tariff reductions on capital goods, mostly not produced at home and needed for industrialization. On the other hand intermediate goods, of the
import-substituting type saw their protective level maintained at a higher level than capital goods [10].

On the export side, the EFTA agreement implied a more rapid tariff reduction facing exports. Even though Portugal's main trade partner and political ally, the U.K., still maintained quotas on textiles exports all indications are that it favored Portugal over other countries. On the domestic side the elimination of export taxes in 1965 and a system of drawback (although complicated and often inefficient) permitted a rising of indirect export incentives. However, these incentives did not offset the lingering anti-export bias of the tariff system until the first episode began in 1970.

A further policy undermining the competitiveness of Portuguese goods was that followed on the exchange rate. Salazar's regime followed a policy of balanced budget and an ever strong escudo. Against four other currencies there was a mild but sustained real appreciation of the currency throughout the period. The slowness of the appreciation was partly a result of the upward wage rigidity as shall be described but did not avoid the need for protection of non-traditional industries.

The real appreciation of escudo accompanied the policy of pegging the nominal exchange rate against the dollar from 1949 to 1971, so that the escudo was revalued against the French franc in 1958, 1959 and 1969 and sterling in 1967. Up to 1965, real effective appreciation involved a bias against exports, even though it proceeded at a slower rate with respect to imports. The sustainability of this policy as well as the almost total absence of exchange controls were possible because the increasing trade deficit was offset in part by the trade surplus of overseas territories (1950-64), in part by workers' remittances and tourism earnings associated with the sharp increase in emigration and tourism after 1964.

Trade agreements are reflected in a higher average of the quantitative index of trade liberalization than in the previous phase. However, the elements of lack of commitment to trade liberalization are still present due to a higher effective protection, the exchange rate policy pursued and contentious domestic policies. In fact, the variability of the index in this phase is still very high.

**Domestic Policies**

During the 1960s, trade liberalization policies were in conflict with industrial policies in the form of unrelaxed domestic controls both on quantities and prices. Among the quantity devices, the
investment licensing process was foremost. Price mechanisms consisted of an extensive and complex system of taxes and subsidies (including tariff and tax rebates for infant industries), controlled wages and control of prices such as those on essential food products and household services. The main objective of these policies was industrialization.

On the other side, trade agreements such as the ones with EFTA or the EC were allowed only insofar as they did not jeopardize the domestic and African priorities and indeed were seen as lessening Europe's lack of political responsiveness towards Portugal's overseas policy.

The foreign and domestic investment licensing process which was in operation, in one way or another, from 1937 to 1972. A license was granted to producers on an individual basis. From 1947 to 1972, restricted sectors were explicitly listed. Extreme cases were the tobacco and beer industries, subject to 100 percent plus effective protection and where firm entry was forbidden, as well as the investments of "national pride" (steel, cement, ship repair and construction, tobacco and oil refineries). There, foreign investments were totally excluded and licenses were tightly screened. For other industries, there were several degrees of protection through licensing.

In agriculture, state trading monopolies controlled purchases and sales of main products with the aim at enforcing price controls. These trade monopolies still exist today in spite of efforts for their liberalization.

In turn, price controls were justified by the cheap food policy which dominated policy up to the end of the 1970s. This policy was felt necessary as a strategy to promote industrialization, maintaining wages at a low level. Accordingly, cheap food was available through administered producer and consumer prices and extensive subsidization.

There was a decoupling between domestic and international prices on one hand and between producer and consumer prices on the other hand. In spite of this protective system agricultural production declined and agricultural trade balance turned into progressively larger deficits.

The agricultural sector declined as a result of the pricing policy which sustained a deterioration of the domestic agricultural-industrial terms of trade never to be offset by gains of productivity. In turn, low productivity was sustained through other active policies, particularly: 1) the subsidy system leading
to extensive (mainly wheat) crop production in land of low yields; and 2) public investment in irrigation in areas of low yielding. The result were high costs, downward pressure on farmers income, investment and lack of incentives to innovate.

In sum, the ambiguity of trade liberalization in the EFTA period resides on the movements of effective protection and domestic policies. The latter were designed to effectively isolate import-substituting sectors from international competition. However, the channels of structural interdependence with Europe were intensified in spite of these policies, as factor movements greatly increased in this period.

EC Phase (1970-74)

We identify the first trade liberalization episode with the 1970-1974, EC phase which saw both external and internal liberalization. This episode can readily be identified in the index and is fully analysed in Chapter III.

Overall economic circumstances for trade liberalization were favorable, and there was a seeming willingness of the authoritarian regime to introducing reforms of a political and economic nature.

The channels of structural interdependence with Europe on trade and factor movements greatly increased through these years. Thus, aside from tariff reductions, there was a steady flow of migrant labor, a spectacular growth of manufacturing exports, and a further opening of Portugal to tourism and direct investment.

During the final negotiations for the first EC enlargement Portugal negotiated a free trade agreement with the EC. Tariff reductions and remaining QRs elimination were established in the agreement. However, quotas for automobiles and protection for "infant industries" were allowed. With respect to the ECSC, a special delay for the removal of quotas on imports of steel products was allowed.

To favor Portugal, a slower tariff reduction schedule was drawn, according to which the final removal of duties would be set between 1980 and 1985. In another protocol, protectionist interests of the EC countries were safeguarded through the imposition of quotas for some "sensitive" products such as the textiles and clothing, paper pulp, tomato concentrate and minerals, which turned out to be the largest Portuguese exports.

Agreed tariff reductions schedules with EFTA, the new EC trade agreement and the unscheduled ad valorem tariff reductions all
contributed to a substantial decline on the level and variance of protection [11]. The decline in protection substantially reduced the bias against exports.

Nevertheless, the absence of macroeconomic restraint and the accumulation of gold reserves generated a sense of economic euphoria on the part of the government as well as on the part of the large industrial and financial conglomerates.

The new climate must, however, be qualified by a gradual deterioration in the type of social stability achieved during the Salazar era. His successor, Caetano, allowed (non-Communist) opposition "electoral committees" to campaign in the 1969 parliamentary elections but none of their candidates won a seat, which lowered instead of raised the legitimacy of the political system.

Furthermore, the political discussion of the colonial war continued to be severely restricted so that some of the so-called "liberal" representatives of the ruling party resigned from parliament in 1971 and 1972.

This combination of economic and political insecurity, which was to prove fatal to the regime, may have been associated with the faster pace of domestic liberalization rather than the most conspicuous symbols of Salazar's economic policy, namely, a balanced budget and a strong currency.

Revolution and Reversal (1974-77)

Portugal seemed to be catching up with the EC in the beginning of the seventies. This sense of the "de facto" membership was brutally shaken by the oil crisis. Unlike most European countries, Portugal experienced an oil boycott by OPEC as punishment for having allowed the U.S. Air Force to refuel in the Azores on the eve of the Yom Kippur War.

In the last quarter of 1973 and in early 1974, there were scattered food riots in Lisbon. The acceleration of inflation, in the face of controlled wages, generated a flurry of (largely underground) trade union activity. Furthermore, prestigious representatives of the armed forces signaled their unwillingness to continue supporting the colonial policies of the Caetano government.

We describe below the political and economic environment of the reversal as well as the implied increase in protection due to the reluctance to devalue the exchange rate. Almost every channel of structural interdependence was curtailed as well.
The unexpectedly quick and bloodless collapse of the Salazar-Caetano regime on April 25, 1974 was followed by almost two years of civil strife and political turmoil. During these two years, almost all of the policies of the former regime were reversed. The public sector borrowing requirement grew enormously by the nationalization of the previous "national pride" investments, as well as banking, insurance and many firms engaged in import-substitution activities.

The agrarian reform meant the occupation by workers of the large farms in the South. The stock market was closed, and nominal wages exploded through trade union militancy.

The reversal itself can be explained by a combination of adverse shocks. One was external and economic - the world recession that followed the first oil crisis in 1973. The other was internal and political - the change following the military coup.

The discovery of freedom, after so many years of authoritarian rule, released workers' long frustrated demands for wage increase and for increases in consumption. These were easily directed by the Communist trade unions into an attempt at creating a "popular democracy" in Portugal. Thus the leaders of the democratic parties were unable to control the situation until the foreign exchange reserves were exhausted.

Reluctance to Devalue the Escudo

Fixed nominal prices from the basic consumer basket to the exchange rate were, however, maintained. A devaluation of the exchange rate was never considered. In that regard, the revolutionary central bankers of 1975 behaved more conservatively than Salazar who, in 1931 (and partly in 1949), devalued the escudo to keep the parity with the pound sterling.

This policy was even more inappropriate in 1975 because major currencies had been floating against each other since April 1973, making the dollar peg of limited relevance. Despite some minor adjustments during the first constitutional government of the Socialist Party (implying an 8 percent nominal effective devaluation), exchange rate adjustment was resisted with much the same spirit as that of France in 1981-82.

The redistribution of income toward labor was enhanced by price controls (inflation fell: from 26 percent in 1974 to 16 percent in 1975). Imports increased by 25 percent and, as a result of social unrest and a climate of uncertainty, investment fell by 39 percent,
exports by 21 percent, and workers' remittances by 13 percent. Increased consumption and the effort at reducing unemployment in 1976 led to a deterioration in the current account deficit, which, in 1977, had almost doubled relative to 1975.

For some time, international payments could be made using part of the gold and foreign exchange that had been accumulated over the years or borrowing using gold as collateral. But it was soon felt that a prohibition of capital outflows (including a freeze on bank deposits) was necessary, along with import restrictions.

Capital controls seemed easier to enforce because of nationalization of the banking system but they obviously did not avoid capital flight and the appearance of a black market for foreign exchange for the first time in Portugal. Import restrictions included a diversified package of instruments, namely surcharges, prior deposits on imports, quotas, and licenses known as BRIs.

The movement towards tariff dismantling was maintained with the accomplishment of the agreements with the EFTA and the EC and the reductions obtained within the Tokyo Round. Nevertheless, before macroeconomic instruments were used, the authorities resorted to various forms of trade intervention to attain short-run balance of payments targets.

First, in 1976 (Decreto-Lei 729/76 of October and 315/77 of August) the specific rates of more than 25 percent dutiable items were doubled with the stated purpose of raising revenue through tariffs following the substantial decline in imports and price increases.

Second, in May 1975 (Decreto-Lei 271-A/75), nondiscriminatory surcharges were introduced. A rate of 20 percent was applied to intermediate goods (about 30 percent of total imports) and a rate of 30 percent was applied to consumer goods (governing about 8 percent of total imports). It was stated in the preamble to the law that, being a uniform, nondiscriminatory tariff, its purpose was strictly to change the situation of the Portuguese balance of payments. Different instruments would accomplish the target of promoting again productive activity and diminishing nonessential ("luxury") consumption. The short-run purpose of the surcharges was reinforced by the fixing of a date, December 31 of that year, as the deadline for their removal. This deadline was successively postponed, and some changes were introduced in the rates.

Third, also in 1975, noninterest deposits were required on 50 percent of the value of imports, made for 6 months before importation of some goods subject to import surcharges. The goods
in question accounted for about 10 percent of industrial imports. This scheme was abolished in 1976.

Fourth, after 1976, an existing system of import licensing (BRIs) was used to slow down imports of a large range of products. Resources spent on "seeking rents" are probably high since, in spite of a government announcement that a reform of the system is under way, its agencies have continued to use licensing as a major protective device.

Fifth, quotas which had existed since the 1960s were maintained mainly on consumer goods (clothing and household electric equipment and transport equipment—automobiles). Regulations on imports of some petrochemical goods were maintained. Quota levels are established each year, and they may have become more restrictive since they are often set in domestic currency. While quotas cover a limited number of goods, and they account for an insignificant share of existing trade, they may be of great relevance in lowering potential trade.

Sixth, with the nationalization of the industrial and financial groups which dominated import substitution in the sixties, the range of goods imported by state monopolies increased.

Still, to offset the growing bias against exports due to import restrictions and an overvalued currency, preferential credit at subsidized rates, modification of insurance schemes and fiscal incentives were introduced in 1976.

On the domestic front, the initial price controls gave way to demand pressures and difficulties of state-owned enterprises, especially utilities. Aside from the violence of the 1975 recession, the increased marginal tax rates and weaker tax administration also explain why measured inflation jumped from 16 percent in 1975 to 27 percent in 1977.

New Negotiations with the EC

The new international economic environment appearing at the end of the period of ambiguous liberalization was used as a justification for the policy reversals of 1974-76, even after most industrial countries had adjusted to the oil crisis. When the threat to democracy disappeared, after the defeat of leftist radicals in late 1975, steps were taken to continue the process of economic integration with the EC.

The renegotiation of the 1972 treaty, with an additional protocol, was achieved in June 1976. It had several purposes, such as
cooperation and promotion of labor mobility, but its main objective at the time was to postpone the reduction of duties protecting Portuguese industry. The possibility of introducing duties, up to 20 percent, to protect existing industries and not only "infant" industries was then allowed for.

Reference should also be made to a Financial Protocol, signed in September 1976 and enforced since November 1978, according to which the European Investment Bank could channel resources to Portugal even before membership. These measures were supposed to contribute in solving the difficulties of the Portuguese economy and in giving it improved competitive conditions in the EC, seen as the main market for Portuguese exports and also as the main source of financing of the Portuguese economy.

It was with these stated purposes, as well as the one of consolidating democracy that Portugal presented the formal demand for integration, on March 28, 1977. And such purposes were clearly stated both in the report of the European Commission dated May 19, 1978, and in the favorable decision of the Council of Ministers (June 6). When negotiations began on October 17, 1978, few people thought they were going to take six years and a half.

Transition to EC Membership (1977-85)

The revolutionary reversal ends with the application for EC membership - a continuation of the multilateral trade liberalization efforts of the pre-revolutionary period - and a devaluation - a definitive departure from the dollar peg which characterized the colonial period and the reversal itself. This marks the beginning of a new trade liberalization episode and of another period of transition to the EC.

Liberalization cum Stabilization Packages (LCSP)

This period is characterized by a strong interaction with macroeconomic stabilization, induced by a more turbulent domestic and external environment, which appeared toward the end of the first episode and was used as a justification for the policy reversals of 1974-76.

With the crucial exceptions of exchange and interest rate policies, macroeconomic management became much activist after the revolution. The second episode begins with the application for EC membership - a continuation of previous multilateral trade liberalization efforts - and a devaluation - a definitive departure from the
dollar peg which characterized the first episode. It was not until mid-1978, however, that exchange rate and interest rate policies began to be used, in the framework of a standby agreement with the IMF.

Three phases can also be defined in the nine-year period between application and membership. The first phase (1977-79) involves an overdue and therefore severe adjustment in relative prices, in the framework of the IMF stand-by agreement of 1978-79. The second phase (1980-82) involves first an explicit anti-inflationary program (1980) and then a refusal to negotiate the Extended Fund Facility (1981-82), despite the second oil crisis and the strong dollar.

Predictably, the third phase (1983-85) includes another IMF stand-by agreement (1983-84) followed by uneasingly strong signals of electoral politics, due to the 1985 presidential elections. As it turned out, there were parliamentary and local elections in 1985 but the first civilian president was not elected until early 1986. Since the transition period toward full EC membership also began in 1986, another trade liberalization episode has just begun, which will for the first time involve Spain, as the other recent member of the EC.

Due to lack of data, the analysis concentrates on the first two phases of the period, respectively the liberalization episode and its reversal.

The main economic circumstances and policy shifts, are reported in Tables 7 and 8 respectively. The abundance of policy shifts during this nine-year period (and even within its three-year phases) has been justified by the changing world and domestic conditions and objectives.

Because trade liberalization was itself more hesitant, it is doubtful whether a genuine episode can be identified before the year of actual EC membership (1986).

Tables 7 and 8

Policy shifts were also induced by quick changing governments: ten short-lived governments (socialist-led or presidential in 1977-79, social-democratic-led in 1980-82, socialist and social-democratic coalition in 1983-85, social-democratic in late 1985) implied a pattern of macroeconomic policy making which largely ignored business cycles prevailing in major trading partners. It also determined the high variability of relative prices which in turn
<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Short run</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overall balance of payments; Disinflation; Access to international capital market</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Economic Circumstances</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External shocks</td>
<td>None</td>
<td>Oil price rise</td>
<td>Strong dollar</td>
</tr>
<tr>
<td></td>
<td>Constant</td>
<td>Strong dollar (to mid 85)</td>
<td>Strong fall</td>
</tr>
<tr>
<td>Terms of trade</td>
<td>Improving</td>
<td>Worsening</td>
<td>Improving</td>
</tr>
<tr>
<td>External deficits</td>
<td>High</td>
<td>Down in 1980 then higher</td>
<td>High (85 lower)</td>
</tr>
<tr>
<td>Inflation</td>
<td>Wild recession</td>
<td>Expansion</td>
<td>Strong recession</td>
</tr>
<tr>
<td>Output growth</td>
<td>Average</td>
<td>Very Poor</td>
<td>Good</td>
</tr>
<tr>
<td>Agricultural Output</td>
<td>Worsening</td>
<td>Worsening</td>
<td>Worsening (85 impr</td>
</tr>
<tr>
<td>Political Circumstances</td>
<td>Minority coalition</td>
<td>Majority coalition (center until mid</td>
<td>Majority coalition (center until mid</td>
</tr>
<tr>
<td>Government (quick turnover)</td>
<td>(left center)</td>
<td>(right center)</td>
<td>CB, MEF, Trade,</td>
</tr>
<tr>
<td>Government agency responsible for economic policy</td>
<td>Central Bank</td>
<td>Ministry of Finance</td>
<td>Industry (uncoordinated)</td>
</tr>
<tr>
<td>International Influence</td>
<td>IMF - high</td>
<td>EC - low</td>
<td>IMF - high</td>
</tr>
<tr>
<td></td>
<td>EC, EFTA - low</td>
<td>EC - rising</td>
<td></td>
</tr>
<tr>
<td>-----------------------------------</td>
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<td>-----------</td>
<td>---------</td>
</tr>
<tr>
<td><strong>Charges on foreign exchange</strong></td>
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<td>Nominal Devaluation</td>
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</tr>
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<td>Export Profitability</td>
<td>High</td>
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<td>Low</td>
</tr>
<tr>
<td><strong>Quotas &amp; Licensing</strong></td>
<td></td>
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</tr>
<tr>
<td>Export Incentives</td>
<td>Rising</td>
<td>Falling</td>
<td>Falling</td>
</tr>
<tr>
<td>Black Market for-Goods</td>
<td>Medium</td>
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<td>Falling</td>
</tr>
<tr>
<td>Remittances Incentives</td>
<td>Rising</td>
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<tr>
<td>Foreign Investment</td>
<td>Catching up to previous level</td>
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<td>Foreign Borrowing by (State-owned Enterprises)</td>
<td>High</td>
<td>High</td>
<td>Lower</td>
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<td>Accompanying Policies</td>
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<td>Expansion</td>
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<td>Fiscal Policy</td>
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<td>Increasing deficits</td>
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<tr>
<td>Real Wages</td>
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<tr>
<td>Controlled Prices</td>
<td>Increase</td>
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<tr>
<td>Interest Rates</td>
<td>Increase</td>
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<td>Sharp increase (1984)</td>
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</table>
lessened the reliability of market signals for resource allocation.

The stabilization packages of 1978 and 1983 negotiated with the IMF were an ex-post solution to balance of payments difficulties and shortages of foreign exchange.

In contrast, the 1980 revaluation was expressly aimed at the domestic objectives: controlling inflation and stimulating investment. During the 1981-82 world recession, devaluation was avoided because of the widespread belief that it would be stagflationary; as a consequence, the growing external deficit required the restrictive packages of 1983-84.

The three phases described are reflected in the trade liberalization index. Two phases dominated by LCSPs (1977-79 and 1983-85) are separated by the partial reversal of 1980-82. Policy swings correspond to changes in slopes of the index as macroeconomic policy changes implied variable trade policy in spite of bounding regional trade agreements.

Trade Agreements and Trade Policy

The 1972 free-trade agreements with the EC, revised in 1976, included a schedule for tariff reductions, which was kept throughout the period. Later during the negotiations for EC membership, a trade agreement between the EC, EFTA and Spain was signed in 1979. According to this agreement, trade restrictions between Portugal and Spain began to be removed for the first time. The implied tariff reductions are reported in Chapter IV [12].

Because of balance of payments difficulties after 1976, the level of protection implied in trade agreements was different from the actual level of protection. A 30 percent nondiscriminatory surcharge was introduced after 1975, and maintained at variable levels since then. Import licenses and quotas became more restrictive. Unfortunately, the rules for import license concession by industries are unknown. They were never clearly legislated (except a general rule explicitly seeking to protect national production), perhaps because they were seen as temporary. Import licensing is scheduled to be abolished in 1989, but during the 1986-89 transition period licenses will be granted automatically or after five days.

Nevertheless, stabilization packages and the EC agreements were announced as separate policies and their relation was not considered. Indeed, QRs, import licensing and quotas, may have offset reductions in tariffs and surcharges at a time of real
revaluation of the currency (1980-82).

Several difficulties were encountered in assessing the effect of real exchange rate movements on resource allocation.

First, not all charges on current account transactions reported in Table 8 are quantifiable. Portuguese currency was and remains largely inconvertible and therefore the effects of macroeconomic policy packages, including devaluations, must be seen under the quantity controls prevailing at the time.

Second, the economic effects of devaluation must take into account other price movements, which were particularly large during 1977-78 and 1982-84, despite the fact that interest rates, wages and domestic prices are in varying degrees controlled.

Third, policies aimed at decreasing the level of aggregate demand in 1978-79 were reversed in 1980-82 so that a new restrictive package had to be put in place in 1983-84.

Fourth, the supply of foreign exchange increased after 1978 and particularly during 1980-82 as a result either of the stabilization package (1978) or of accelerated borrowing abroad by the government and state-owned enterprises (1980-82). Demand behavior, the government deficit, and the associated growth of the money supply are likely to have led to the accelerated inflation in this period. The real revaluation of the currency during these years led to the closing of a phase which precipitated the devaluation package of 1983.

The hesitant nature of trade liberalization in this period is best revealed when timing policy shifts. In 1978, the 1976 import deposit was abolished and tariffs resumed their decline. In fact, tariffs and their variance declined from 1977 to 1983. Surcharges on imports declined vigorously in 1978-79 and export incentives declined until 1983.

On the basis of these direct price devices alone, one would conclude that this is clearly a period of liberalization. The strong devaluation in 1977-78 reinforced the role of price mechanisms relative to the period preceding it. In these years, QR premiums seem to have been low enough to induce a higher role for market prices. Quotas were not used up probably because of rigorous contraction of aggregate demand and lower premiums.

However, from 1980 to 1982, the situation changed and quantity devices played a more important role. With the revaluation of 1980, licenses were made more restrictive, since quota (and may be
license) premiums increased until 1983. Black market on goods became more active. Because of the decline in agricultural production, state importers were forced to import larger quantities of "essential" food products. The increased level of economic activity led to increased imports of "essential" intermediate goods (fertilizers and petroleum) by state importers. Since these were paid in (overvalued) dollars, import quotas of state monopolies played an important role in resource allocation during 1980-82.

Finally, during these years, the commitment to large new investment contracts led to favoring imports of investment goods. Import allocation was increasingly determined by government intervention and the allocation of QRs.

On the domestic front, policies were not of a liberalizing nature. Keeping the tradition of regulating the economy, the government maintained price controls on most food products, public utilities and energy products which require extensive subsidization due to inflation and variable international prices. Particularly, the enlargement of the gap between consumer and producer food prices created the need for expanding subsidies in the sector. The selectivity of credit at variable interest rates became still more complex with exports, agricultural, housing and investment benefitting from it whereas consumer goods (particularly durables) were discriminated against. At the end of 1982, though, QRs were not effective enough to control the excess demand for foreign exchange and a new exchange rate devaluation was required in 1983.

Prospects for the European Transition: 1986-96

This analysis ends in 1985 when a third liberalization episode, more uniform than previous ones, involving agriculture and Spain begins in 1986. It also foresees external financial liberalization.

At the closing of negotiations, the imports from the EC and from EFTA countries, corresponding to about 60 percent of Portuguese imports, were entering almost free of duties. With membership, the effects of free trade in industrial products with Spain, as a consequence of joint accession, are potentially more significant than the effects of free trade with the Ten, because intra-Iberian trade is still heavily restricted and natural barriers to trade are much smaller.

Given the virtually simultaneous restoration of democracy in the two countries, the situation of mutual neglect was destined to last throughout the negotiations for the Iberian enlargement. The basic
reason for restricted intra- Iberian trade from the Portuguese side has been the notion that the larger size of Spain poses a threat impervious to policy coordination between the two countries. Because the stakes are higher, trade policy with Spain can accordingly be seen as a signal of the intentions of the government with respect to trade liberalization in general.

In other words, a third trade liberalization began with membership and actual transition to the EC and a larger commitment to anti-inflationary policies followed by structural domestic reforms of a liberalizing nature. There are several steps, beginning in 1986 and ending in 1993, for trade liberalization with the EC.

The relations between Portugal and Spain, probably the most striking economic effect of membership, are basically governed by what was agreed with the whole Community, even though some exceptions are accepted in a separate protocol.

The exceptions make bilateral liberalization more gradual that the common regime. They involved safeguard clauses in the case of sudden changes in the bilateral flows of trade of paper and steel products. A regime of quotas is also feature in the protocol. Protecting Spanish interests, there are quotas on oil products during six years, on textiles during four or five years, on petrochemical and cork products during five years, and on tobacco during six years. In exchange, Portugal obtained special conditions to protect the fishing sector from the European largest Spanish fleet and competition [13].
ANNEX

Construction of the Trade Liberalization Index

The index of trade liberalization from 1948 to 1986 was constructed as follows. The first period (1948-74) was divided into three phases, according to the major determinant of trade liberalization - from 1948 to 1959, the Marshall Plan (together with OEEC and EPU), from 1960 to 1969, EFTA; from 1970 to 1974, the free-trade agreement with the EC. After the 1975-76 reversal, the second period spans the duration of the negotiations toward membership in the EC (1977-85). During this period, the policy emphasis on European integration kept growing, but the variable stance of macroeconomic policy suggested three phases: 1977-79, IMF devaluation package; 1980-82, anti-inflationary revaluation and foreign borrowing; 1983-85, IMF devaluation package.

Attaching a number with the same scale as the trade liberalization index to these phases and identifying a third liberalization episode to begin with the transition toward full membership in the EC (1986-96), gives the values of the external index reported below. During both periods, the degree of commitment to trade liberalization rose from phase to phase. To emphasize the growing policy emphasis on European integration during the second period, the index for 1986 is set at 18. Contrast this with a value of 5 for the 1975-76 reversal.

External Policies

1948-59: 10
1950-69: 15
1970-74: 20
1975-76: 5
1977-79: 15
1980-82: 16
1983-85: 17
1986 : 18

The effect of foreign economic policy objectives implied by membership in international organizations was constrained by domestic controls policy objectives which also varied from phase to
phase. Most important were: investment licensing during the first two phases, efforts at establishing a "Portuguese economic union" during the second phase. Only during the third phase was the domestic objective fully consistent with the external one. This is why we define a trade liberalization episode during this phase.

Similarly, during the stabilization phases of 1977-79 and 1983-85, efforts were made at relaxing some domestic controls, whereas the constraint of the public sector deficit became stronger in 1980-85. Noting the ambiguity of the year 1980, we define a trade liberalization episode in 1977-80.

Due to accession, some controls will be relaxed in 1986, but the lack of preparation for membership due to electoral politics in 1985 and early 1986 suggests a value of 5 for that year. The values of the domestic index are reported below:

**Internal Policies**

1948-59: 8  
1960-69: 5  
1970-74: 20  
1975-76: 3  
1977-79: 8  
1980-82: 3  
1983-85: 3  
1986: 5

Aside from policy objectives, the strength of the channels of structural interdependence with abroad encompasses trade in both goods and factors. We emphasize four: exports, imports, labor and capital movements [14]. They changed during these phases in a manner captured by the numbers reported below.

**Channels**

1948-59: Exports, 10; Imports, 12; Labor, 9; Capital, 8.  
1960-69: Exports, 15; Imports, 14; Labor, 16; Capital, 14.  
1970-74: Exports, 15; Imports, 15; Labor, 16; Capital, 16.
1975-76: Exports, 6; Imports, 10; Labor, 1; Capital, 1.
1977-79: Exports, 15; Imports, 12; Labor, 1; Capital, 10.
1980-82: Exports, 10; Imports, 14; Labor, 1; Capital, 12.
1983-85: Exports, 12; Imports, 11; Labor, 1; Capital, 13.
1986 : Exports, 20; Imports, 20; Labor, 11; Capital, 16.

Taking a simple average of the six indexes and rounding to the nearest integer, we obtain the synthetic index reported below.

Average Index

1948-59: 10
1960-69: 12
1970-74: 17
1975-76: 6
1977-79: 11
1980-82: 10
1983-85: 11
1986 : 18

While the trade liberalization index should reflect changes from year-to-year rather than between phases, data is often not available for the purpose.

Based on the evolution of the effective exchange rate (1948-85), tariff collections and export and import to output ratios (1948-84), terms of trade and relative unit labor costs (1953-85) and relative unit costs (including user cost of capital 1966-85), we adjusted the synthetic index up or down by one or two points so as to keep unchanged the average for the phase.

The resulting trade liberalization index has the values indicated in Table 9 which includes the direction of movement in the
variables used to introduce the changes from the average index reported above, including some remarks about the changes [15].

Table 9
Table 9

Index of Trade Liberalization

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NOTES

[1] This special involvement of Salazar in the country's foreign policy is stressed in a monumental biography by his former Minister of Foreign Affairs, Franco Nogueira. Salazar's government decided on this question and no information exists from parliamentary sources. The rapporteur to the Chamber of Corporations stated: "the Country through the Parliament and the Chamber of Corporations, is consulted only at a quite advanced stage of a large and complex work of international cooperation". See Camara Corporativa, VII Legislature, 1960, Vol. 1, Lisbon, 1961, pp. 380-1, where it is added that the text of the agreement to be ratified was not accompanied by any report, even a short report stating the fundamental elements of the policy that was being built for two or three years." This rapporteur became one of the major critics of the government during the EC phase: see his own statement in Moura (1969).

[2] The Portuguese ambivalence is evident in the reaction to General Marshall's celebrated Harvard address. Two weeks later, on June 21st, 1947, the Portuguese ambassador in Washington sent a note to the U.S. administration "giving all the support within its means to the Marshall Plan". At the Paris Conference, the Portuguese representative managed to keep Portugal in the list of beneficiaries of direct aid, but was instructed not to accept any funds for the first disbursement of Marshall aid, in 1948-49. However, in 1949-50, Portugal benefitted from the Fund in different ways (borrowing, grants and drawing rights), in a total of about 58.7 million dollars (Xavier, 1970, p. 79). See also Salazar's speech, "Portugal in the Atlantic Alliance", July 25th, 1949. Note, finally, that, according to Barbosa (1970), Marshall aid was more important for the Portuguese administration because of the new management methods it introduced rather than because of the amounts involved.

[3] See Guerra, Freire and Magalhães (1981) for accounts by some of the personalities involved and Macedo (1977) for an interpretation of this period.


[5] Through Decreto-Lei 42802 and 42803, both of January 13rd, 1960, the treaty establishing the European Monetary Agreement was ratified by Portugal. But Portugal did not feel the need to ever use this mechanism (Xavier, 1970, pp. 89-90). On this period, see also Guerra, Freire and Magalhães (1981, p.4) and Macedo (1982, p.83). According to Correia (1969), during the Kennedy Round,
Portugal gave advantages corresponding to 365 millions 1964 escudos of imports and obtained advantages corresponding to 2.827 million 1964 escudos of exports.

[6] The process of liberalization of intra-OECE trade was particularly accelerated for Portugal, which in 1955 was second only to Italy. The process of liberalization with the United States and Canada was slower. Similarly, the EPU quota of 70 million units of account helped finance the balance-of-payments deficits of 1948 and 1949. Soon thereafter, benefitting from the effect of the Korean war on the prices of some raw materials, Portugal moved towards a position of surplus over the quota. See also Cunha (1969, pp. 47 ss); Xavier (1970, p. 82) and Correia (1969, pp. 12-22).


[8] The schedule of tariff reductions within EFTA was accelerated relative to the date agreed in the Stockholm Convention. Decisions of the Council, taken between February 16th, 1961 and May 16th, 1963, involved all of the dates of the common regime. In the special regime of Annex G, the reduction to 70% was anticipated from January 1st, 1965 to January 1st, 1968. In a decision of the Council of December 18th, 1969, the timetable for tariff reductions was set, keeping the final step on December 31st, 1979. Such reductions were as follows: for 1973 40%, for 1975 30% and for 1977 20%. Furthermore, section 6 of Annex G stated that at any time before July 1st, 1972, Portugal could increase the import duty on a product or establish a new import duty on a product not produced in significant quantities in the Portuguese territory, provided that this import duty: (i) was necessary to help promote the development of a particular line of production; and (ii) was not higher on an ad-valorem basis than the normal level of customs duties implied by the most-favored nation clause. This section of Annex G thus accepted that Portugal could increase protection according to the infant industry argument. The new (or increased) duties were to be reduced progressively and abolished on January 1st, 1980. Finally, according to section 7 of Annex G, Portugal could introduce quantitative restrictions on exports of an exhaustible mining product if, taking into account the availability of the product, domestic industries might be endangered by exports. See Correia (1969).

[9] Some authors are surprised by how favorable these agreements were, considering the doubtful commitment of the Portuguese authorities, even with respect to the integration in EFTA. According to Moura (1969, p. 29), "the refusal of new forms of
international organization and of modernizing contacts is clear in the EFTA option, officially remaining the hope that the European idea will not succeed". In the words of Tsoukalis (1981, p.51), it was "a choice for non-commitment in European affairs"; see also Cravinho (1979). Others think, however, that in the framework of EFTA, there was a real commitment towards European construction; see Xavier (1970, p.123). We prefer to emphasize the ambiguity of the government's objectives, as in Macedo (1986).

[10] See SA-Table 6.2.

[11] Ad-valorem tariffs decreased in 1974 mostly because of the specific nature of rates. See the discussion in Chapter III.

[12] A summary of these Agreements is in ATA.


[15] The variables are: x export to output ratio; m import to output ratio; t average tariff; n nominal effective exchange rate; r real effective exchange rate; p terms of trade; l relative unit labor costs; c relative unit costs. The remarks are: 1/ Import licensing set in place. 2/ New tariff before joining EFTA. 3/ Colonial wars begin, legislation enacted to create Portuguese economic union. 4/ Accession to IBRD, IMF, GATT. 5/ Investment licensing revised, not relaxed. 6/ Price controls tightened. 7/ Exchange crisis devaluation. 8/ Successful stabilization program. 9/ Discrete revaluation, successful anti-inflationary policy. 10/ Import licensing tightened. 11/ Exchange crisis, devaluation; import surcharge increased. 12/ Import surcharge lowered. 13/ Crawling peg suspended.
CHAPTER III

FIRST TRADE LIBERALIZATION EPISODE: 1970-74

Intended and Actual Liberalization

The early seventies were a period of great economic dynamism in Portugal, during which tariff reductions scheduled in trade agreements were accompanied by domestic deregulation and increased international factor mobility. This substantially reduced the level and variance of protection as well as the bias against exports.

The ambiguities of the authoritarian and nationalistic regime were exacerbated by the very success of the trade liberalization policy in bringing Portugal economically closer to its European trading partners. This successful catching-up undermined the traditional rationale for restricted civil rights. Moreover, the continuation of the colonial war without any serious attempt at a political solution showed an immediate shortcoming of the absence of democracy.

Despite the gradual deterioration of the macroeconomic environment, the reversal of this episode is predicated on the fragility of the regime rather than on its economic consequences.

During the sixties, the decrease in the nominal rate of protection had not been matched by a decrease in average effective rates. The tariff reduction effect of international trade agreements such as EFTA and GATT together with the increase in international prices was thus offset by domestic resistances, especially in the corporate sector, but the evidence is that protection did not increase employment. Indeed, in the consumer goods industries, effective protection rose from 38 to 62% and employment fell, whereas, in the capital goods industries, protection fell from 58 to 29% and employment rose [1]. The changes in effective protection can be seen in Chart 2.

This bias against manufactured exports - illustrated in Table 3 of Chapter I - was unlikely to have been removed by the use of a drawback system to compensate exporters of the tariff-induced high cost of inputs, in part because of administrative and bureaucratic requirements and delays [2]. In any event, during the episode, the speed of liberalization increased and the bias against exports disappeared. Effective protection for importing industries became lower than for exporting and export- and import competing for the first time.
Chart 2
Effective tariffs (%)

Source: SA-Table 6.2.
There was then a decrease in the level of nominal protection, from 13 to 4 percent between 1970 and 1974, as well as a decline in effective protection, from 28 to 12 percent (with a decrease also in the standard deviation). The decrease in the nominal protection was due to remaining EFTA scheduled tariff reductions and to the EC trade agreement of 1972. It was also an effect of the specific nature of more than 80 percent of tariff rates. When world inflation began in the mid-1960s, the corresponding ad valorem rates became lower and lower.

The beginning of 1974 is probably the closest point to free-trade, at least as far as tariff protection is concerned. In the meantime, during 1970-74, quotas on some important consumer goods (automobiles and household electric equipment), steel products and petrochemical products were maintained or extended. Systematic data is unavailable but, due to favorable external payments circumstances, they were probably less restrictive than before [3].

On the other side, the available instruments of export promotion, such as long-term credit arrangements for exporters, were seldom used, partly because financial institutions were more interested in short-run operations.

Finally, factor mobility also increased significantly during the episode, in the form of both an accelerated outmigration of labor, in part to avoid the military draft, and a rapid inflow of foreign direct investment leading to more capital per man than would have been the case through trade liberalization alone. Nevertheless, in line with the idea of "export enclave", Portugal continued to compete effectively with its EFTA and EC partners in labor-intensive manufactures.

In sum, trade liberalization was not only influenced by intended tariff reductions but rather by actual factor mobility and domestic deregulation.

Circumstances When the Policy Was Introduced

In September 1968, the succession of Salazar was remarkably smooth. The first years of Marcelo Caetano's premiership were characterized by steps taken to liberalize the political life and to lessen domestic economic controls.

The continuous reserve accumulation during the sixties, particularly after 1967, convinced the new Caetano government that
economic development and liberalizing policies could be greatly accelerated relative to the rates achieved during the Salazar period. In fact, stimulating investment was the main objective of development policy.

With this purpose, Caetano appointed new technocrats to his first government and allowed a more widespread participation of Parliament and other social forces. He was, however, not able to resist the growing opposition by the more conservative and powerful elements at his right gather around the figure of the President of the Republic, Admiral Tomas, so that the social-political consensus of Salazar's time broke down, paving the way to the 1974 military coup.

In spite of the deep-seated structural problems which continue to be the attributes of the Portuguese economy, as discussed in Chapter II, and in spite of the rigidity of the political regime, there was a sense of euphoria—known as the "Marcelist Spring"—when the trade liberalization episode started.

The current account had been in growing surpluses since 1967 in spite of trade balance deficits. The odd year of 1969 saw (but only temporarily) a foreign demand decline and home recession. In fact, increased remittances, tourism earnings and foreign investment more than offset the excess demand for foreign exchange so that reserves accumulated [4].

Growth which had been around 6 percent in the sixties accelerated to 9 percent in 1968 and 1970. The 1969 recession was due to contracting foreign demand, and declining agricultural production (4 percent) and industrial productions (only growing at 6 percent). Growth in 1968 and 1970 may be attributed to industry and services (9 percent on average). The agricultural sector stagnation became a visible problem at the time.

Several public investments were initiated (leading to increases 14 percent in 1968 and 40 percent in 1969) and current expenditures (consumption, including defense) also grew, but, due to inflation-induced forced savings and a buoyant economic activity, tax receipts increased even faster (20 percent in 1970). Thus the public sector remained a net saver throughout the episode.

One policy aimed at increasing investment for economic development was to maintain interest rates low. Wage increases since 1966 may have induced a bias towards capital-intensive projects.

In any event, the set of policies launched did not avoid an excess of savings over investment as indicated by the accumulation of free
reserves over required reserves of the commercial banking system [5]. The excess supply in the domestic market, reflected in the external surpluses, allowed liberalization policies run their course without visible adjustment costs. It was, in any event, larger in the private than in the public sector, suggesting that the government was able to step up expenditure.

The growing differentials between domestic and foreign interest rates led to capital flight so that the external accounts of net capital movements became negative in 1968-69, for the first time since 1947. Measures were taken from 1968 onwards to attract capital and foreign investment.

During the sixties real wages in manufacturing rose 2 percent on average and only in 1970 they rose by 5 percent. In agriculture, during that year, they rose by 24 percent, in part because of the extension to rural workers of social security benefits previously reserved to industry.

But the faster rise in agriculture was also a response to output decline, increased demand for food and a shortage of labor due to emigration and draftees for the African war. Moreover, in 1971-72, prices may have caught up with nominal wages, slowing down or reversing the positive trend in real wages [6].

Accompanying Policies

Aside from pursuing domestic liberalization, the Portuguese authorities had a mostly passive role in relation to policies for internal and external balance. Few, if any, policy measures were designed to manage demand, let alone to provide macroeconomic support to the trade liberalization policy.

Domestic Liberalization

Before 1970 the most important policy intervention directly conflicting with liberalization policies was the licensing of foreign and domestic investment, which had been in place since the 1930s. In addition to this regulatory constraint, potential investors from outside the large groups were more likely to be rationed in the credit market, dominated by the commercial banks. The policy of maintaining very low interest rates exacerbated the monopoly power of these large groups.

Similarly, the import substitution policy was particularly favorable to the large industrial and financial groups, involved in the production of products such as steel, cement, petrochemical and
chemical products, ship repair and construction. In these sectors, protection was often granted through direct import prohibitions and quotas. Altogether the favored groups seem to have had an edge on investment license and quota premiums over other non favored groups. In more traditional and labor-intensive industries (such as food products, textiles, footwear, wood and cork products, metal products and small machinery industries), a more liberal policy was followed.

The liberalizing tendency of Caetano's government began to be reflected in Decree no. 393/70 of August 19, and it was reinforced by Law no. 3/72 of November 28 which reduced the restricted list by 1/3, basically involving defense industries and some "basic" industries with exceptionally high set-up costs and great intersectoral impact. Similarly, Decree-Law no. 75174 of February 28 implemented the Industrial Development Act (Lei de Fomento Industrial) by means of a widespread scheme of industrial incentives.

Thus, not only firms competition was improved but also incentives including those of a fiscal and financial nature were introduced. These, however, favored the capital intensive sectors. Among fiscal incentives specially relevant are those on lowering tariffs by 50 percent on capital goods used on investments and total exemption on those capital goods not produced domestically. Taxes were lowered favoring capital goods production and depreciation allowances were introduced. In fact, new lines of credit lines were the main policy tools supporting the Industrial Development Act of 1970.

Other Policies

While domestic policies became less conflicting with trade liberalization policies, they were not designed as accompanying policies. Even if increasing competition at home was seen as an instrument to promote economic development, the preference of the Caetano government for capital-intensive projects prevented any serious attempt at solving the structural imbalances of the Portuguese economy, and thus at fighting inflation and capital flight.

There was, nevertheless, some effort to implement policies for improving the agricultural sector growth and incomes. They were aimed at improving the structure of production, mainly for increase production on those staples with higher income elasticity (meat, corn and oil seeds), developing the infrastructures and increasing production prices. Food industries at rural level were stimulated with both fiscal and credit incentives. Crop areas particularly in areas which produced cereals, were reoriented for forestry or
pastures and a Fund for Reestructuring Land Tenure was created.

Indirect incentives to exports were maintained and somewhat extended as new credit lines and new fiscal incentives were implemented. Preferential credit clearly favored exports and when interest rates were raised for most type of credit in 1970, they were not raised for exports credit and credit for investment goods. Fiscal incentives also did not favor exporting activities more than investment goods.

Exchange rate policy was passive throughout the episode, even after the collapse of the Bretton Woods system in 1971. Moreover, as result of the realignments, the escudo revalued with respect to the dollar, even though it devalued slightly in relation to European currencies.

Monetary policy was expansionary in part induced by the inflows of foreign exchange in part as a result of the public investment policy and the overall attempt to stimulate credit for productive investment. Money supply broadly defined grew on average at 22 percent p.a. between 1970-73 faster than the 16 percent p.a. average growth of nominal income. Indeed, a major policy effort from 1969 to 1971 involved the improvement of the financial market. Time deposits which were 32 percent of all deposits in 1965 jumped to 46 percent in 1971 [7].

The objective of these measures was to increase the relative importance of the medium and long run credit. There were substantial changes in the range and differentials of interest rates and terms for repayment both on deposit and credit side. Long run credit and its renegotiation was eased. Newly-created investment banks saw their rates favored in relation to other banks. However, the required reserves on sight deposits were lowered more than the required reserves for longer term deposits. These changes were designed to attract savers to medium term deposits and overcome the traditional commercial banks preference for short term credit lines.

The measures, at least in the commercial banking system, did not have a definitive success. In fact, medium and long term bank credit remained at around 3 percent of total credit. Thus, to complement the private financing system, the public sector was stimulated towards savings mobilization, and public sector credit grew faster than private one.

Preferential credit lines to favor preferred sectors were established (including those for exports and productive industrial investment). Credit for forestation and for the agricultural sector
was increased and redesigned. This meant extended government intervention on interest rates and credit allocation.

Prices which have been growing at 4 percent in the sixties, grew 9 percent in 1969 and on average 11 percent in 1970-73. In 1969-71, price controls, particularly on food prices, were relaxed and subsidies lowered.

Measures were taken to liberalize domestic trade aiming at to increase competition and rationalize distribution channels. However, in 1972 with the continuous price rises, price controls were again tighten and extended. No attempt was made to control inflation through fiscal policy and demand management. Indeed, food prices rose faster than other prices.

In 1968, to fight illegal capital flight and the also illegal deposits abroad, tighter controls were introduced, together with an amnesty to domestic investors holding balances abroad. To attract foreign investment garantees on transfers of profits and other gains were also introduced. These measures were maintained throughout the episode and capital movements improved in favor of Portugal and foreign investment accelerated [8].

Summarizing, the policies introduced in this episode were generally more liberal than before. They increased competition of firms, domestic trade, relaxed investment licensing and promoted the financial system. However, the investment effort also meant enlarged government intervention on interest rates, preferential credit and controls on international capital movements. After 1972, price controls were extended. These forms of intervention would be maintained and greatly enlarged after 1974.

Economic Performance Following Liberalization

The continuous trade liberalization with EFTA, the trade agreement with the EC in 1972 and across-the-board tariff reductions make this period the most illustrative of a credible trade liberalization stance in Portugal.

In spite of newly emerging political conflicts, the opportunities from trade and domestic economic liberalization were captured by economic agents, as revealed by the patterns of resource allocation reported below. The response of the economy was greatly helped by favorable macroeconomic environment. The military coup of 1974, when the episode collapsed, was not determined by economic reasons.
On the aggregate, the degree of openness of the economy accelerated from 3 percent on average in the sixties to 13, 7, 3 and 5 percent each of the years 1969 to 1972. However, accelerated inflation led to a partial reversal of domestic expansion and liberalized policies which were tightened further in 1973, so that openness grew at a lower rate in 1973 and 1974.

As the effects of the first oil shock set in and the reluctance of the Salazar and Caetano regimes to change the exchange rate was shared by the revolutionary authorities, the liberalizing drive reversed itself.

Table 10 provides an overall view of the economic performance during the episode and compares it with previous years, since there were no well-defined policy measures toward trade liberalization.

Table 10

Before 1970 there were very slow changes in major prices, steep rises of imports and exports, output, investment and income. Employment still grew slower largely as a result of stagnant labor supply due to emigration and draftees for Africa war. Thus, unemployment was also kept low at 2-3 percent on average. The trend of earlier years was exacerbated during the liberalization episode.

The acceleration of inflation in the early seventies was due to domestic policies and world trends which more than offset the effect of lowering trade barriers. It was only after 1971 that inflation became sizable, especially for consumer prices: it was then the highest in the OECD. In 1974, in part due to the oil price shock, in part due to domestic demand expansion, the inflation rate jumped to 29 percent.

The figures on the real effective exchange rate suggest a continuation of the real appreciation which began in the earlier period. A measure of relative unit costs suggests that the passive formal exchange rate policy was more than offset by declining labor and capital costs so that competitiveness actually improved [9].

However it improved less in 1970-74 than it did before (5 percent in 1967-69) and profitability for exports and imports grew practically at the same rate (7 percent between 1970-74).

Real wages were overtaken by price inflation in 1971 and 1972, stagnated in 1973 but, in 1974, the rise was close to 14 percent. Similarly, a rough estimate of the real interest rate using the
<table>
<thead>
<tr>
<th>Economic Questions</th>
<th>Economic Performance (% p.a.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Major Prices</strong></td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>High (11%)</td>
</tr>
<tr>
<td>Exchange rate (real)</td>
<td>Lower appreciation</td>
</tr>
<tr>
<td>Relative unit costs (foreign/private)</td>
<td>Low increase (2%)</td>
</tr>
<tr>
<td>Profitability for exporting</td>
<td>High (7%)</td>
</tr>
<tr>
<td><strong>Imports</strong></td>
<td></td>
</tr>
<tr>
<td>Volume growth</td>
<td>Rising (14%)</td>
</tr>
<tr>
<td>Imports to GDP ratio</td>
<td>Rising (6%)</td>
</tr>
<tr>
<td><strong>Exports</strong></td>
<td></td>
</tr>
<tr>
<td>Volume growth</td>
<td>Rising (11%)</td>
</tr>
<tr>
<td>Exports to GDP ratio</td>
<td>Rising (2%)</td>
</tr>
<tr>
<td><strong>Openness (Imports, Exports)</strong></td>
<td></td>
</tr>
<tr>
<td>Volume growth</td>
<td>Rising (13%)</td>
</tr>
<tr>
<td>% of GDP</td>
<td>Rising (4%)</td>
</tr>
<tr>
<td><strong>Output, Income</strong></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>Rising (9%)</td>
</tr>
<tr>
<td>Income</td>
<td>Rising (6%)</td>
</tr>
<tr>
<td>Income per capita</td>
<td>Rising (6%)</td>
</tr>
<tr>
<td><strong>Employment, Investment</strong></td>
<td></td>
</tr>
<tr>
<td>Employment</td>
<td>Stable</td>
</tr>
<tr>
<td>Labor Productivity</td>
<td>Rising (8%)</td>
</tr>
<tr>
<td>Investment</td>
<td>Rising (11%)</td>
</tr>
<tr>
<td>Corporations (n%)</td>
<td>Rising (13%)</td>
</tr>
</tbody>
</table>

* The economic performance of 1974 is excluded from the annual averages.
maximum mortgage rate and the increase of the consumer price index over the previous year shows that it became increasingly negative in the early seventies.

A negative relationship between the import share and the import real exchange rate holds for the trade liberalization episode, during which the elasticity was unity [10]. Significant changes in the structure of imports can also be observed, after a period of fairly stable shares. This is particularly the case for the combined share of food products and raw materials, especially oil, but also for the main manufacturing imports.

The share of exports in output also rose, even though it remained below imports both in value and rate of increase. Since the real effective exchange rate for exports shows a real appreciation throughout the period, the elasticity has the wrong sign.

The earlier trend for a loss of export competitiveness in primary and food products and a gain in competitiveness in manufacturing exports became evident during the episode. While the share of the former categories fell from 45 percent to 30 percent during these fifteen years, manufactures (excluding food and petroleum products) rose from 53 percent to about 70 percent.

Except for the late sixties, the rate of growth of output accelerated, as shown on Table 12 above. The slowdown of the late sixties is common to trade and output and the same can be said about the acceleration of the early seventies, including the interruption brought about by the 1974 Revolution. Per capita income grew fast albeit at a slower rate than output. Unfortunately income data is not reliable and its gap with respect to production is difficult to estimate.

During the episode, there was a substantial increase in the number of corporations in the capital goods industry, whereas growth slackened in construction and services. There was also a fall in the number of firms closing. Net entry remained high in the early seventies, offsetting a fall in 1969, but net entry falls again in 1974. Corporations are virtually absent from the primary sector and concentrated in services.

Patterns of Sectoral Response

Economic performance at the five sector level is summarized on Table 11. Trade liberalization and trade ratios are on panel A and illustrate well the across-the-board decline in effective protection particularly on consumer goods traditionally protected
by tariffs. As mentioned, the bias against exports declined and the largely export and import competing, labor intensive consumer goods saw their trade ratios rise.

Table 11

Export ratios also rose in the capital goods industries, which had expanded more rapidly than other industries in the 1960s in part due to foreign investment. Foreign investment accelerated greatly during the episode and the opening of new markets (including Latin America) may explain capital goods industries expansion. Overall, across-the-board liberalization led to trade effects consistent with the classical expectation of comparative advantage in a labor abundant country, except for the decline of the agricultural sector.

On panel B resource allocation is illustrated among the same five sectors. Investment accelerated across-the-board as a result of the financial measures introduced in 1969-71. In fact, real interest rates, administratively fixed were negative throughout the episode (around -3 percent on average).

Employment stagnated or increased mildly (depending on statistical sources) as a result of the declining labor supply due to emigration and the widening of the wage gap. Indeed, real wages increased more on average in 1970-73 than the productively adjusted for the deterioration of the terms of trade so that the wagegap widened [11]. There was a displacement of labor explained probably by faster real wages increases in 1969-70 and real capital costs decline so that labor intensive industries reduced employment not to be rehired when real wages dropped (1971 and 1972). But, in the presence of factor prices distortions, labor displacement cannot be attributed to trade liberalization policies.

The question still remains whether the credible trade and domestic liberalization led to a pattern of resource allocation, particularly investment commitments distinct from previous patterns, i.e., favoring the "export enclave" (export and domestic oriented industries) rather than the favored, monopolistic import substituting industries.

Even though investment commitments do seem to be distinct from previous patterns, the difference is almost neutral in relation to the "export enclave". This can be seen on Table 11 where sectors were ordered by the level of gross fixed capital formation as given in industrial statistics and on average for 1970 to 1974.
Table 11

Economic Performance at the 5 Sector Level  
1970-1974

Panel A - Trade

<table>
<thead>
<tr>
<th>Effective Protection</th>
<th>Import/Output</th>
<th>Export/Output</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy</td>
<td>-12.3</td>
<td>12.0</td>
</tr>
<tr>
<td>Primary Sector</td>
<td>-0.8</td>
<td>16.2</td>
</tr>
<tr>
<td>Consumer Goods</td>
<td>-22.2</td>
<td>20.8</td>
</tr>
<tr>
<td>Intermediate Goods</td>
<td>-12.0</td>
<td>8.2</td>
</tr>
<tr>
<td>Capital Goods</td>
<td>-17.6</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Panel B - Resource Allocation

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy</td>
<td>9.1</td>
<td>-0.1</td>
<td>11.1</td>
</tr>
<tr>
<td>Primary Sector</td>
<td>1.8</td>
<td>-3.4</td>
<td>8.1</td>
</tr>
<tr>
<td>Consumer Goods</td>
<td>10.4</td>
<td>-1.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Intermediate Goods</td>
<td>9.4</td>
<td>0.6</td>
<td>10.0</td>
</tr>
<tr>
<td>Capital Goods</td>
<td>11.5</td>
<td>0.4</td>
<td>10.4</td>
</tr>
<tr>
<td>Construction, Services</td>
<td>10.4</td>
<td>1.9</td>
<td>11.1</td>
</tr>
</tbody>
</table>

Table 12

The resource pull is still large for some import substituting industries but is also significant for industries in the "export enclave". Investment in the top industries of the list is traceable to individual projects. Such is the case, for instance, for the investment in the new industrial complex of Sines (petroleum products and plastics), a pulp plant (paper products) and tires production (rubber).

Investment in beverages resulted from the liberalized new investment code which open the beer industry to competition. At the end of the list, investment in agriculture stagnated (in spite of some supportive policy measures) and investment in food processing actually declined.

To assess the effect of trade policy on openness, Table 12 ranks sectors by effective protection changes and reports the respective change in import and export to output ratios.

The peacemeal trade agreements seem not to have favored any industry group in particular with the exception of leather and footwear. The openness to import is well illustrated. On the export side, non-electrical machinery and most industries of the "export enclave" performed well in spite of simultaneous openness to imports. No collapse occurred but industries directly affected by the oil shock (petroleum products and plastics) performed less well. See Table 13.

Table 13

The political economy of protection

We now discuss some possible reasons for protection and thus the possible sources of resistance. While tests were carried out for about 40 sectors in the input-output tables of 1964, 1970 and 1974, we only report some results for episode which we are analysing.

A negative correlation was found between the rate of effective protection and the level of wages in 1970, suggesting that protection favored sectors with lower wages. While there is no correlation with the share of employment, for that year, protection seems intended to protect sectors where large corporations were dominant, according to the average number of employees.

Moreover, in 1970, protection favored corporations established in the previous years rather than in the following years. This


### Table 12

Economic Performance: Resource Allocation of 1970-74

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Investment</th>
<th>Employment</th>
<th>Type *</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petroleum Products</td>
<td>157</td>
<td>4.2</td>
<td>IS (FI)</td>
</tr>
<tr>
<td>Rubber, Plastics</td>
<td>61</td>
<td>-3.1</td>
<td>IS (FI)</td>
</tr>
<tr>
<td>Paper Products</td>
<td>50</td>
<td>7.0</td>
<td>XE (FI)</td>
</tr>
<tr>
<td>Beverages</td>
<td>47</td>
<td>14.0</td>
<td>Mixed (wine=XE)</td>
</tr>
<tr>
<td>Non-Metalic Mineral Products</td>
<td>39</td>
<td>0.1</td>
<td>Mixed</td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>26</td>
<td>6.4</td>
<td>IS (FI)</td>
</tr>
<tr>
<td>Textiles, Clothing</td>
<td>23</td>
<td>-1.9</td>
<td>XE</td>
</tr>
<tr>
<td>Tobacco</td>
<td>21</td>
<td>-3.4</td>
<td>IS</td>
</tr>
<tr>
<td>Wood, Cork</td>
<td>12</td>
<td>-4.4</td>
<td>XE</td>
</tr>
<tr>
<td>Chemical Products</td>
<td>8</td>
<td>3.7</td>
<td>IS (FI)</td>
</tr>
<tr>
<td>Leather, Footwear</td>
<td>6</td>
<td>0.4</td>
<td>XE</td>
</tr>
<tr>
<td>Metal Products</td>
<td>6</td>
<td>-7.5</td>
<td>XE</td>
</tr>
<tr>
<td>Electrical Machinery</td>
<td>5</td>
<td>1.3</td>
<td>IS (FI)</td>
</tr>
<tr>
<td>Other Manufacturing</td>
<td>4</td>
<td>NA</td>
<td>--</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1</td>
<td>-3.2</td>
<td>--</td>
</tr>
<tr>
<td>Food Products</td>
<td>-7</td>
<td>2.1</td>
<td>XE</td>
</tr>
<tr>
<td>Metallic Mineral Products</td>
<td>-10</td>
<td>7.9</td>
<td>IS</td>
</tr>
<tr>
<td>Non-electrical Machinery</td>
<td>-13</td>
<td>2.8</td>
<td>IS (FI)</td>
</tr>
</tbody>
</table>

* XE=Export enclave
  IS=Import substituting
  FI=Foreign ownership significant

Sources: SA-Tables 4.12, INE, Industrial Statistics, several issues.
<table>
<thead>
<tr>
<th>Sectors</th>
<th>Effective Protection</th>
<th>Import/Output</th>
<th>Export/Output</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rubber, Plastic</td>
<td>-42</td>
<td>13.2</td>
<td>-9.4</td>
</tr>
<tr>
<td>Transport Equip.</td>
<td>-36</td>
<td>-3.8</td>
<td>-0.6</td>
</tr>
<tr>
<td>Food Products</td>
<td>-25</td>
<td>30.4</td>
<td>-1.4</td>
</tr>
<tr>
<td>Met.Min. Products</td>
<td>-21</td>
<td>16.6</td>
<td>1.0</td>
</tr>
<tr>
<td>Textiles, Clothing</td>
<td>-18</td>
<td>18.9</td>
<td>12.1</td>
</tr>
<tr>
<td>Chemical Products</td>
<td>-15</td>
<td>14.3</td>
<td>11.9</td>
</tr>
<tr>
<td>Wood, Cork</td>
<td>-8</td>
<td>14.7</td>
<td>4.7</td>
</tr>
<tr>
<td>Metal Products</td>
<td>-8</td>
<td>19.5</td>
<td>4.4</td>
</tr>
<tr>
<td>Electrical Machin.</td>
<td>-6</td>
<td>1.6</td>
<td>7.2</td>
</tr>
<tr>
<td>Paper Products</td>
<td>-5</td>
<td>0.9</td>
<td>-0.1</td>
</tr>
<tr>
<td>Non-met.Min. Products</td>
<td>-5</td>
<td>7.8</td>
<td>-6.8</td>
</tr>
<tr>
<td>Non-electrical Machin.</td>
<td>-4</td>
<td>21.7</td>
<td>35.4</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-1</td>
<td>16.2</td>
<td>-4.5</td>
</tr>
<tr>
<td>Leather, Footwear</td>
<td>14</td>
<td>16.9</td>
<td>13.8</td>
</tr>
<tr>
<td>Beverages</td>
<td>Neg. to Pos.</td>
<td>-3.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Petroleum Products</td>
<td>Unreliable</td>
<td>-0.8</td>
<td>-11.9</td>
</tr>
<tr>
<td>Tobacco</td>
<td>Unreliable</td>
<td>1.9</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Sources: SA-Tables 6.2, 2.23 and 2.25.
negative correlation was confirmed for 1974. Relative to employment creation, in 1970, less protection was given to the sectors in which less employment was to be created in the next four years. Conversely, in 1974, the significant relationship is with sectors in which employment had changed during the previous four years. This confirms that the period between 1970 and 1974 was the most relevant for trade liberalization.

Protection seems to have been given mainly to sectors in which the percentage of imported consumer goods was lower, but significant results were not found for geographical concentration, foreign ownership of capital, or for natural resources [12].

One strong reason for tariff intervention in Portugal seems to have been the collection of tax revenue. We have therefore tested the long-term price elasticity of demand in each sector, relative to the nominal values of the tariff. Using available estimates of demand elasticities between 1971 and 1977, a regression was run for 38 industrial and trade sectors of the input-output tables of 1970 and 1974, to find that nominal protection was lower in sectors in which the price elasticity of imports was higher, and vice versa [13].

Sustainability of Liberalization

The economic sustainability of the episode rests on a counterfactual hypothesis. We do not have a clear perception of how accelerated inflation, deterioration of the terms of trade, unrealistic foreign exchange pricing, further deterioration of the terms of trade due to the oil shock of 1973 and also further deterioration of income distribution would affect economic performance without the shock of the April revolution.

Judging by the aggregate and the sectoral wages and labor shares, income distribution seems to have deteriorated in relation to the "Marxist Spring" of 1969-70. Policies on price and exchange controls and credit allocation were also reversed and tightened already in 1973.

We believe, on the whole, that the liberalization drive might have been sustainable, albeit at a slower pace, if political and social circumstances had not changed so drastically. This judgement rests largely on the sound macroeconomic circumstances when the policy was introduced, the continuous government budget surplus and the inexistence of costs of adjustment attributable to trade liberalization. It also assumes that a sizable wage gap would not arise or that a faster adjustment to a more active exchange rate policy would eliminate it.
NOTES

[1] The other two categories remained at roughly the same levels. The standard deviation of nominal tariffs rose from 32 to 55 between 1964 and 1970, larger than the standard deviation reported in SA-Table 6.2, suggesting a much higher variation within the large four categories, especially consumer goods. Trends in effective protection can be inferred from the comparative evolution of protection in four traditional product categories: primary products, consumer goods, intermediate goods, and capital goods (this is shown in Chart 2 and in SA-Table 6.2, where the weights of these categories in merchandise imports and exports are also reported). The effect of changes in trade patterns between these broad categories is negligible for nominal protection, but significant for effective protection rates (see SA-Table 6.3).

[2] See Carvalho (1979). To assess the general path towards trade liberalization in this period, account has to be taken of non-tariff barriers as well. There were quotas in three important sectors: automobiles, steel, and petrochemical products, accounting for 18 percent of total imports in 1964. These quotas were maintained and still exist today. The drawback system lost importance after 1974. The role of export taxes was always very small.

[3] New restrictions of the 1960s and 1970s were introduced with the purpose of promoting new industries. In fact, the introduction of infant industry restrictions was accepted, for some time and in certain conditions, both by Annex G to the Stockholm Convention establishing EFTA, and by the Trade Agreement with the EC in 1972 (see ATA). It was a quite different situation from that existing in the 1930s and 1940s when a general system of exchange controls and quantitative restrictions was in effect.

to accelerate after that. However, in 1971 and 1972 remittances and tourism earnings grew faster than previously. They grew even faster in dollar terms due to the revaluation of European currencies (the residence of most emigrants and tourists) following the December 1971 realignment (see SA-Tables 2.1, 2.3 and 2.6).

[5] According to the Bank of Portugal, in spite of rapid growth of bank credit (two times more rapid in 1969-71 than in 1965-68), the ratio of free reserves over required reserves was 18 percent in 1969 and 39 percent in 1971.

[6] See Macedo (1982) for an interpretation of this decline in real wages in terms of relative deprivation by the working classes.


[8] See SA-Table 3.9.

[9] See Special Study for an explanation of this measure of competitiveness.

[10] Point elasticities as well as estimated elasticities using regression analysis on 1962-1978 data suggest that overall import price elasticities are low even though statistically significant.

[11] SA-Table 1.7.

[12] It should be stressed, however, some of the main sectors (automobile, steel, chemical and petrochemical products) receiving non-tariff protection were located in the Lisbon-Setubal area. There is also some indication that the participation of foreign capital was higher in sectors with higher rates of effective protection. See Porto (1976, pp. 80ss.).

[13] The data calculated by the Ministry of Industry and Energy (1980) is reported in Rendeiro (1980). Note that the Portuguese authorities might also have intended to tax consumption through the tariff for equity reasons. This hypothesis was rejected, as the
CHAPTER IV
SECOND TRADE LIBERALIZATION EPISODE: 1977-80

Announced and Actual Liberalization

This episode spans the three years of stabilization and liberalization and was initiated by the announcement of application for EC membership. This announcement led to an effort by the Portuguese authorities to remove or reduce the effects of the instruments introduced in 1975-76, to liberalize existing trade monopolies as well as to carry out scheduled tariff reductions.

From the end of 1980 until the new stabilization package of 1983, these liberalization efforts were frustrated and became progressively less credible as the economy's relentless expansion was driven by an increasing government deficit and a growing external debt, inducing protectionist measures for balance of payments purposes. As import licensing played a more important role in this process, the second liberalization episode was partially reversed.

The entire period since the 1975-76 reversal of the first trade liberalization episode is indeed characterized by strong interaction between liberalization and stabilization policies, that is to say by the recurrence of liberalization cum stabilization packages (LCSPs) [1].

The twice repeated pattern shows the introduction of trade restrictions as a mean to avoid devaluation during foreign exchange crises (1976 to first semestre of 1977 and again in 1982-1983), followed by stabilization packages (1978 and 1984), in turn leading to external balance and relaxation of trade and exchange controls (1979-80 and again in 1984-85). Thus, after 1980 the credibility of the repeated trade liberalization announcements within the slow negotiating process with the EC hung on the sustainability of macroeconomic stabilization.
The stabilization and liberalization policies and effects are inseparable. Trade restrictions were thought necessary to redress external imbalances in 1976-77 and again in 1982-83. In turn, stabilization policies following the 1978 standby agreements with the IMF were important in determining price changes and volume of trade flows. In particular, wage costs and the devaluation of the escudo determined largely the competitiveness of Portuguese exports while the contraction of domestic demand determined the volume of imports. Only in 1979 and 1980, can it be assumed that the effects of liberalization policies overcame the consequences of stabilization policies.

The potentially decisive step towards trade liberalization, taken with the applications for EC membership, was to a large extent politically motivated. After a long period of right-wing dictatorship and a sudden threat of left-wing dictatorship, in 1974-75, the authorities saw integration in the EC as a kind of insurance [2].

But the request for integration also had an economic rationale, including the expectation of a significant increase in trade opportunities and development aid from Europe, despite little awareness of the benefits and costs resulting from belonging to the Common Market [3].

Corresponding to these freer trade goals, in 1976 there was a renegotiation of the trade agreement with the EC. With the closing of negotiations, the imports from the EC and from the EFTA countries, corresponding to 59 percent of the Portuguese imports in 1982, have been entering almost free of duties. With actual membership in 1986 a new episode of liberalization just started.

The effects of free trade with Spain, as a consequence of its expected joint accession to the EC, are in fact potentially more significant than the effects of free trade with the Ten. The reason is that intra-Iberian trade is heavily protected, despite the 1979 agreement between Spain and EFTA, and that natural barriers to trade, are much smaller. Because the stakes are higher, trade policy with Spain can accordingly be seen as a signal of the intentions of the government with respect to trade liberalization in general.

We now describe the main instruments of trade policy during this episode, tariffs, non-tariff barriers (especially import licensing), and export incentives (especially exchange rate policy), so as to ascertain the main features of the episode. We then discuss the circumstances in which the policy was introduced, the accompanying policies and the performance following
liberalization.

Tariffs

Tariff reductions agreed with the EC were implemented at the scheduled dates, so that remaining tariffs were mainly those with respect to third countries, including Spain [4]. By 1980, three-fourths of nonagricultural imports from EC entered duty-free, excluding surcharges which by that time were at a rate of 10 percent. Exports went to the EC duty-free except for "sensitive products". By 1980, tariff reductions agreements with Spain had already been implemented but, due to the existence of high nontariff barriers, trade liberalization with Spain has been largely unsuccessful.

After surcharges were introduced in 1976 to fight external imbalances, tariffs were raised in 1977 so that both nominal and effective rates of protection increased significantly after 1974. In 1977, the average rate of nominal protection was 14 percent compared to 4 percent in 1974, and the average rate of effective protection was 37 percent against 12 percent in 1974.

The bias against exports was however not as large as it has been in 1970 because of the less discriminatory nature of the surcharge. By 1980, the nominal tariff (and surcharges) had declined to 5 percent, with the highest reductions for consumer and intermediate goods.

In 1980-82, the conversion of specific into ad valorem rates led to some increase in protection against third countries' imports. But this slight increase was mainly due to the remaining purpose of raising revenue and as a means to strengthen the bargaining position for tariff negotiations with the EC in light of the scheduled adoption of the common external tariff (CET). The simple average of nominal protection in 1982 was 14 percent; it would be 11 percent if the CET were used instead. Along the same lines, the simple average of effective protection would drop from 33 to 23 percent, if the 1982 tariff were replaced by the CET [5].

Tariff surcharges were introduced in 1976 and varied through the period. The 1977 surcharge was established in 1976 (Decree-Law 720-B/76, 779/76 of October) and operated until March 31, 1977. The preceding rate of 20 percent was raised to 30 percent and covered a large number of commodities; a new rate of 60 percent was introduced to be applied to a group of less essential or "luxury" goods, on which the rate of 30 percent was formerly applied. On June 6, 1977 (Law 34/77), this rate of 60 percent was extended to a new group of goods [6].
The short-run purpose of the surcharges was shown with its reduction between 1978 and 1982. The rate of 30 percent was reduced to 20 percent in 1978 (Decree-Laws 115/78 and 300/78 of April and June, respectively), and again to 10 percent in 1979 (Law 21-A/79 in June and Decree-Law 110/79 of May).

However, due to the particular foreign exchange difficulties encountered in the first semester of 1983, surcharges were again raised to 30 percent in February 1983 and then lowered to 10 percent in March 1984, with a smaller coverage of goods.

Nontariff Barriers

The major nontariff barrier was a scheme of import licensing — called import register (BRI) — initiated during World War II. The main purpose of import licensing was originally registration, and it had been automatically granted. However, after August 1975, it has been used for import control as well. The reversal of the episode has precisely to do with this particular instrument.

Licenses to import were granted on a case-by-case basis to wholesalers and producers alike and the general rules were to slow down imports covering a large group of goods including capital goods produced domestically. While the details of license allocation are unknown, it seems to have in part replaced protective pricing devices, especially from 1980 to 1982.

The BRI system implied higher domestic prices and greater uncertainty in transactions, leading to a waste of resources and corruption. The understanding of this fact led the government to introduce legislation to prevent the use of import licensing for protective purposes [7].

Quotas existed already before and still exist for a few products: for some consumer goods (such as household electric equipment and clothing) and transport equipment (automobiles). Perhaps because they have become more restrictive, the weight of quota goods in total imports is small and declining [8]: 7 percent in 1976 and around 2.5 percent in 1980 (consumer goods, 1 percent, and automobiles, 1.5 percent). The amount of the quota is set every year, generally in domestic currency. They are distributed to oligopolist importers pro data: for household electric equipment based on the share of the last two years' imports by the firms, and for automobiles and components they have been designed according to the restructuring of the industry.
Automobile quota rents are difficult to estimate because of the composition of both imported and domestically produced goods. Typically, sophisticated and expensive components are totally imported while the cheaper elements are domestically produced. At the available statistical level of aggregation, the difference between import price and producer price underestimates quota rents. Theoretically, quota rents for household equipment could be established as in Table 14. However, these are rough estimates because of the existence of "parallel" markets in this sector of an unknown size and the difference in composition of imports and domestic competing products. Quota rents seem to be very high for some household equipment and automobiles.

Table 14

The controversial use of nontariff barriers led the government to complement the system with a set of more transparent policies and to express the intention of phasing it out in the future [9].

To the extent that importers' monopolies raise the price of imports in the domestic market and prevent entry of different qualities and varieties of the same product, they must be included, too, in the effort for liberalization. The existing monopolies are public enterprises and cover the markets described on Table 15.

Table 15

It has proven difficult to break down these state monopolies, and, indeed in some cases they will be broken only due to the EC rules. For EPAC the first liberalization proposal was made in 1980 (6 percent of consumed volume of wheat). However, creating new rules of competition for the importing of these goods met with severe resistance on the part of the government bureaucracy as well as on the part of economic agents [10].

Private firms claim that they are at a disadvantage with respect to public enterprises in access to foreign exchange and coverage of exchange risk and also with respect to foreign competitors because they are not permitted to open foreign accounts and transact in futures markets. These difficulties may have been exacerbated by the combination of trade liberalization and foreign exchange controls.

In sum, sectors for which liberalization has been slower are the ones producing "sensitive products" for which quotas are in place. These products are also subject to licensing, and the same applies to imports of state monopolies, particularly petroleum derivatives,
### Table 14

**Average Quota Premium of some Electrical Household Products** *

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic Price/ Import Price Ratio (1)</th>
<th>Surcharges ** (2)</th>
<th>Quota Premium *** (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>1.41</td>
<td>8.1</td>
<td>32.8</td>
</tr>
<tr>
<td>1975</td>
<td>1.23</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>1976</td>
<td>1.30</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>1977</td>
<td>1.35</td>
<td>30.0</td>
<td>5.0</td>
</tr>
<tr>
<td>1978</td>
<td>2.06</td>
<td>27.5</td>
<td>78.5</td>
</tr>
<tr>
<td>1979</td>
<td>1.61</td>
<td>13.3</td>
<td>47.3</td>
</tr>
<tr>
<td>1980</td>
<td>2.08</td>
<td>10.0</td>
<td>98.0</td>
</tr>
<tr>
<td>1981</td>
<td>2.56</td>
<td>10.0</td>
<td>146.0</td>
</tr>
<tr>
<td>1982</td>
<td>2.30</td>
<td>10.0</td>
<td>120.0</td>
</tr>
<tr>
<td>1983</td>
<td>2.55</td>
<td>28.3</td>
<td>127.0</td>
</tr>
</tbody>
</table>

---

* Covering refrigerators, heating apparatus, vacuum cleaners, irons, radio and television, representing around 70% of total electric equipment.

** Average tariff (and surcharges) for total electric equipment in 1974. After 1977, only surcharges were applied to these goods.

*** Premium is given per unity of foreign currency value of the import license.

Source: Teodosio (1985) SA-Table 6.10.
Table 15

Trade Monopolies

<table>
<thead>
<tr>
<th>Good</th>
<th>Firm</th>
<th>Approximate Imports (% of total imports, 1980)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cereals</td>
<td>EPAC</td>
<td>6</td>
</tr>
<tr>
<td>Sugar</td>
<td>AGA</td>
<td>2</td>
</tr>
<tr>
<td>Oilseeds</td>
<td>IAPO</td>
<td>2</td>
</tr>
<tr>
<td>Tobacco</td>
<td>Tabaqueira</td>
<td>0.4 - 0.5</td>
</tr>
<tr>
<td>Fuels</td>
<td>Petrogal</td>
<td>24</td>
</tr>
<tr>
<td>Fertilizers</td>
<td>Quimigal, SAPEC</td>
<td>NA</td>
</tr>
<tr>
<td>Meat</td>
<td>JNPP</td>
<td>NA</td>
</tr>
</tbody>
</table>
tobacco and some food products, as described above.

Export Incentives

Trade intervention was also designed to promote exports, first through exchange rate devaluation. One first devaluation occurred in February 1977 (15 percent against the dollar) and one second one in May 1978 (7 percent) while the crawling peg was at 1.25 percent. During 1978 and 1979, market shares abroad improved. However, with the slowing down of the crawling peg and the revaluation of the escudo in 1980 (6 percent) there was a reversal of the situation [11].

Between 1974 and 1977 Portuguese high unit labor costs relative to its main partners were probably the most important determinant of the lack of export competitiveness. After 1977, devaluations and the crawling peg depreciation have been one of the most important forms of export incentives. This was particularly true in 1978-79 and from the second semester of 1983 to the first semester of 1984.

A second source of incentives favoring exporting rather than producing for the home market is the decline of protection since 1977. This general trend for trade liberalization was interrupted in 1983 when both surcharges and NTB were temporarily raised. However, in 1984 these barriers to trade were again reduced [12].

Direct incentives to exporters were newly regulated in 1976 and in 1977 to cover credit subsidies and fiscal incentives. Further credit and fiscal incentives and help on contracts and on export promotion abroad were given, based on development contracts of exporters since 1977 and to those entitled to exporters' certificates since 1982. These certificates have been granted to firms with domestic value added of more than 30 percent of the export value. From 1977 to the end of 1983, however, interest rate subsidies were the most important form of incentives to exporters [13].

The legislation introduced in 1976 and 1980 (Decree-Laws 289/76 and 481/80) sought to simplify the access of exporters to preferential credit, with interest rate subsidies on short-run credit for working capital (export plans and firm orders) [14].

The maximum interest rate rebate was 5 points (short-run credit for working capital) in 1977 and 7.5 points in 1983. Given the interest rate structure in Portugal, these rebates led to subsidized interest rates of 9.75 to 11.5 in 1977 and 29.5 in 1984 [15].
Even if the credit incentive induced producers to export rather than to sell domestically in some years, the increase in market rates and the decline of subsidized credit indicate that this incentive has been losing importance.

There are also several tax incentives. From 1977 to 1979, they covered deductions to industrial taxable income: (1) of 5 percent of the export value; (2) expenditures with staff training and marketing; and (3) accelerated depreciation for large exporters (exporters exceeding 5 million escudos and 25 percent of value of domestic sales). Other fiscal incentives were exemption of sales tax on export and credit contracts, and exemption of tax on capital gains and on tax payable on interest on capital contributions and profits made by or to shareholders in specified conditions (Decree-Law 42/77 of June 1977).

The most significant changes to tax incentives was to create a formula for deduction to the industrial income tax base which is always smaller than 4 percent of the export value (Decree-Law 408/80 of September 1980) [16]. Nevertheless, during this episode, both credit and tax incentives were less effective than the sustained real devaluation of the escudo.

Main features of trade policy

In 1978 and 1979, price devices (tariffs and surcharges) declined, while export incentives declined until 1983. The strong real devaluation in 1977-78 reinforced the role of price mechanisms. Finally in these years QRs premiums seem to have been lower enough to induce a higher role for market prices as shown in Table 15 above for some goods subject to quotas and import licensing.

In 1979, several liberalization measures were adopted, namely: (1) surcharges were reduced from 20 to 10 percent covering 21 percent of imports while the 60 percent surcharge was maintained on 1 percent of imports; (ii) quotas were established reducing imports under quotas from 2.8 percent in 1977 to 1.3 percent in 1979 and probably contributing to the increase of the implicit tariffs on household equipment and automobiles in 1980; (iii) special licensing for the purchase of fuels (July 1979); and (iv) licensing by decree of imports of equipment (August 1979) and automobiles for firms (August and December).

In 1980, the main features were the replacement of the specific tariffs by ad valorem tariffs (Decree-Law 204/A/80 of June), which increased tariffs somewhat, and the more intensive use of import licensing, for which precise data is not available.

Between 1977 and 1978, both tariff levels and their dispersion were
substantially reduced [17]. Still, consumer goods were more protected than intermediate and capital goods although the 1970 bias against exports of the protective structure had been reduced. Exports were supported by incentives.

In 1980, tariffs on non-food imports were significantly above nominal tariff average for Spain and non-EC countries. In this year the tariff structure included already the first year reductions with Spain, agreed upon in 1979.

However, liberalization policies were partially reversed because, even though tariffs and surcharges continued to fall, quantity devices played a more important role, as suggested by the rise in quota premiums from 1980 to 1982 [18].

Moreover, the commitment to large new investment contracts led to favor imports of investment goods. Hence, import allocation became increasingly determined by governments intervention and the allocation of QR's rather than tariffs.

Circumstances When the Policy Was Introduced

Political Circumstances

The military coup which in 1974 toppled the authoritarian regime in turn set up by the military coup of 1926 was followed by a climate of political instability. There were six provisional and six constitutional governments up to 1980. Afterwards, in spite of a clear depolitization of day-to-day life, governements have been succeeding each other at short intervals.

Following active communist participation in power, the constitutional governments who negotiated the IMF agreement of 1978 and perceived the consolidation of democracy closely tied to European integration were led by the Socialist Party. The application for EC membership and the commitment to the 1972-76 agreements was politically and ideologically motivated rather than based on expected economic benefits. To a great extent it was seen as an insurance against dictatorship.

At a time when politization was spreading, EC application was vehemently supported by the three "democratic parties" (from left to right, socialists, social democrats and centrists) and opposed by the Communist Party. Nevertheless, the discussion of the European option was mostly carried out at the party or parliament level and seemed not to have spread to economic agents. Entrepreneurs' associations were more concerned with the social and economic disarray than with the economic consequences of the
implied liberalization. One of the two main trade unions was controlled by the communists and opposed EC entry.

In any event, the exceptionally difficult economic conditions in 1976–77 were met by protectionist measures, which also contributed to postponing public awareness about the economic implications of EC membership.

In 1978, and particularly in 1979 when the first liberalization measures were taken and the negotiations with the EC began to address specific aspects, there were several political declarations of commitment to the policy. Public awareness began to spread and discussion revived but still not in terms of the economic consequences of membership. Rather the emphasis was put on the EC as a new and expanding source of subsidies to the Portuguese people.

After 1980, the awareness of the budgetary conflicts in the EC changed the political discourse somewhat. The emphasis shifted to the advantages of a "cold shower" effect on the efficiency of Portuguese firms and the leverage that the smallness of Portuguese economy might bring to the negotiation process. Nevertheless, the access to EC funds continued to be stressed.

The tying of Portugal and Spain in the accession process may have created a stronger debate on the consequences of liberalization than the EC accession per se. On the one hand, the use by post-1977 governments of the commitment to membership as a measure of their success in foreign policy made them dissociate themselves from the Spanish negotiations, foreseen to be much more complicated and lengthy than the Portuguese negotiations.

On the other hand, the implied liberalization with Spain was perceived as a political step with more important economic consequences. One should expect, therefore, that the Portuguese authorities would have paid much more attention to the agreement to be reached with this country. In fact, the negotiations were very brief and in some cases economic circumstances were disregarded in the name of political expediency.

Anyway, outright opposition to entry has been more frequently heard from extremists on left and right than from economic agents or policymakers. To this easy acceptance contributed the feeling that Portugal may reverse or attenuate the adoption of most unfavorable economic policies, if domestic circumstances were to call for it. This happened in 1983, when new protective measures were adopted.
With all the steps taken, the perception has been one of commitment by the government to entry and stay with the EC. But such commitment was not credible up to 1986 in terms of its economic consequences because accompanying measures, especially those connected with the deregulation of the economy, were not implemented despite repeated announcements of structural reforms.

Economic circumstances

During the second episode, the conditions of the balance of payments and the acceleration of inflation were particularly influential. In contrast with the first episode, the expansion of public and private expenditure was financed by running down reserves and borrowing abroad. The narrowing of the output gap opened by the 1974 events was transmitted to the current account balance, particularly when real wages did not fall enough.

In 1976, the strong protective measures described earlier did not avoid the growing external deficit and were also responsible for the loss of export competitiveness. A policy package was not implemented until February of 1977, when there were mounting pressures to borrow abroad. The measures then introduced did not prevent the increase in the current account deficit as expenditures by the public sector and state-owned enterprises, together with consumer spending, remained unchecked.

A stabilization package for the period June 1978 - March 1979 was agreed upon with the IMF. Its objective was to control external imbalances by setting ceilings on domestic credit creation and public sector borrowing in the domestic nationalized banking sector (but not the international capital market). The rate of crawl was loosely tied to the rate of monetary expansion.

The current account deficit had widened continuously from 1974 to 1977 when it reached 9 percent of GDP. It was halved in 1978 and was near zero at the closing of 1979. Following the high barriers to trade in 1977-78 and the simultaneous stabilization package, the new liberalization drive can be identified with the near equilibrium current account of 1979. Moreover, in this year the balance of nonmonetary transactions showed a significant surplus (almost 7 percent of GDP) whereas it had been increasingly in deficit from 1974 to 1977.

Most of the recovery of the current account in 1979 is attributable to emigrants' remittances and tourism, which offset the trade balance deficit. The increase in invisible credits cannot be attributed to income trends in the countries of origin since the effects of the second oil price rise were already being felt.
Instead, a portfolio adjustment by migrants in favor of escudo assets seems to have followed the unfavorable political and economic conditions of 1974-77 [19].

The trade balance deficits which had been increasing up to 1977, declined in 1978 and remained unchanged at 15 percent of GDP in 1979. It was financed by invisibles in the same way as had been the case before 1974. Imports declined by 2 percent in 1978 and increased again by 7 percent in 1979, after substantial rises in the 1974-77 period, due to expanding domestic demand. By the end of 1979, exports paid for about half of imports, in spite of vigorous increase in exports in 1978 and 1979.

Medium and long-term capital inflows have been traditionally a minor share of available credit, compared with the invisible surplus. However, since the increasing deficits of the 1974-77 were financed mostly by drawing on the substantial gold and foreign exchange reserves, access to foreign capital became increasingly important. At the same time, the large political risk premium Portugal suffered during this period made such credit less available. Following the seal of approval of the IMF in 1977, foreign credit became the preferred means to finance balance of payments deficits.

The climate of confidence in 1978-79 was reinforced by the continuation of substantial non-monetary capital inflows especially to finance the borrowing requirement of the public sector and state-owned enterprises, while the banking sector reduced substantially its foreign liabilities in 1979.

In this year, the overall outcome was a decrease in the Bank of Portugal's indebtedness, a reduction in drawings on the IMF and a simultaneous increase in foreign exchange reserves. This exceptional performance was in part achieved by a revaluation of gold reserves. Nevertheless, by the end of 1979, external debt was already $7.3 billion, about one half of reserves.

After a poor export performance from 1974 to 1977, due to external factors such as the world depression as well as internal factors such as the rise in labor costs in 1975/76 and production stoppages, exports increased by 12 percent in 1978 and, still more vigorously, by 29 percent in 1979. In these two years, exports rose faster than demand in foreign markets.

This was probably due to the recovery of lost positions in traditional markets, as Portugal's international competitiveness recovered substantially. In fact, the real depreciation of the Portuguese currency from mid-1977 onwards and the lowering of
relative wages enabled profits on exports to be rebuilt at the same time as the contraction of domestic demand made foreign markets more attractive to producers than the domestic market.

Between 1973 and 1977, Portugal's market share in the industrialized countries declined by 39 percent (35 percent in the EC and EFTA). Both in 1978 and 1979 there was a gain in market shares in the same group of countries by 3 and 17 percent respectively. However, these catching-up increases represented a larger gain in market shares in the EC (11 percent in 1978) than in EFTA. Market shares in EFTA have actually been declining, while average market shares in the industrialized countries and in the EC attained the 1973 level in 1979.

By product, most 1978-79 growth was due to manufactured exports, especially textiles, clothing and footwear, which account for about one-third of exports. In 1979, wood, cork and paper products also increased substantially. By contrast, agricultural goods and machinery performed less well. By 1979, only footwear, wood and cork products had increased the market share in the OECD countries above the 1973 level [20].

Export performance in 1978-79 was of a catching-up nature and therefore difficult to maintain in the long run. Indeed exports were concentrated in traditional sectors, where competition from other OECD countries and other NIC's is expected to increase.

The world recession motivated by the second oil shock was reflected in a slowdown of growth of OECD output in 1979 relative to 1978 (3.25 percent vs. 3.9 percent), particularly in the second semester. Full recession hit OECD countries, and a larger number of EC countries, in 1980 and it was to last up to the end of 1982. In spite of the slowdown in 1979, trade was still buoyant in OECD countries. It was to collapse in 1980 when imports in OECD stagnated and a new surge of protectionism was felt.

With accelerated inflation in OECD countries (13 percent in 1980, 10 percent in 1979 versus 8 percent in 1978), the terms of trade deteriorated in Portugal by 5 percent both in 1979 and 1980, after an improvement in 1977 (5 percent) and stagnation in 1978. In spite of the deterioration of the terms of trade, Portuguese exports performed well in 1979. The negative effect was felt in 1980.

In 1978-79, with the improvement of the Portuguese current account and following the compliance with the targets set in the stabilization program, there were no serious shortages of foreign capital. This is in contrast with 1976, when the world economies had recuperated from the first oil crisis and world liquidity had
increased.

The phase of financing deficits with reserves (1974-77) was followed by two years of increasing foreign borrowing and a buildup in foreign exchange reserves. In fact, while in 1976 net medium and long-term capital inflows were $26 million (only 2 percent of the current account deficit) they increased 30 times between that year and 1979, to reach $813 million [21].

In 1979, there was a recovery of output, which was particularly brisk during the second half of the year. GDP grew 4.5 percent compared to 3.2 percent when stabilization policies were introduced. Unemployment fell, after having increased continuously since 1974. The decline in the output gap was export-led rather than domestic demand-led: domestic demand only expanded moderately, particularly when compared with the 1977 expansion.

In fact, the modest demand increase corresponded to a shift from the previous high consumption levels towards investment. Inflation was still high in 1979 but slowed down, especially in the fourth quarter of 1979. Real wages declined for the third year in a row and the labor share in national income also fell.

Accompanying Policies

The main policy changes of the period from 1977 to March 1979 were induced by the need to have access to foreign credits. In 1976, the worsening of the current account deficit led to the introduction of protective measures but the December elections led to the postponement of a devaluation required to reverse the loss of export competitiveness.

In February 1977, there was the relaxation of price controls, ceilings on wage increases, increases in interest rates and an effective devaluation of 15 percent. Expanding demand and a narrowing output gap led to further deterioration of external accounts and, in August of 1977, a further policy package was introduced: another increase in interest rates and the announcement of a crawling peg regime at the rate of 1 percent per month. This rate of crawl, based on inflation differentials with major trading partners, was supplemented by forward cover by the central bank until 1978.

Domestic credit creation amounted to 7, 11 and 5 percent in the last three quarters of 1977 while the rates of consumer price inflation were 1, 4 and 5 percent.
The further deterioration of the current account thus required a stabilization program capable of holding down domestic demand and restoring external competitiveness.

Stabilization Program

The main features of the economic stabilization program, drawn up in an agreement with the IMF signed in May 1978, provided for: (1) a 7 percent devaluation and the continuation of the crawling peg regime with depreciation of the effective exchange rate by 1.25 percent per month; (2) raising interest rates and the discount rate from 13 to 18 percent; (3) setting quarterly targets for total domestic credit, the money supply and the monetary base and setting a ceiling on the growth of bank credit; (4) reduction of rediscount lines and standardization of compulsory reserve ratios at 7 percent; (5) introduction of a surcharge on main direct taxes (10 to 15 percent) and of an increase by 10 percent in the general sales tax; and (6) setting a ceiling of 20 percent on wage increases.

Fiscal policy was intended to have a neutral impact on the economy while the system of price controls was used more flexibly so as to allow rises in production costs to be passed on to consumers. This was supposed to allow profits to recover from their depressed post-revolutionary level. Overall, in 1979 macroeconomic policy was less restrictive than in 1978.

Along with the use of more active exchange rate policy, import restrictions were somewhat relaxed: in January 1978, import deposits were abolished; in October, the 30 percent import surcharges were reduced to 20 percent (in the case of automobiles with an offsetting increase in domestic taxation) and the number of items covered by surcharges was reduced.

Nevertheless, import quotas and other surcharges were maintained, as well as the exports incentives introduced in 1976.

For the first time, monetary policy played an active role in macroeconomic stabilization. The tightening of credit to the private and public sector as well as the introduction of rediscount policy by the central bank as a means of controlling commercial bank liquidity played a crucial role in reducing aggregate demand. The strong rise in the administratively fixed interest rates also helped to attain this goal, even though the selectivity of credit made the management of the system quite complex.
Fiscal policy during the stabilization process became more expansionary than expected and, after 1978, authorities found it increasingly difficult to control both the rise in expenditures and the fall in tax revenues. Price and incomes policy helped to curb wage costs: by 1978 increasing unemployment in the labor market facilitated the downward adjustment of real wages.

All told, in 1978 and 1979 interest rates increases, wage ceilings and devaluation had strong results on external balance but not so much on internal balance.

Devaluation and the crawling peg

Exchange rate policy was a major instrument of trade policy in the second liberalization episode but it can also be looked at as an accompanying policy, since its use in 1980 was independent of export promotion.

The Portuguese escudo is largely inconvertible (in the sense of Article XIV of the IMF agreement). Also, despite the advent of generalized floating in April of 1973, exchange rate policy was passive until the Summer of 1976.

Since then, the central bank sought to stabilize an effective exchange rate based on a basket of currencies reflecting the direction of the Portuguese current account with its main trading partners. In 1977, furthermore, this effective rate has crawled relative to that basket in an attempt to offset inflation differentials.

Entry in the EC may call this policy into question, to the extent that it requires the introduction of some form of convertibility, but no intention has been announced so far of joining the European Monetary System.

Exchange rate adjustments have succeeded in improving competitiveness through devaluations of the real effective exchange rate in 1977-78 and in 1983. In 1980, they were instead designed to fight inflation. Since there was no clear direction for exchange rate policy in 1979, 1981 and 1982, the effectiveness of this instrument may not have been maximized over the entire period.

Discrete devaluations or revaluations accompanied changes in the rate of crawl. Domestic currency depreciated in nominal terms throughout the period but especially from 1977 to 1979 and from the fourth quarter of 1981 onwards. In 1980 and 1981 there was almost no change in the nominal effective exchange rate.
Following the introduction of liberalization measures from mid-1979 onwards, the real exchange rate frequently appreciated up to the first quarter of 1982. The rate of real depreciation then accelerated, as the current account deficit deteriorated.

One should use a real effective exchange rate index which accounts for the changes in tariffs, terms of trade and relative wage costs. There was a slowdown of real depreciation in 1979, as exchange rate adjustments and increases in relative wages modestly offset the deterioration of the terms of trade and tariff reductions. In 1980 and 1981, there was a real appreciation of the escudo, largely due to a decline of relative foreign wages and further deterioration of the terms of trade. Only after 1982, there was a real depreciation and increased export competitiveness.

In 1979, the real depreciation was larger for exports than for imports while, in 1980-81, the real appreciation was larger for imports than for exports. Hence exports lost competitiveness in the foreign market by less than imports lost competitiveness in the home market. This was more the result of exchange rate devaluations (offset in 1980-81 by the deterioration in the terms of trade) than of commercial policy [22].

Hence, during the second episode, the profitability of exports grew faster than the profitability of imports. In 1982-83, the relative rate of appreciation of exports and imports was reversed.

Monetary Policy

Since 1978, monetary policy has become one of the main tools to manage the economy. This was in part the result of the stabilization program, where quarterly targets for domestic credit creation (by the private and public sectors) were announced for the first time. They were accompanied by rises in interest rates and a tighter control of bank credit, including the regulation of bank reserves. Thus rediscout rates were raised and rediscout lines were tightened. Up to the first quarter of 1979, monetary policy was very restrictive.

From March 1979 onwards, the main changes in policy were: (1) the lower credibility of the announcement of targets for domestic credit creation since only ceilings on (the nationalized) bank loans were to be enforced, so as to counteract the depreciation of the net foreign asset position of the country and the expanding
government debt; (2) readjustments of the administratively controlled interest rates became sporadic and hence relatively large; (3) the selectivity of credit and the complexity of preferred interest rates (to housing, exports, agriculture and investment) was maintained, if not increased.

On the whole, from 1979 to the first quarter of 1982, monetary policy became less restrictive with the unannounced relaxation of the domestic credit ceiling system and the drastic increases in the foreign indebtedness of state-owned enterprises [23]. Monetary policy from the second quarter of 1979 to the third quarter of 1982 allowed a fairly satisfactory control of domestic credit growth but to the disadvantage of the private sector. In practice, there were no credit ceilings for the public sector (general government and state-owned enterprises) which absorbed both domestic and foreign resources.

After targeting domestic credit creation, the monetary authorities determined the internal borrowing requirements by the general government. Credit available for the private sector (including state-owned enterprises) was determined as a residual. But state-owned enterprises had the option to borrow abroad, so that the changes in ceilings on the bank loans were particularly binding for the private sector.

Those exporters which held either export certificates or firm contracts were eligible for preferential credit. Nevertheless, exports, which are mostly private, were probably reduced by the selectivity of the credit ceilings. The system of controlling only domestic credit made it difficult for the monetary authorities to control money supply and reduced the effectiveness of monetary policy up to 1982. The money supply began to accelerate in the second quarter of 1979 (ten points higher than GDP over the year).

The central bank cannot control a rise in liquidity anyway because of the low interest rates and narrowness of the money market. The bank has also been reluctant in enforcing reserve requirements because of the strong decline in the profitability of the nationalized banking sector.

Except for the interbank rate, interest rates are administratively fixed. During 1979 and up to mid-1981, they were prevented from rising in an attempt to fight inflation and stimulate investment. Larger rises of interest rates were decided in the first quarter of 1982 and 1983 as a complementary measure to the more restrictive policy stance.

Note that from 1978 onwards, the authorities, with the purpose of
supporting specific sectors, complemented the selectivity of credit with an increasing number of preferred lending rates and spreads. The favored sectors were housing, exports, agriculture and investment. The most unfavored sector was consumer's credit, which was penalized with a surcharge of 7.75 percent [24].

Fiscal Policy and the Government Deficit

The public sector grew rapidly from 1973 to 1978 [25]. This was due to expanding social welfare and education systems, as well as to incomes and employment policy. In 1980, the government announced a freeze on new hiring in the civil service. However, public employment increased in all departments both at the central and local levels.

Employment in the public sector grew 9 percent between 1974 and 1979, initially by absorbing returnees from the former colonies. Also the expanding social welfare system led to transfers out of public sector at increasing growth rates even though social transfers as percent of GDP are still one of the lowest in the OECD countries [26].

Moreover, the enlargement of the nationalized sector and its financial difficulties led to a substantial increase in subsidies and to equity fund and capital transfers [27].

Finally, subsidies for those regulated prices such as food products increased substantially as the gap between producer and consumer prices widened and the implicit protection to production increased rapidly after 1976.

To meet expanding expenditures, taxes as well as the regulated prices of food products and public services have been raised several times during the period 1979-83, but the public sector deficit has continued to rise. Indeed, the overall result of fiscal policy in the last ten years has been ever-increasing deficits and growing borrowing requirements.

In 1973, the public sector was a small net lender (and net saver). In 1982, it was a net borrower of around 13 percent of national income. In 1981, the consolidated borrowing requirement of the public sector and nonfinancial state-owned enterprises reached 19 percent of national income [28].

With the exception of 1980, every year there were either increases on existing tax rates, or the introduction of new taxes, or the enlargement of taxable income. Some taxes, such as stamp taxes, car sales' taxes and tobacco excise tax, were raised frequently. In May
1978, as part of the stabilization package, a surtax on main direct taxes (on wage income - 15 percent and other - 10 percent) was introduced as well as an increase on sales taxes (10 percent). In October, import surcharges were lowered (30 to 20 percent) and again in May 1979 (to 10 percent).

In 1979, a special tax on non-wage income was introduced. In 1980, there was, for the first time, a lowering of rates on wage income (professional and complementary taxes), and profit and capital taxes were raised. Moreover, in 1980, the government decided to crack down on rampant tax evasion, which, together with delays in the 1979 tax collection and increased imports allowed unusual revenue increase in 1980 [29].

Foreign exchange controls and foreign investment

Transactions of foreign exchange were very restricted during the reversal, and remained so during this episode. Authorizations to residents on access to foreign exchange have been restricted to those holding import and export licenses granted less than 120 days previously. Whereas the alleged purpose of this registration is to enforce the surrender of foreign exchange to the monetary authorities, they were used as a protective device for imports.

The official market for foreign exchange has been devised to remain mainly in Portugal, but an unofficial market has developed, via under or over invoicing by holders of BRIs (or BRES for exports), via capital flight (particularly in 1974-76) and via tourism and emigrants' remittances [30].

Foreign investment expanded rapidly in the period following the EFTA agreement. After a decline of foreign investment during 1974-75, a new Investment Code was published in 1977, which authorized foreign investment in all sectors except the nationalized sectors (including banking, even though the two foreign banks had not been nationalized in 1975). The terms of access to credit by foreign firms are identical to those of domestic enterprises and the transfers of profits are only subject to authorization if they exceed 20 percent of the proceeds of sales of liquidation.

The Foreign Investment Institute provides the authorizations, but the procedure, including the intervention of the Bank of Portugal, was quite bureaucratic and in some cases the authorizations have been subject to delays. Since 1979, foreign investment has been picking up, partly attracted by the announcement of Portuguese integration into de EC but competition for potential investors has been stiff particularly from Spain, who offers a more attractive
regime.

Domestic Controls

The scheme of industrial licensing was further weakened after the Revolution by Decree-Law no. 533/74, which in turn was superseded by Law no. 46/77 of July 8, defining the basic sectors restricted to nationalized industries. This law was not implemented until Decree-Law no. 519-11/79 of September 29, which creates an industrial register for statistical purposes alone and explicitly revokes any previous license, thereby allowing competition in all (non-basic) sectors.

While this was an important step, it should be kept in mind that banking and insurance continued to be included from the basic sector list until 1983, and private banks did not begin operating until 1986.

Aside from investment licensing, direct government control of maximum prices on bread, milk, sugar, medicine, fertilizers and animal feeds, public utilities and energy products require extensive subsidies by the Supply Fund. These goods accounted for 42 percent of households' average expenditures in 1977-78. However, mainly due to the deregulation of food products, this percentage declined to 31 percent in 1981-82, and to 20 percent in 1982.

There is an extensive system of subsidies for agricultural production, food consumption and utility charges. As mentioned increased food subsidies, between 1978 and 1987, were necessary to fill the widening gap between production prices and consumer prices both of which were heavily regulated.

Moreover, the level of protection of heavily imported agricultural products rose substantially in these years. The growing deficits of the Supply Fund forced the relaxation of price controls in several instances (1977, 1981-83) and regulated prices rose faster than other prices at least in 1982-83 (25, 32 percent respectively) [31].

In 1977, a restrictive wage adjustment mechanism was introduced, comprising authorizations by the Ministry of Labor of wage increases which were binding for any sector of the economy. Those authorizations could be delayed for one year and set retroactively. From 1979, the system has been relaxed and wage ceilings are merely indicative, setting guidelines to wage increases for firms with declared or controlled prices. These guidelines are set in line with the official targets for inflation. The system has provided a
fairly tight control on real wages increases. On the other hand, minimum wages have been adjusted periodically since 1977.

In sum, accompanying policies were not designed to support and make more credible liberalization policies which were largely uncoordinated with other policies particularly in 1979-82. Some coordination existed within the stabilization packages both in 1978 and 1983 when a more realistic pricing of foreign exchange accompanied trade liberalization. However, following 1980, uncoordination was again the rule: exchange rate, fiscal and monetary policy undercut the benefits and sustainability of trade liberalization initiated in 1977.

Economic Performance Following Liberalization

The aggregate economic performance on prices, trade, output, income, employment and investment for the second trade liberalization episode, as well as for the reversal are on Table 16.

Table 16

Consumer prices which had increased by 4 percent per annum on average between 1968-73, grew much more rapidly after 1974. In 1977, inflation was at a rate of 27 percent, it decelerated between 1978 and 1980 (22, 24 and 17 percent) and took off in 1981 (20 percent in 1981, 22 percent in 1982 and 26 percent in 1983). Quarterly data shows that the period when inflation slowed down the most was between the last quarter of 1978 (6.6 percent) and the last quarter of 1980 (2.9 percent).

On the other hand, the rise in wholesale prices up to 1979 slowed down substantially in 1980. This period also corresponds to a slower decline in real wages, as the relaxation of price controls was offset by a slower nominal exchange rate devaluation, inducing a real appreciation in 1980. Appreciation of the currency induced a drop in both the prices of importables and the consumer price index.

Because of good weather conditions, 1980 saw a slowdown in food prices, increased subsidies and a slower rate of nominal exchange rate devaluation [32]. The 1981-82 drought had the opposite effect: in spite of the continuation of the price and wage liberalization policy, inflation took off.

The explanation for the contradictory movements of liberalization and inflation in 1981 and the further inflationary pressures of 1982-83 lies in the catching-up of administrative prices, in
<table>
<thead>
<tr>
<th>Questions</th>
<th>1977-79</th>
<th>1980-82</th>
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<tr>
<td><strong>Major Prices</strong></td>
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<td>Inflation</td>
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<td>Real Ef ER</td>
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<td>Relative unit costs</td>
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<td><strong>Imports</strong></td>
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<td>Volume growth</td>
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<tr>
<td>Imports GDP ratio</td>
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<td>5</td>
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<tr>
<td><strong>Exports</strong></td>
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<tr>
<td>Volume growth</td>
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<td>Exports GDP ratio</td>
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<tr>
<td><strong>Openness</strong></td>
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<td>Volume growth</td>
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<td>% to GDP</td>
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<td><strong>Output, Income</strong></td>
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<td>Agricultural GDP</td>
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<tr>
<td>Income</td>
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<tr>
<td>Income per capita</td>
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<td><strong>Employment, Investment</strong></td>
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<td>Investment</td>
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<td>6</td>
</tr>
<tr>
<td>Net number of corporations</td>
<td>-4</td>
<td>23</td>
</tr>
</tbody>
</table>

* The year 1980 is included in the reversal
imported inflation induced by the second oil shock and on expectations adjustment (real wages increased in 1981-82 but declined in 1983).

One would expect that the appreciation of the currency would induce a decline in the rate of inflation (because prices of both importable and nontradeables fall). However, this is not likely to happen quickly in an economy where resources do not move smoothly across sectors.

Real discriminatory devaluation can be roughly estimated for years in which detailed tariff (surcharges included) are available. The changes in the indexes, which are larger for imports than for exports, do not account for changes in nontariff barriers to trade and export incentives. Changes were largest for intermediate goods, both imports and exports, but they were also significant for capital goods and exports of intermediate goods [33].

Real wages have had large fluctuations in the last 10 years and the same is true of relative prices. After sharp wage increases in 1974-76, real wages fell steadily up to 1979. In 1979, the wage gap nearly closed (real wages in manufacturing fell by 6 percent per year in 1977-79). Nominal wages increased again by more than the rate of price inflation in 1980-81, when there was an increase in the real wage gap [34].

The effect of liberalization on interest rates is somewhat irrelevant because those are administratively fixed. In fact, despite the excess liquidity in the economy between 1979 and 1981, nominal interest rates did not fall. They did increase substantially in 1982 and 1983, partly as a response to the acceleration of inflation.

The strong interaction between stabilization and liberalization policies on one hand and shifts in domestic and foreign demand on the other are reflected in very loose relationships between prices and trade flows. In fact, current or delayed point elasticities have generally the wrong sign [35]. Thus, trade volume changes are generally more reliable as indicators of trade response.

Recall that after a strong import growth in 1976-77, imports stagnated in 1978, because of the 13.5 percent real effective devaluation. The stabilization program induced a slowdown in demand and the declining in stockbuilding caused by the increase in interest rates. Import volumes declined 2 percent and the ratio of imports to GDP declined 5 percent. Most of nonfood, nonoil imports declined except for mineral products which increased by 11 percent because of the opening of the Sines oil refinery. Machinery imports
stagnated because they were exempt of the import surcharge and benefited from preferential credit.

Both the oil-induced terms to trade deterioration of 5 to 7 percent between 1979 and 1981 and relative domestic wage growth (2 and 5 percent in 1980, 1981) dominated the changes in protective levels as contributory factors to the depreciation of the real exchange rate. Imports grew by 8, 13 and 6 percent respectively in 1979, 80 and 1981. This corresponded to a real depreciation in 1979 and to a real appreciation in 1980 and 1981.

It can be stressed that by sector, the largest increase was for imports of oil and food. In 1979 and 1982 mineral products imports grew 16 and 15 percent and agricultural products imports - mainly cereals - grew strongly in 1979 (demand-induced) and in 1981-82 (drought-induced). In 1980, the growth in the economy led to an increase of machinery imports and intermediate goods, which were stimulated by growing fixed investment and stocks. When the economy slowed down in 1981, machinery imports slow down too.

After a loss of market shares abroad in the years preceding 1978, exports grew fast in this year and in 1979 due mainly to real devaluation, the restorations of profitability and the catching-up of market shares. From 1980 to mid-1982, during the world recession, there was a real appreciation of the currency and Portuguese exports lost competitiveness, losing market shares which would be recaptured again in 1983. Thus, a seeming pattern of export growth periods is that of taking advantage of cyclically being out of phase with partners, with catching-up of previous losses in market shares and a substantial real depreciation.

On the whole and after a period of relative closeness of the economy up to 1978, trade became more important. However, one must be careful in tying changes in this ratio to trade liberalization because the increase in the trade ratio after 1978 came mostly from imports.

Since 1980-81 were drought years, imports of agricultural products were abnormally large. Only trade in mineral products and machinery have higher elasticity to product changes (1.7 on average from 1978-81) than other goods (1.3). The export plus import ratio has been very variable but after 1979 seems to have accompanied the real exchange rate variation. For the period 1977 to 1981, the openness of sectors varies among sectors. It was more remarkable for transport equipment, paper and products and wood and cork (up to the end of 1980). A continuous and more sustained openness was seen in chemical products.
On another front, and at the aggregate level, the responsiveness of exports and imports to changes in trade ratios and the import surplus are volatile through the period. During the years when activity was in phase with trading partners (1979 and 1983) exports' responsiveness was higher than for imports. In the years when activity was out of phase with partners, imports' responsiveness was higher.

The real appreciation in 1980-81 and the growing excess demand of the public sector increased the import surplus substantially in 1981, after a smaller deficit in 1979. In spite of a real depreciation in 1982, this surplus remained high and only subsided in 1983. At the same time, with the current deficit growing, the external debt was by the end of 1983 twice that of 1979. The acceleration of the import surplus played a major part in the deterioration of the external balance.

During the last ten years, the import surplus has been strongly correlated with GDP (coefficient .94) and the government's excess demand (.69). Because of the strong correlation between the level of economic activity and excess demand by the government (.89), a regression of the import surplus on both variables is misleading, especially in the presence of autocorrelation. The explanation lies in the growing size of the public sector in recent years. The correlation between the real effective exchange rate and the excess demand of the government is also very large (.87) and hence the results of a regression of import surplus on these two variables led also to biased estimates.

Reflecting increasing difficulties of access to foreign exchange between 1979-82, the maturity profile of debt service deteriorated in these years. While in 1979, medium and long-term debt represented 77 percent of total debt its share fell to 72 percent in 1982 [36].

Average growth throughout the period was reasonable, particularly when account is taken of the disruptive situation of the 1974-77 period. On average, GDP grew 5.5 percent in 1975-80 (3.6 percent between 1979 and 1982). The arrival of returnees from Africa led to an increase in both effective demand and potential output. The growth of the period was essentially domestic demand led but for the period of 1978-79, which was export-led. From 1979 to 1982, the year of lower activity was 1981 and the economy grew the fastest in 1979-80. Productivity gains were high in these years.

Income gains follow the approximate path of output growth in these years. Income as well as income per capita grew much slower (1 to 2 percent from 1979 to 1982) than they had grown during the spasm of

Employment creation practically stagnated during the period including the episode of 1979-80. The reasons lie on the peculiarities of labor markets. Again, employment variations have little to do with trade policies. In any event, the overemployment situation in both the private and public sectors and the existence of disguised unemployment in agriculture and employment in parallel markets make statistics of employment growth and particularly of unemployment quite unreliable.

Exit of the corporate sector are more closely related to the conduct of economic policy. Exit was high in 1978-79 as a result both of the disruptions in production characteristic of the 1974-76 reversal and stabilization policies. Exit slowed down in 1980-81, but caught up in 1982-83, as a result of both the decline in (domestic and foreign) demand and the squeeze in profits. By sectors, the structure of bankruptcies shows that they became more frequent in the manufacturing industry (50 percent in 1979 and 60 percent in percent in 1983) than in services (49 percent in 1979 and 40 percent in 1983). They affect consumer goods relatively more than other goods.

In sum, economic performance during the 1977-85 period cannot generally be attributed to trade liberalization. We investigated the sources of major shifts in variables and found them to be attributable to large shift in domestic policies and external shocks. The partial reversal of 1980-82 is due to largely ignoring foreign market conditions, increased inflation and delayed devaluation. The effects of the 1978-79 liberalization policies were taken over by the consequences of the second oil shocks and inflation in the middle of 1980.

Patterns of Sectoral Response

Because of the variability of prices and major economic variables during this episode, the question arises of whether the devaluation package of 1977-78, which coincided with the announcement of EC integration, led firms to adjust resources, particularly investment, in response to the announced liberalization. Market signals were volatile and no clear pattern of resource allocation is visible. The important role of the productive nationalized and
public sectors which attract foreign and domestic resources, particularly capital goods, must also be kept in mind.

Investment responded with about one-year lag to shifts in policy. Thus it grew at 12 percent in 1977, in a kind of catching-up process and contracted in 1979 to be retaken in 1980 to 1982 due to expansionary policies. Inventory accumulation was used as an adjustment of firms to devaluation expectations and depression. The counter-cyclical nature of domestic demand and foreign demand for investment goods was also particularly visible in 1980-81 and in 1983-84.

Table 17 shows the sectoral gross fixed capital formation in manufacturing. Among the exporting industries, only leather and footwear responded to liberalization with a high rate of growth of investment. As mentioned earlier, investment was particularly high in industries where public ownership is significant such as tobacco, iron and steel industry and rubber and plastics. Slow growth of investment was observed mainly in traditional exporting industries (except for footwear), which are mostly owned by the private sector. The exception is cement, included in the nonmetallic mineral products sector.

Table 17

The striking evidence of Table 17 is the higher than average rate of investment of the public-owned sector relative to the private sector and also its invariance to change in profits. Even in times of economic slowdown (1977-78 and 1981) these industries escaped from overall economic conditions, which were thus felt with a vengeance by the private sector.

The performance of public owned group of industries is much more variable than the private ownership group. Their level of absorption of foreign and domestic resources and time response is likely to have biased the overall industrial response to liberalization. It is likely to have contributed to the reversal of liberalization in 1983.

Impact of the Public Sector

After 1974 the government deficit increased throughout and was a major source of demand leakages. During the second episode, the larger and increasing deficits of the public sector had no effective bearing with the speed of liberalization but questioned its survival. In fact, the public sector deficits contributed to the partial reversal of 1980-82, when the borrowing requirement of
<table>
<thead>
<tr>
<th>Category</th>
<th>Average Growth</th>
<th>Main Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Tobacco</td>
<td>63.0</td>
<td>Public</td>
</tr>
<tr>
<td>11 Metallic Mineral Products</td>
<td>48.3</td>
<td>Public</td>
</tr>
<tr>
<td>13 Rubber, Plastics</td>
<td>33.6</td>
<td>Public/Private</td>
</tr>
<tr>
<td>7 Footwear</td>
<td>31.4</td>
<td>Private</td>
</tr>
<tr>
<td>12 Chemical Products</td>
<td>24.0</td>
<td>Public/Private</td>
</tr>
<tr>
<td>15 Non-Electric Machinery</td>
<td>22.8</td>
<td>Private/Foreign</td>
</tr>
<tr>
<td>16 Electric Machinery</td>
<td>17.9</td>
<td>Private/Foreign</td>
</tr>
<tr>
<td>9 Paper Products</td>
<td>15.1</td>
<td>Public/Foreign</td>
</tr>
<tr>
<td>17 Transport Equipment</td>
<td>10.7</td>
<td>Private/Foreign</td>
</tr>
<tr>
<td>4 Beverages</td>
<td>10.5</td>
<td>Private</td>
</tr>
<tr>
<td>8 Wood, Cork</td>
<td>10.2</td>
<td>Private</td>
</tr>
<tr>
<td>18 Other</td>
<td>7.5</td>
<td>-</td>
</tr>
<tr>
<td>3 Food Products</td>
<td>6.3</td>
<td>Private</td>
</tr>
<tr>
<td>10 Non-Metallic Mineral Products</td>
<td>6.3</td>
<td>Public/Private</td>
</tr>
<tr>
<td>14 Metal Products</td>
<td>6.1</td>
<td>Private</td>
</tr>
<tr>
<td>6 Textiles, Clothing</td>
<td>0.1</td>
<td>Private</td>
</tr>
</tbody>
</table>

Note: Investment in utilities and other public services, not included here, was also very high.

Source: SA-Table 5.8.
the enlarged public sector (including nonfinancial state-owned enterprises) reached over 20 percent of national income.

Moreover, total government debt (including government guaranteed debt), deflated by the CPI, grew very fast: 15 percent in 1977-79, 28 percent in 1981 and 11 percent in 1982. External government debt grew still faster: 39 percent in 1977-79, 27 percent in 1981 and 39 percent in 1982. Only in 1980 total and external debt, still in real terms, stabilized. These rate are still substantially higher than those for the economy external debt. The inclusion of state-owned enterprises is justified on two grounds: (1) the importance of government transfers to them (26 percent to 33 percent of expenditures); and (2) the importance of state-owned enterprises and government as borrowers in the foreign and domestic markets, respectively.

Recall that the level and the composition of the central government deficit was another lasting shift in policy during the reversal of 1975-76. Receipts declined because of tax evasion and the slowdown in foreign trade. On the other hand, expenditures increased substantially with a widespread rise in the hiring of new personnel, as well as with the expansion of social security payments, traditional subsidies and transfers to the new nationalized enterprises.

At the time of the liberalization cum stabilization package of 1977-78, fiscal policy was intended to have a neutral impact on the economy but controlled prices of public utilities and "essential" consumer goods (including petroleum products) were allowed to rise. However, by 1978, net borrowing by the central administration sector reached 11 percent of GDP while it has been 3.5 percent in 1976. Since then, each government in turn has announced its intention to reduce fiscal deficits, generally without credibility, since net borrowing requirements have remained too high as percentage of national income.

Public policy may affect liberalization and its sustainability in several ways: (1) deficits may become an important source of the government's difficulty in controlling the money supply and inflation, thus upsetting the devaluation-liberalization effects; (2) government demand for domestic resources may compete with that of private activities including those earning foreign exchange (exportables, tourism) slowing down their growth and capacity to pay for the liberalized imports; and (3) with state-owned enterprises induced to borrow abroad or having priority on importing "essential" goods, a bias against the most productive use of foreign resources is created. Hence, the government deficit will have both a short- and long-run impact on liberalization and its
effects.

Unfortunately, no direct evidence exists for clear inferences on these grounds. Money supply grew rapidly in 1979-80 and less rapidly in 1981-82, but was checked only in 1983. The impact of the government deficit on the economy has been rising despite attempts to increase tax revenues through higher direct tax rates new taxes such as surcharges and, in 1980, through a crackdown on tax evasion, believed to be widespread. Nevertheless, the government failed to establish a sustained increase in government receipts to cover deficits through a comprehensive tax reform.

On the other hand, the competition between the private sector and government and state-owned enterprises in the access to domestic and foreign savings was high in several periods. On the domestic front, this was particularly true during periods of financial restraint (1977-78) and, to some extent in 1981-83; on the foreign front, the foreign exchange shortage of 1977-78 and 1982-83 may be particularly significant. Government has privileged access to domestic credit and state-owned enterprises had liberal access to foreign credit up to 1983.

The implication is that the government deficit particularly on the expenditure side and the policies of state-owned enterprises led in part to the reversal of the liberalization initiated in 1977-78. This culminated with increased controls in 1982, foreign exchange shortages and restriction at the beginning of 1983 and a new devaluation package later in that year.

The experiences is then that in the upper swings of business cycles (coincidental with the aftermath of IMF led policies) the budget is expanded. The problem is that expenditures commitments during good times tend to roll over bad times (1981-83) often because those expenditures cover more than one fiscal year and also because the strong political lobbying of the public sector either from the unions or from the managers of the state-owned entreprises [37].
NOTES

[1] See Special Study


[7] Moreover, in 1983, the government expressed the intention of phasing it out as well as of liberalizing public enterprises' trade monopolies. The treaty of accession to the EC contains the same prescription, suggesting that the intention was not carried out in practice.

[8] See SA-Table 6.9.

[9] Decree-Law 47/84 and Regulation 6/84 of February 1984 determine a six-month vigilance period for competing (nonquota covered) imports; this led to difficulties for domestic products and subsequent safeguard import restrictions. Its protective intention was, however, an effort to eliminate the element of arbitrariness of the BRI system and establish clearer rules for licenses.

[10] By Decree-Law 64/84 (February) 10 percent of import volume could be imported by private firms. At the same time a liberalization of the market price (between the limits set by import price and producer price) was intended. Restatements for liberalization were done again in 1986 proving the difficulty in breaking down this monopoly. For AGA, the liberalization of 50 percent of sugar trade was decided in 1983. In June 1984, 50 percent of oilseed imports was liberalized and the intention was to liberalize the rest up to the end of the year, and indeed IAPO stopped operations in 1985.

[11] Only when the escudo devaluated again in June 1982 (9.4 percent) did market shares recover abroad. This trend was strengthened by the two devaluations of 1983 (March, 2 percent, and June, 12 percent) and the increase of the crawling peg in March (0.75 to 1 percent). See Special Study on the rate of crawl and on
evidence about the erosion of the crawling peg.

[12] Import surcharges were raised to 30 percent in February 1983 (the same level as in 1977) but were reduced to 10 percent in January 1984 again. On NTB, see above.

[13] By the "aviso" of December 31, 1983, interest rate subsidies of short-run credit for working capital were abolished, so as to decrease distortions of financial costs and reduce the costs to the budget. The government also announced its intention to reduce credit subsidies after 1984 on the stated assumption that devaluation will be the main incentive to exporters.

[14] After 1982, special credit lines were created for equipment of exporters and services. Subsidized mid-term credit also exists for firm orders and preferential credit for import and export promotion. Exporters holding certificates had additional credit lines at subsidized interest rates for working capital for export plans in 1982 and 1983. By and large, the most frequent credit used was the short-run type to the end of 1983.

[15] These rates appear in general higher than practiced by other countries. In July 1984, OECD countries agreed on a range of minimum interest rates for medium-term credit of 10.7 to 13.35 percent depending on the country's income and maturity of the loan. The range of interest rates agreed to in 1983 was 9.5 to 12.15 percent. The minimum rates on domestic credit are in general higher than these rates both in 1983 and 1984. The fact that real interest rates were negative in some periods is not by itself an incentive for producers to export rather than produce for the home market. Also, there were other forms of subsidized credit for investment covering exporting firms, primary sectors, housing, and manufacturing. The system of incentives (SIII) is well known as being inoperative and is here ignored. Presently the system is being reviewed.

[16] Also, in October 1983, the exemption of capital surtax was foreseen on the same basis as capital tax for exporters. Given the general rise of tax rates in the last years, especially in 1983, tax incentives to exporters may have become more important.

[17] Recall that the 1977-80 tariff reduction is overestimated because there are tariffs before exemptions which were likely to be higher in 1977 than in 1980. No data is yet available on exemptions. However, tariff rates are available from 1977 to 1981 at different levels of aggregation than that used in SA-Table 7.2. The average tariff (including surcharges) declined from 7.3 percent in 1977 to 3.5 percent in 1981. See SA-Table 6.5.
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[18] The increased premiums were due to expanding demand and the exchange rate revaluation of 1980 to 1982. Black market on goods became more active. Moreover, state import monopolies absorbed a larger share of the available foreign exchange because they were forced to provide a steady flow of "essential" goods in face of declining agricultural output (food products, fertilizers) and rising levels of economic activity (petroleum). Since these were paid in dear dollars, import quotas of state monopolies played an important role in resource allocation during 1980-82.

[19] In 1977 incentives to attract emigrant savings were introduced: foreign savings accounts and advantageous rates for housing credit for emigrants. Transfers, which grew 44 percent in 1978 and 52 percent in 1979 not only reflected restored confidence in the economic and political circumstances, but were also an answer to incentives to attract emigrants' savings, further stimulated by the substantial devaluation of the escudo in 1978 and 1979.


[21] The payment crisis due to the large debt of Latin American countries had its repercussion in Portugal at the end of 1982, when severe shortages of foreign exchange were felt. Beforehand, from the end of 1979 to 1982, growing current account deficits were essentially financed by foreign credit (SA-Table 2.1) so that, at the end of 1982, foreign debt was almost twice that of 1979 (SA-Table 2.7). In 1982, credit terms also became less favorable because Portugal was covering growing current deficits, servicing the debt at increasingly difficult conditions and witnessing a decline in invisible credits.


[23] From the summer of 1982 onwards, the monetary authorities' intention has been to control the expansion of total rather than of domestic credit. This has been coordinated with objectives for the current account deficit and its financing. In October 1983, the government signed a new letter of intent with the IMF which specified ceilings on total credit (both domestic and foreign). A package with new taxes and higher rates on old ones was also announced. Money supply only slowed down in the fourth quarter of 1981 and grew progressively slower in the second quarter of 1982 and in the first half of 1983, due to financing difficulties in external markets.
[24] In April 1982, there was a rearrangement of subsidized rates and more restrictive conditions for access to preferential credit were introduced. The rate of subsidy for agricultural short-term credit was reduced. The subsidy to exports were raised slightly in 1983 and abolished in 1984.


[26] As a percentage of GDP, social transfers were 16 percent in Spain, 12 percent in Greece and 10 percent in Portugal and in 1982 (OECD).

[27] The Bank of Portugal estimates that the non-financial state-owned enterprises (in which the state has an equity holding of more than 50 percent) accounted for 16 percent of GDP, 32 percent of investment, 17 percent of earnings and 8 percent of employment. They are in general highly capital-intensive sectors.

[28] In 1983, in spite of substantial rises in tax rates and introduction of new taxes as well as rises in controlled prices agreed upon with the IMF, the announced targets were once again not met, thus raising the issue of the credibility of the government in its announcements of programs to control either tax receipts or expenditures. Properly computed, the deficit of the central administration (including social security) reached 17 percent of gross domestic product in 1983 when the announced deficit was about 7.5 percent and the realized deficit was under 9 percent. Therefore, no matter how strong the inflation correction, such divergences suggest the inability of the government to enforce any fiscal policy whatever. See Lopes (1983).

[29] The most important tax rise in 1981 was on interest of bank deposits (15 to 18 percent). Also, there was a unification of the turnover tax rate at a lower average level (as a preparation for the introduction of the value added tax) but an increase on car sales taxes, excise taxes and stamp duty. In 1982, several indirect taxes were raised. In 1983, the tax burden was greatly increased with a large discretionary increase on taxation (SA-Table 6.17). In February, import surcharges were raised from 10 to 30 percent. Stamp tax was also raised but the complementary and professional taxes were reduced. In July, special taxes on profits and corporate expenditures were also raised. As part of the stabilization program agreed with the IMF, a full package of tax increases and new taxes was introduced in October 1983: a special tax on earned income, an increase on the rate of income liable to land and capital tax, a rise in car sales, and stamp taxes and new taxes on luxury consumption.
[30] Unauthorized dealers abroad created an unofficial spot market located mainly in Lisbon but also in Rio de Janeiro (Brazil). In late 1977, the black market premium reached 20 percent whereas, that after the IMF agreement of 1978, the black market rate fell below the official rate. The size of the black market is subject to controversy but has probably declined since 1977. See Macedo (1984) and Cocco and Santos (1984). However, since the strong appreciation of the U.S. dollar, the black market in this currency may have increased. In February 1985, at least one firm has been prosecuted for dealing in black market foreign exchange, and, because of the nature of the customers, this has been widely reported in the press.

[31] Regulated prices increases and subsidies removal (on food prices) are partly behind the acceleration of measured inflation after 1981 (22 and 26 percent in 1982, 1983). Parallel to direct price controls, there is a system of declared prices and, after April 1983, of agreed prices. The declared price system involves an ex-post control if the government thinks the price rise is not justified in terms of the underlying rise in costs. Some services are also under the price control system. The "surveillance" system is basically a system of notification by the firm to the government. Overall price controls have been intended to be liberalized since 1983 but no schedule has been drawn to 1985. No reliable indicators exist for black market activity in regulated goods but estimates suggest that activities in this market increased steeply from 1975 onwards, to reach around 8 percent of GDP in 1978 and 11 percent in 1981 according to Cocco and Santos (1984).

[32] Portugal is highly dependent on food and energy products (SA-Tables 2.19 and 2.35). In 1981-82, food products account for 34 percent of household consumption. Domestic excess demand was compensated by imports. Import prices of food and energy increased in 1980-81 and declined in 1982. Both price controls of 1980 and domestic inefficiency of trade monopolists helped the increased inflationary pressures of 1981 onwards. On the contrary there was a severe drought in 1981 and 1982 (agricultural production fell 12 and 13 percent in these years), price controls were relaxed and international prices increased in 1981-82. In 1983, subsidies were reduced, there was a decontrol of prices and a substantial real depreciation. The inflationary pressures that could have been felt since 1980 were felt after 1981. Finally, increases in both nonwage factor incomes and taxation explain the rise in prices in 1982-83.

[33] See SA-Table 2.29.
[34] The downturn of nominal wages contributed 37 percent to the increase in the deflator of total demand versus 20 percent in 1979 according to the Bank of Portugal. A second downward swing in 1982 and 1983 led to a decline in the wage gap (see CM-SAT 1.7). From 1980 to 1982, domestic relative wages increased and there was a loss of competitiveness and a real appreciation up to the end of 1981. Also, since 1979, wage ceilings became less binding than before, so that the variance across industries may have increased.

[35] See SA-Tables 2.29, 2.32 and 2.33.

[36] This situation only improved in 1983. In relation to GDP, total debt service was 6, 8 and 10 percent respectively from 1980 to 1982. The ratio of debt to GDP has often been higher than the average for the 25 largest world debtors. Again, the deterioration of debt size, debt service and ratio of debt to reserves (especially during 1981-82) should be attributed to the conduct of macroeconomic policy rather than to the liberalization stance.

[37] Is the current trade liberalization (1986-87) hanging again on fiscal order? In other words, should fiscal discipline be introduced now when the transition period for full EC integration is starting and receipts from trade taxes are declining? Past experience seems to indicate that fiscal discipline is essential to sustain a liberalization policy. In particular, fiscal discipline implies expenditures decline and restructurings and fiscal reform rather than present policy of increasing revenues through larger differentials between state controlled domestic prices (oil and food) and world prices. These policy is only sustainable in the short run but does not guarantee fiscal order for the years to come. However, the present economic situation is particularly favorable for fiscal reforms and the present efforts for curbing subsidies and transfers seem to indicate political awareness to the problem.
CHAPTER V

INFERENCES FOR THE TIMING AND SEQUENCING
OF TRADE LIBERALIZATION POLICIES

In Chapters III and IV, it was shown that trade liberalization episodes in Portugal did not represent an explicit commitment by the authorities but were instead part of multilateral trade agreements. Thus, even within the short-lived episodes of 1970-74 and 1977-80, policies were maintained which contradicted the objective of trade liberalization.

In this Chapter we draw inferences and lessons from the Portuguese experience. The comparative inferences refer to: 1/ the preference for a gradual, multi-stage trade liberalization; 2/ the preference for a slow but steady speed of liberalization; 3/ the desirability of a separate stage for replacing quantitative restrictions by tariffs; 4/ the undesirability of a separate stage for export promotion; 5/ the preference for a uniform rather than a discriminatory treatment of sectors in a gradual process.

Since the liberalization process has been discriminatory, there is little to say on 6/ choices among alternative forms of a uniform process; except to doubt the desirability of 7/ discrimination among activities. Similarly, the Portuguese experience is mixed with respect to: 8/ the appropriate circumstances for the introduction of a liberalization policy; 9/ the sustainability of the liberalization policy under other policy measures; and 10/ the relationship of a desirable path of trade liberalization to other policies, especially financial liberalization.

After examining each one of these ten points, we conclude with four broad lessons from the Portuguese experience, which make up for some of the ambiguous inferences in making the Portuguese experience quite illuminating in a comparative context.

Ten Comparative Inferences

1/ Gradual, multi-stage versus one-stage trade liberalization.
Although the two liberalization episodes span only 5 and 4 years each, they involved gradual multi-shot trade policies, based on peacemeal trade negotiations and partial domestic liberalization during the first episode and on a "liberalization-cum-stabilization package" (CLSP) during the second episode.

They were never completed in either episode, so that no advantage was derived from the gradual nature of the policy, which turned out to be an unintended by-product of macroeconomic stabilization during the second episode.

On the trade side, the announcement of liberalization made by joining EFTA and participating in GATT, then by organizing a free trade agreement with the EC, implied several overlapping calendars of tariff reductions. But the process had a stronger economic impact than implied by these calendars alone. During the first episode, labor outflows and capital inflows joined forces with the eroding effect of world inflation on the specific tariff schedule to accelerate the openness of the economy.

During the second episode, the application for EC membership involved the expectation of belonging to an Economic Union, so that the arguments in favor of a gradual liberalization stand on firmer ground. The expectation effect on the credibility of a gradual policy was strengthened by the existence of mostly uncoordinated "liberalization-cum-stabilization packages".

Effects on labor

In both episodes, labor decline was highest in the agricultural sector. Note, however, that, in either episode, the agricultural sector was left out of the liberalization process. This probably led to costs of adjustment higher than they otherwise would have been.

The labor costs and increased imports of food should have implied a treatment of agriculture as a special sector preferably with a system of income subsidies rather than prevailing price subsidies and state-owned trade monopolies designed to keep food prices low.

Trade liberalization effects on employment are clearer at the sectoral level. In a process of liberalization of trade in manufactures, labor is likely to decline in industry but not in primary activities, construction and services. Given the discriminatory nature of the process, though, there were no costs
of adjustment in terms of employment attributable to trade liberalization in both episodes.

At the aggregate level, the economy was close to full employment through the first episode and the stagnation of aggregate employment was due to the effect of guest workers in sustaining a declining labor supply as well as to a widening wage gap.

Employment declined in agriculture (3%) and increased in construction and services (2%). Within manufacturing, labor displaced from the liberalized consumer goods industries was offset by the rise in employment in intermediate and capital goods, where there was much less liberalization. This displacement of labor may have resulted from higher relative wages with respect to lower interest rates giving an incentive to labor saving techniques. With the usual caveats about these ratios, the capital labor ratio grew 7 percent on average from 1970-74 to decline to a crawl of less than 1 percent from 1977-80 seemingly confirming the capital deepening of the first episode.

During the second episode the 8 to 10 percent unemployment cannot be attributed to trade liberalization. These figures overestimate employment because of the disguised unemployment existing in several sectors, particularly in state-owned entreprises. In effect, labor legislation enacted during the period of revolutionary turmoil forced firms to retain excess labor and created an obstacle to labor mobility. The unemployment of the period may be attributed to the excesses of the revolutionary period, followed by a stabilization program and a recession.

At the sectoral level, unemployment figures are quite unreliable although there is the perception that labor laws have aggravated labor adjustment costs by preventing lay-offs during a period of restructuring. The figures on employment showed again a decline in the agricultural sector of 7 percent reallocated to construction and services (3.5%) and capital goods industries (2 percent).

Capital and Production Effects

Gradual multilateral trade liberalization is not sustainable unless there are also policies designed to promote internal liberalization.

Resource allocation in industry is related to productive and market structure. In Chapter II, a rough relation between market structure and trade orientation of production was established. We identified
two segments of industrial production. One private, traditional, more competitive segment oriented toward the domestic and foreign markets, with exporting sectors being mainly in consumer goods industries. The other a non-competitive, import-substituting segment, which became essentially state-owned after the revolution. We called the first segment the "export enclave", naturally without excluding linkages between them.

Resource allocation between traditional and non-traditional industries during 1970-74 cannot be attributed to trade liberalization policies along classical comparative advantages lines. In particular, the absolute level of manufacturing investment was determined centrally and enforced by an industrial investment license up to 1972.

During 1977-79, in turn, resource allocation was dominated by the conduct of macroeconomic policy and tight credit rationing to private enterprises. In both episodes, the import-substituting industries escaped trade liberalization.

During the first episode, production increased by 9 percent on aggregate but capital goods (where foreign investment is important), non-tradable sectors and consumer goods production grew faster than import-substituting sectors such as intermediate goods. The larger reduction in effective protection was precisely in the consumer goods industries. These industries were essentially export oriented.

The favorable world and domestic environment led also to expanding investment in almost every sector. Exceptions are agriculture, food products and metallic mineral products. From the evidence there is no clear relation between percentage declines on effective protection, production and investment.

In the second episode, in a much more unfavorable domestic and world environment, the average investment from 1977 to 79 grew 6 percent a year (compared to 11 percent in 1970-74), in spite of the stabilization program. In fact both investment and production recovered rapidly in 1979-80 after the recession of 1978. Production and investment grew in intermediate and capital goods industries reflecting the government financing of state-owned enterprises and also the mild increase of private investment. In fact, private production increased by greater use of installed capacity rather than by adding new capacity. There were few bankruptcies during the first episode. However, the unstable political and economic environment of the reversal of
1975-76, with inflation, losses in competitiveness and labor unrest led to significant accumulation of corporate debt. Thus the number of bankruptcies accelerated during the second episode to decline during the 1980-82 reversal. These losses cannot be attributed to trade liberalization. They were instead a consequence of macroeconomic stabilization, to the extent that interest rates increased, generating a debt overhang.

There were no visible costs of adjustment on account of production and capital effects attributable to liberalization. During the first episode the favorable domestic conditions led to an expansion of production and investment across sectors, with the exceptions mentioned. In the second episode the external recovery also favored the import-substituting industries, which had become state-owned in 1975.

Competitiveness and Relative Prices

The costs of adjustment in terms of growing losses in competitiveness and trade deficits seem to have been higher in the first episode than in the second, although the current account was in surplus in 1970-74 and in deficit in 1977-79.

The trade deficit doubled in dollars between 1970 and 1974 and was almost maintained in the second episode. Competitiveness deteriorated significantly in the first episode but not in the second. The improved competitiveness in 1977-79 was due to the deflationary policies introduced about one year before the reduction in surtaxes but simultaneous to the announcement of the application to EC membership. Nevertheless, deflationary policies had a stronger impact than this announcement, which was perhaps not believed. Changes in competitiveness due to the liberalization cum stabilization packages are described in detail in the Special Study mentioned at the outset.

In a process of liberalization, the equilibrium level of the exchange rate tend to be higher than before, which calls for a real devaluation if competitiveness has to be maintained and if goods are gross substitutes. Moreover, adjustments and information on the new set of relative prices takes time, tending to an initial over deterioration of competitiveness. Unfortunately, sectoral relative prices are not reliable. The argument, basically in favor of gradualness, is cast in aggregate terms.

At the aggregate level, the loss of competitiveness in the first episode is based on indicators for imports and exports measuring
the relative price changes of tradables with respect to non-tradables.

In fact, the acceleration of the real appreciation in 1970-74, was higher for imports than for exports. Moreover, in an economy with high income elasticities of demand for imports of machinery, the expansion of the economy increased imports dramatically, leading to a strong deterioration in the trade balance. However, domestic to foreign labor and capital costs improved. Accelerated inflation and expansionary monetary policy, coupled with a fixed exchange rate policy, depressed wages and turned real interest rates negative, making the liberalization difficult to sustain. On the other hand, relative unit labor and capital costs improved, so that trade liberalization in the first episode was probably more cautious than the economic environment allowed. In sum, the policy was too gradual.

In the second episode, competitiveness improved much more both in terms of relative prices and relative factor costs and was complemented by tighter monetary and fiscal policy. The income elasticity of imports fell and at the same time world export shares increased. From a large current account deficit in 1976, the current account was near balance in 1979.

Despite appearances to the contrary, the quick policy shifts after 1976 also implied a second liberalization with an excessive amount of gradualism, due to the existence of LCSPs including two IMF-sponsored devaluations preceding and following an anti-inflationary exchange rate revaluation in 1980.

The second episode did not manage to accelerate structural adjustment to the enlarged and less prosperous European economy of the seventies. Had it been more gradual and the episode might have envisaged more consistent trade and domestic liberalization policies.

The number of policy instruments, introduced in 1974-76, restricting international and domestic trade, was much larger in the second episode than in the first. A multi-stage, more gradual process would have been justifiable had it not been for the reversal of 1981-82. Thus the preference for gradualism is intimately tied to the ability to commit to a steady speed of liberalization.

2/ The Speed of Liberalization
Both episodes were rather short although they involved a multi-stage process. It would thus seem that the small costs of adjustment of the ambiguous trade liberalization episodes in Portugal could support an argument for a multi-stage but rapid liberalization process.

However, the argument in favor of a slow but steady process is more convincing in this instance. On one hand, the issue of credibility hinges on a correct assessment of the social and political resistance to liberalization. On the other hand, the need to correct domestic inconsistent policies requires considerable administrative capabilities in order for the responses to the new circumstances to be appropriate. These trade-offs lead in the case of Portugal to prefer a go-slow approach.

Credibility vs. Social and Political Resistance to Liberalization

An argument for a slow process may be grounded on credible liberalization upsetting the social consensus and provoking its reversal. A case for low speed on these grounds can be made for the first episode but not for the second. Note that inconsistencies of political decisions played a more important role than economic policies for the breakdown of the Caetano regime. Moreover, the rise in food prices in 1971 and 1972 may have been more important than liberalization per se in generating workers deprivation and thus explaining the deteriorating social consensus.

Capital opposed the credible liberalization of the first episode but not in the second. The powerful economic groups formed in Salazar times were dispersed during 1974-76 so that during the second episode capital was unable to lobby for protection in manufacturing. The new entrepreneurs welcome the changes of 1977-79 anyway. Their concern had to do more with labor unrest and corporate debt than with liberalization. Even after the announcement of EC application for membership, trade liberalization was not credible due to the absence of a consistent set of policies.

Paradoxically, trade liberalization was seen as anti-labor in both episodes. However, labor had no voice during the first episode and social turbulence was so dominant in the second episode that it was difficult for organized labor to bargain in economic terms, which introduced a destabilizing effect in the newly-found political freedom.

The argument for a gradual and slow process of implementation in
the first episode is thus based on the resistance of capital owners - especially in the large groups devoted to import-substituting activities - and on the deteriorating political consensus which led to the resistance of labor to liberalization along purely ideological grounds.

Administrative capacity vs. consistent domestic policies

Policies which affect the effects of trade liberalization are domestic controls on prices, wages and interest rates, exchange controls and other domestic controls on investment and credit. Their removal simultaneously with trade liberalization could be defended in a consistent process of trade liberalization.

The first episode of the liberalization process was credible but not fully planned. It included the removal of investment licensing in 1972 and some price and wage controls, at least in 1969-70. Even though there were favorable economic conditions for a less cautious process, the argument for slowness remains valid.

For instance, the increase in controlled prices, particularly food prices, was probably too rapid. The difficulty with the external accounts due to losses in competitiveness called for a quick response. In spite of declining wages, the administration was unable to provide this quick response. Note, however, that a slower process would not have avoided the reversal of 1975-76, which was politically motivated.

In the second episode, the credibility issue became as important as the administrative speed of response to changing domestic and international uncertainties. The announcement of application for EC membership was not credible but the stabilization package was. Because the later had microeconomic effects, these overlapped with tariff reduction effects, leading to effective trade liberalization.

Thus, the credibility issue, which favors rapid liberalization, seems weaker than the political and economic instability and administrative capability to respond, which favors a slower approach.

3/ Desirability of a Separate Stage for Replacing Quantitative Restrictions by Tariffs

In a multi-stage trade liberalization episode a separate stage for substituting widespread quantitative restrictions by tariffs can be
grounded on dampening the impact of liberalization on the trade balance and allowing a transition for some products to adapt to more competitive markets.

In the first episode, QR's were limited to household electric equipment, automobiles and some petroleum products. These products were seen as having high income elasticity of import demand.

In the second episode, quotas in these products were tightened and import licensing became widespread, covering an undisclosed number of goods. It is on the second episode that we draw some lessons because QR's were declared to aim at lowering trade deficits even though they also had a strictly protective purpose.

The two episodes of liberalization did not include a substitution of QR's by tariffs because this was ruled out by the trade agreements themselves. The widespread use of QR's after 1976 contributed for the discredit of trade liberalization policies as well as originating a source of discretionary power by the public administration, corruption and black markets. QR's were tightened or relaxed depending on the short-term balance-of-payments position.

There is evidence that the deflationary program in the second liberalization episode reduced the importance of QR's creating redundancy in quotas, reducing license premiums, the discretionary power of public servants and reducing black market for goods and foreign exchange.

The conditions for eliminating or reducing the QR's system could not have been better. In the multi-stage trade liberalization of 1977-80 an opportunity for eliminating the QR's system was thus lost. Because QR's were maintained into place, the appreciation of 1980-82, and the increased quota premiums, contributed to the reversal of liberalization.

In sum, free trade agreements with the EC and EFTA greatly limited the initiative in adopting the most efficient and the inevitable policy implied by the EC accession.

This means that such stage was obviously desirable at least in the second liberalization episode but was lost by the authorities in 1977-79.

As with liberalization with Spain, a separate stage for QR's elimination, although with safeguards provisions, was to become an

4/ Undesirability of a Separate Stage for Export Promotion

A separate stage for export promotion in a multi-stage trade liberalization can be justified because trade liberalization can in some circumstances create a temporary bias against exports.

Export promotion is here understood as temporary indirect incentives to exports either in the form of tax or financial incentives, as applied in Portugal particularly during the second episode. It does not refer to direct incentives such as the promotion of new products or markets, market information, import-export funds, special insurance lines and the like. These incentives increase the price elasticity of exports and do not have to be tied to an anti-export bias.

In both episodes changes of the real exchange rate were clearly more effective than any form of incentives to maintain market shares. In fact, indirect export incentives were never very important in Portugal and even those existing were of little use to exporters. However, in 1980-82, they had more importance through interest rate rebates and tax incentives at a time when nominal rates were high.

Movements of the real exchange rate were not designed for export promotion. The efficacy of the policy in the second episode of liberalization is explained by the large real devaluation in 1977-78 and the increase in the price elasticity of export demand. It is also explained by reallocation of sales to foreign markets following the 1978 recession and recovering the market shares lost during the 1975-76 reversal in 1977-79, when indirect incentives were not as important as in 1980-82.

In the first episode, export promotion was grounded on an inefficient drawback system, eroded by the decline in tariffs, and preferential credit lines. The latter were probably offset by the real appreciation so that exports grew slower than imports. Aside from the movements in the real exchange rates there is no evidence of a trade policy bias against exports in this period.

In the second episode, a complicated system of incentives such as interest rate rebates, preferential credit, tax and tariff exemptions and other devices were used but the real devaluation dominated them. They were considered necessary to offset external
demand contraction and to offset the anti-export bias of the tariff surcharge system.

In this episode export promotion policies, while being less important than the increase in competitiveness, created distortions in the domestic market as well as demanding a heavy and inefficient machinery to select candidates for which the incentives would apply.

The relative price of tradables with respect to non-tradables appreciated 6 percent between 1970 and 1974 while it depreciated by 15 percent in 1977-79. This corresponds to a fixed nominal exchange rate (traded weighted) in the first episode and a nominal devaluation of 24 percent in the second episode.

While there was a deterioration of competitiveness during the first episode, competitiveness in the second episode increased significantly. Exports as percentage of GDP grew on average only 2 percent p.a. in 1970-73 but they increased 11 percent p.a. in 1977-79.

Note, however, that the increase in exports during the second episode was due to existing capacity rather than a resource pull by the exporting sector. In fact, investment stagnated in the exporting sectors and the domestic recession, together with inventory accumulation, explains the remarkable increase in exports.

In sum, active policies to maintain or enhance competitiveness at a realistic level are preferable to a stage of export promotion in the form of indirect incentives. This is equally important when an anti-export bias exists, due to import surcharge such as those which took place during the second episode.

The inefficiency of indirect export incentives, in the form of slow and discretionary bureaucratic machinery, as well as in the form of arbitrary and discriminatory interest rate and credit structure and complicated tax and tariff exemptions, argues against a separate stage of export promotion with these type of incentives.

5/ Uniform versus discriminatory treatment of sectors in a gradual process

Both episodes of liberalization in Portugal were discriminatory because they did not involve agriculture and services and because
of domestic policies favoring the import-substituting segment, which became mostly state-owned after 1975.

The neglect of the agricultural sector in the last forty years represented a cost for the liberalization process. The economy which was self-sufficient in food products in the fifties became increasingly a net importer. After the oil crises, the balance of trade deficit showed a double vulnerability in food and oil.

Moreover, the bad harvest contributed to a reversal of liberalization in 1981-82. Clearly, the transformation of traditional agriculture by greater trade liberalization in the 60's might have avoided the increased imports and thus the need to export more in the future, so as to pay for the external debt.

It might also have avoided the increasing role of state-owned trade monopolies and their increasing deficits, which contributed to the deterioration of fiscal deficits after the second episode.

The favoring of state-owned industrial production which largely coincides with import-substituting sectors also had costs for the process not only on the resource allocation side but also on the government budget deficit, another major factor leading to the partial reversal of the second episode.

Geographically, they were discriminatory in favor of EFTA and the colonies in the first episode. Even though they were less discriminatory in the second episode, there was nevertheless a bias of protection against non-EEC, non-EFTA imports, especially Spain.

6/ Choices among alternative forms of a uniform process

It can be argued that if the process had been more uniform, it would have lessened some of the structural imbalance which characterized the episodes. This does not exclude the eligibility of these sectors for temporary direct subsidization to smooth out their adjustment to liberalization.

As with other policies, the inclusion of the agricultural sector in a liberalization process was designed for the first time in the EC accession agreement and started to be implemented in 1986.

7/ The nature of a desirable discrimination among activities

The experience of Portugal does not suggest that the discrimination between raw materials and manufactures was especially desirable. To
the extent that it did not include agriculture, the export sector was an enclave and the import-substituting sector became nationalized during the 1975-76 reversal, making adjustment more difficult.

The time-honored Colbert mercantilist doctrine, according to which protection of domestic value-added helps development, cannot therefore be defended on the basis of the evidence gathered from the Portuguese case.

8/ Appropriate circumstances for the introduction of a liberalization policy

In the late sixties, the economic circumstances for the introduction of a liberalization policy seemed appropriate, but the opposite is true of the late seventies.

The first liberalization episode was initiated in a climate of dynamism, with no public debt and widespread business confidence. Later, it became a period of great political and economic uncertainty, so that trade liberalization was easily reversed in 1975-76.

The circumstances by the late seventies were much more adverse to the extent that the second oil shock and the "Reagan dollar" shock prevented any serious liberalization from taking place.

In 1969, Marcelo Caetano announced steps to liberalize the political life and to lessen the economic controls although maintaining the African policy and other domestic institutional arrangements. Trade and domestic liberalization seemed desirable due to reserve accumulation, external surpluses and increased savings available for public and private investment.

Since 1967, rising trade deficits had been accompanied by current account surpluses. Aside from increased migrants remittances and tourism earnings, foreign investment also increased so that the overall balance was in surplus, hiding the consequences of real exchange rate appreciation for export competitiveness. The government sector was a net saver and overall savings were above overall investment. No external shocks were foreseeable and the recent harvests were good.

Despite the undercurrent of suspicion about Caetano's ability to manage his announced gradual transition to more democratic political institutions, the economic circumstances seemed appropriate.
Nevertheless, the reversal of liberalization was very profound.

The second episode of liberalization was initiated by the stabilization program in an unfavorable domestic and foreign economic environment. The accumulated gold reserves were no longer sufficient for access to external financial markets needed to finance external deficits. This time not only the trade deficit was larger but the earnings on tourism and remittances were also smaller.

Adding to that government size and budget deficits were much larger. The economy was over-spending and inflation was rising from a high level. The stabilization program temporarily corrected these imbalances and allowed a liberalization which consisted in the reduction or elimination of several barriers to trade introduced in 1975-76.

The inappropriate circumstances for liberalization did not however impinge on its durability, since, after the partial reversal of 1981-82, there was another LCSP, from which the current liberalization episode has sprung.

The experience of Portugal suggests that the circumstances can be appropriate for liberalization and yet lead to strong reversals, whereas what seem to be less appropriate circumstances may lead to a mild reversal. This is indeed an inference about sustainability as well.

9/ Sustainability of the liberalization policy under other policy measures

The sustainability of trade liberalization policy can be assessed with respect to domestic controls and with respect to stabilization policy (including exchange rate policy, monetary and fiscal policy).

Domestic controls

In the first episode, there was a partial liberalization of several controls on investment licensing and prices, although the later were not sustainable. In an inflationary environment, the increase of these prices contributed to the reversal of 1974. However, foreign currency controls were tightened.

In the second episode, the liberalization of prices and exchange controls were aimed at reducing the effect of measures introduced
in 1974-76. The liberalization of domestic controls were not coordinated with trade policy. In particular, controlled price increases, were made under the pressure of mounting debt by the government agencies which administer the prices of those goods.

Although they were not aimed at supporting trade liberalization, these measures were in the right direction, so that we judge the second episode sustainable under these policy measures.

In sum, due to its gradual nature, the first episode would have been fairly easy to maintain with appropriate macroeconomic policy, even through periods of external shocks. Nevertheless, the role of invisibles, especially remittances, in sustaining a balance of payments surplus was, to some extent, independent of the trade liberalization policy.

Stabilization policy

In the first episode, expansionary credit and the subsequent rise in prices particularly food prices, was the main source of inflation, cutting on competitiveness and increasing trade deficits as mentioned. Even though investment licensing was more liberal, the investment effort meant enlarged government intervention on interest rates, preferential credit and international capital movements. After 1972, price controls were extended. The public sector was a net saver, so there was room for tariff cuts and reduced tax receipts, without strong effects on the economy.

The fixed exchange rate led to real appreciation in an environment of accelerated inflation and deteriorating terms of trade. In 1971, the rise in prices (12 percent) was the highest among OECD countries. A devaluation relative to major Euroepean currencies and lower wages with respect to partners did not avoid a trade-weighted real appreciation. As mentioned, the ensuing trade deficits, would have led to a revision of this policy particularly in 1973. However, even if inappropriate, the exchange rate policy was not an important factor leading to the collapse of the episode.

In the second episode, the stabilization package included policies to reduce aggregate demand: tightening of credit to the private and public sector, introduction of the rediscount policy to control banks' liquidity and increase in interest rates. However, credit to the public sector expanded relative to credit to the private sector and the selectivity of credit made the management of the system quite complex.
Even though fiscal policy was supposed to remain neutral during the stabilization process, it became expansionary and uncontrolable. The borrowing requirement of 13 percent of national income in 1981 reflects an increase of fiscal deficits since 1974, which still goes on even though it was brought under some control.

The exchange rate policy included in the IMF stabilization package was appropriate and accompanied by tight monetary policy so that there was a large nominal and real depreciation. The depreciation cut into quota premiums and allowed the reduction of the import surcharge. Although a sustainable liberalization episode does not imply a devaluation, the real depreciation implied by the LCSP contributed to the temporary success of trade liberalization.

While fiscal policy was relatively neutral in the first episode and monetary policy was accomodating to a fixed exchange rate regime; in the second episode, expansionary fiscal policy implied a stop-and-go monetary and exchange rate policy, contributing to the reversal of trade liberalization.

The lack of sustainability of the second liberalization episode must be attributed to the volatile macroeconomic environment, especially to the growing deficits of the public sector. This underscores the negative effect of a LCSP: once the external stabilization is achieved, the pressure for liberalization subsides, especially when it refers to a check on government spending.

10/ Relationship of a desirable path of trade liberalization to other policies

The success of a trade liberalization episode is less determined by the expected free-trade situation than by accompanying macroeconomic policies. The likelihood of a new episode does however depend on the expectation of a free-trade situation, such as EC membership.

Before 1974, the macroeconomic environment was favorable and, despite conflicting objectives, the acceleration of trade liberalization was possible in 1970. After 1977, the macroeconomic environment was unfavorable and, repeated pronouncements in favor of European integration notwithstanding, trade liberalization was not sustained and instead followed the stop-and-go pattern of macroeconomic stabilization.

Because accompanying macroeconomic policies are so relevant for the
sustainability of liberalization, we comment here on a desirable sequencing of trade and financial liberalization. The issue is important as domestic and external financial liberalization is scheduled in the current liberalization process initiated in 1986 with membership in the European Community.

Past experience on trade liberalization, in the two episodes, showed a need for tighter control on financial markets. It showed also that the authorities did not score high on both fiscal and monetary stabilization policies.

During the first episode, a "financially shallow" strategy prevailed. In an inflationary environment and administratively fixed interest rates, these were lowered to stimulate investment so that there was capital flight. Policies to control outflows of capital and stimulate inflows of investment were implemented. In spite of greater differentiation of operations than in previous periods and a boom in the stock exchange, the banking system increased reserves rapidly above required reserves.

The boom in the stock market and the excess of liquidity in the economy failed to diversify the existing financial groups. Domestic financial liberalization under a balance of payments surplus allowed an increase in consumption and investment. Even though the surplus was quickly reversed after the oil crisis and the revolution, the high absorption continued.

The initial situation of the second episode was much worse. The banking system had been nationalized and inflation was accelerating. The active monetary policy, this time avoiding negative interest rates and establishing tight domestic credit was predicated on the continued repression of the financial markets. Credit to the public sector grew much faster than other credit so that inflation accelerated: the enlarged public sector and mounting government debt contributed to the partial reversal of 1980-82.

Four Portuguese Lessons

Aside from the two liberalization episodes, Portugal's experience with trade liberalization from the Marshall plan to EC membership—what may be called the longest transition—strongly suggests four lessons:

1) Throughout the sample period (1948-86), multilateral
commitments did not prevent the actual path of the sequencing of trade liberalization to diverge from the most desirable path;

(2) During Salazar's authoritarian regime, migrant remittances and an appropriate macroeconomic environment offset government controls and support to import-substitution, allowing a remarkable export performance in an enclave type situation;

(3) Under Caetano, the dismantling of domestic controls in the face of a worsening income distribution made trade liberalization vulnerable to strong, if temporary, reversals; and

(4) After the April revolution, the visibility of policy instruments such as the exchange rate and the interest rate delayed their use in macroeconomic adjustment relative to tariff surcharges or quantitative restrictions.

The fourth lesson is a simple extension of "Cooper's Law", according to which the Minister of Finance who decides a devaluation is likely to loose his job during the following six months, exacerbated by the many years during which the escudo was heralded as being a strong currency. Thus the six provisional governments and the first constitutional government of Mario Soares refused to devalue or raise interest rates, let alone control government spending.

Similarly, the second lessons follows from Le Chatelier's principle, according to which the relaxation of a constraint improves welfare so that openness is greater with factor mobility than without, therefore generating expectations of sustainability over and above the trade agreements.

The first and third lessons, though, are more troublesome since they imply that a defensive - or even a passive - response to increased structural interdependence, especially coming from small countries, may lead quick to reversals.

If the costs of adjustment to the 1970-74 period were negligible, the costs of adjustment to the 1977-85 succession of LCPs and their reversal are still significant today.

This is all the more serious as entry in the EC implies not only more profound changes than EFTA implied in the sixties, but also a greater policy interdependence with the inherent costs of inappropriate policies. As the goal for the internal EC market in 1992 approaches, the specific transition agreed upon with Portugal
may lose policy relevance, except insofar as the ten years justify more development aid from the Community.

It is also serious, because the Spanish costs of adjustment were less and the policy pattern was less erratic in the past and -- in the framework of their joint accession to the EC in 1986 -- Portugal and Spain embarked then on a significant bilateral trade liberalization episode, which also has a bearing on the financial liberalization envisaged in the objective of the internal EC market.

External financial liberalization is envisaged in the EC accession agreement. The order of liberalization is trade liberalization occurring simultaneously with domestic real liberalization and domestic financial preceding external financial liberalization. The gradual nature and the sequencing seems reasonable given the known volatility of financial markets and the gradual nature of the current real liberalization. At least on this matter, the agreement with the EC is flexible enough to allow domestic policy responses to changes in economic conditions.

Indeed, there are no experiences of domestic or external liberalization of the financial markets in Portugal, except for the increased competition in domestic banking brought in 1985 when private banks were allowed some degree of competition with nationalized banks. Since 1986, short term interest rates are no longer administratively fixed, allowing market determination of rates structure and spreads, and increasing the diversity of financial assets available to savers. Similarly, the number of firms able to finance their expansion through the stock exchange increased dramatically in 1987.

These measures were possible because there were increases in income, tax incentives and a general climate of confidence, following the stabilization program of 1983-84 and the recovery in the world economy.

The current liberalization process is likely to be sustainable only in an economy with a smaller public sector, which requires lower government expenditures. Even though some state-owned enterprises are announced to be sold, government expenditures did not stop growing yet. Indeed, one-shot financing of the fiscal deficit through sales of government assets is no guaranty for the sustainability of trade and financial liberalization.

The sequencing also implies a much more complex macroeconomic
management and better coordination with partners. In particular, prices as well as interest rates will increasingly be determined abroad. Monetary policy tied to fiscal and exchange rate policy ought to be positively rather than negatively correlated with EC business cycles. Nevertheless, the possible membership of the escudo to the exchange arrangement of the European Monetary System is inseparable of a credible financial liberalization.

The sequencing of economic policy will thus be less constrained by international trade agreements and more by the implications of the internal EC market, especially with regard to factor mobility. It is hoped that the first and third Portuguese lessons will not be ignored, so that the country can reap the benefits of the longest transition to the EC without further ambiguities and reversals.
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ANNEX ON TRADE AGREEMENTS

Introduction

In this annex, we review the main trade agreements into which Portugal entered from 1948 to 1985, ATA-Tables 1 and 2 summarize the steps of the four most important ones: EFTA in 1959, EC in 1972, Spain in 1979 and EC membership in 1986.

OEEC and EPU

In 1948 Portugal was a founding member of the OEEC and of the EPU.

Within the OEEC, the removal of quantitative restrictions was particularly fast for Portugal. Indeed, in 1954, when in the whole of the OEEC the percentage of sectors not affected by quantitative restrictions was 45%, Portugal already reached 75%.
liberalization was much slower for the United States and Canada.

Membership in EPU alleviated payments difficulties in the process of trade liberalization. Through EPU, where Portugal had a quota of 70 million units of account, it was possible to solve the balance of payments deficits of 1948 and 1949. Soon, benefitting from the effect of the Korean war on the prices of some raw materials, Portugal moved towards a position of surplus over the quota (Cunha, 1965, pp. 47 ss. and Xavier, 1970, p. 82).

During this first phase (1948-1960), there are no indications of departures from the process of trade and payments liberalization granted by OEEC and EPU. Within these institutions, the authorities claimed to be committed to implementing the process. Doubts arise, however, because the average tariff in 1959 was clearly higher than in 1948: the general level of the tariff increased from 9.9 percent in 1984 to 14.2 percent in 1959, and the joint burden with other border taxes increased from 13.4 to 20 percent.

Accession to EFTA

When it became clear, at the end of the fifties, that the continental countries of Western Europe were moving towards some
In 1953, Salazar had expressed the hope that the United Kingdom would not be involved in strong European integration (see Guerra, Freire and Magalhães, 1981). As it became apparent that the UK would be part of one movement of integration, Portugal could not stay outside and risk losing a traditional export market which accounted for more than 12 percent of total merchandise exports.

Thus, when Britain's effort to establish a free trade area covering all the OEEC territory failed because it became clear that France, West Germany, Italy, Belgium, Holland and Luxembourg were decided to form the EC, the alternative to follow would be to form a free trade area with the remaining countries. It would be possible, in this way, to keep a Western European market and have a strong bargaining power relative to the EC.

To follow the same policy as UK seemed a sensible decision also because this country was interested in preserving similar objectives relatively to overseas territories. Indeed, integration within the EC would be difficult to accept by Salazar, since it would lead to some loss of sovereignty in relation to the colonies. This loss of autonomy was rejected on both economic and political grounds.

Under these circumstances, the EFTA solution appeared as the best acceptable solution for the country, securing the

...
special trade regime included in Annex G of the Convention, without having been required to give in exchange special advantages to the other member countries. Moreover, the agreement was never applied to agricultural goods.

As one main feature, this regime consisted in granting a slower liberalization schedule to Portuguese important industrial goods, as can be seen in ATA-Table 4. While for example in 1969, according to the common regime (applicable to most of Portuguese exports) the rates were already 10 percent of the original rates, according to the special regime of the Annex G (applicable to most of Portuguese imports) the rates were still 60 percent of the previous rates; and for the final removal of the import duties Portugal would have twenty years instead of ten.

Moreover, in section 6 of Annex G it was stated that at any time before July 1, 1972, Portugal could increase the import duty on a product or establish a new import duty on a product not produced in significant quantities in the Portuguese territory, provided that this import duty: (i) was necessary to promote the development of a particular line of production; and (ii) was not higher on an ad valorem basis than the normal level of customs duties implied by the most-favored nation clause, applicable to similar products produced in the territory covered by the association (the mainland and the Azores and Madeira). This section of Annex G thus accepted that Portugal could increase protection according to the infant industry argument.
In section 3 of Annex G it was stated that this special regime was not applicable to products also exported by Portugal in a percentage which in the average of the last years had been of 15 percent or over 15 percent of the production made in the territory covered by the association (was also not applicable in a few other exceptional cases).

The share of products covered in the first year by the special regime Annex G can be seen in ATA-Table 5. While 87.3 percent of Portuguese exports to other EFTA countries could immediately benefit from the common regime of the Convention, 65 percent of the imports could benefit from the more protectionist regime of Annex G.

In the following years, the schedule of tariff reductions within EFTA was accelerated relative to the dates agreed in the Stockholm Convention: decisions of the Council, taken between February 16, 1961 and May 16, 1963 involved all of the dates in the common regime. In the special regime Annex G, the reduction to 70 percent was moved from January 1, 1965 to January 1, 1963. In a decision of the Council of December 18, 1969, the final timetable for tariff reductions was redefined. Such reductions were fixed in regular steps, for 1973 (40 percent), for 1975 (30 percent) and for 1977 (20 percent). The end remained, however, at the originally agreed date: December 31, 1979.
Colonial integration

Meanwhile some legal efforts were made to promote the integration of the mainland with the colonies. The move was essentially political motivated, rather than a serious belief in its economic advantages. This form of integration had its parallel in other colonial powers' policy in Europe.

Integrating overseas territories and the metropolis in an economic union had been, since the beginning, one of the objectives of Salazar's "New State". Indeed, the first constitutional document of the regime, enacted in 1931, was the Colonial Act, whose article 34 mentioned the principle of "natural solidarity" between the metropolis and the colonies. This natural solidarity was said to be the foundation of the various economies, and stemmed from the "moral and political links" between the metropolis and the colonies. The Political Constitution of the Portuguese Republic was enacted in 1933 but it was not until 1951, with the approval of Law n. 2048 of June 11, that the philosophy of economic integration with the colonies was fully accepted. Article 34 of the Colonial Act was thus replaced by article 158 of the Constitution, and a paragraph was added which clearly stated the objective of national integration:

"The economic reorganisation of the overseas territories must integrate itself with the general economic organisation of Portugal..."
To reach the aims stated in this article, the free circulation of products within the national territory should be facilitated by appropriate means, including the gradual reduction or elimination of tariff duties. The same principle will apply insofar as possible to the circulation of people and capital assets.

Thus, in the fifties, steps were taken to facilitate trade between the various Portuguese customs territories, so as to move towards a customs union. Art. 9 of Decree-Law n. 41026 of March 9, 1957 established free trade among the different overseas provinces as far as their domestic production was concerned. It was also decided that metropolitan imports from overseas would only pay 30 percent of the minimum tariff and some products—such as tea, cattle, lumber, fruit and fish—were free of duties. Moreover imports from metropolitan Portugal were generally granted a 50 percent rate reduction in the tariff of the overseas provinces.

A more systematic and significant step was taken by Decree-Law n. 44016 of November 8, 1961, which was purposed to abolish all barriers to the free circulation of domestic products within the various territories of the nation. This was to take place before January 1, 1971 but the ten-year period could be extended until twelve, "in case of justified need" (art. 1). As general economic conditions warranted, capital account liberalization was also to be attained (art. 2).
quantitative restrictions, or the introduction of new ones, exceptions were considered in Chapter IV. They were, however, to be justified on grounds of facilitating the adaptation of economic activities to the new conditions of competition or in situations when a particular sector was experiencing difficulties which threatened the economic situation of a region or territory and no other measures could be taken.

This Decree-Law also took measures to promote the elimination of disparities between regional legal and administrative systems, which hindered inter-regional trade (Chapter V), as well as the improvement in transportation (Chapter VI).

Finally, Chapter IX contemplated the liberalization of exchange controls between territories. A regime of free interregional payments was adopted by Decree-Law n. 44703 of November 17, 1961 but it was soon suspended because structural disequilibria prevented its application.

But even from a strictly commercial viewpoint, Portuguese economic integration had much weaker effects than the integration of the metropolitan area with Europe. In the fifties, the share of the overseas territories in metropolitan imports declined while the share for exports increased. In the sixties, however, both shares declined significantly (during all this period, the overseas territories had however important surpluses of the "Escudo Zone", except in 1948-49 and in
sixties was characterized by a substantial increase, specially in exports. In terms of rates of growth, imports from EFTA grew 31 percent between 1959 and 1972 whereas imports from overseas grew 19 percent. Exports towards EFTA grew 65 percent and towards the overseas territories 9 percent. While the EFTA growth rates dwarf all others, specially on the export side, the share of European trade (including EC) rose throughout the period: in the year following the free trade agreement with the EC (1973), it reached 56.6 percent on the import side (it was 56.7 percent in 1954) and 62.4 percent on the export side (up from 40 percent in 1954), while the corresponding figures for the overseas share were 10.1 percent (17 percent in 1954) and 14.8 percent (25 percent in 1954).

Colonial policy was therefore not successful in preventing the rise of the share of European exports by 56 percent, being divided in a decline of the overseas share by 41 percent and a decline of the rest of the world share by 35 percent. Import shares did not change as much, since the European were stable, but there was a decline of the overseas share of 41 percent and a matched increase of the rest of the world share of 27 percent (mainly USA).

Accession to GATT
it became apparent that convenient conditions could not otherwise be obtained for trade relations with the countries of the recently formed EC, which absorbed 42 percent of Portuguese exports. Portugal was accepted in the Fifth Tariff Conference, that became known as the Dillon Round, and, from 1964 to 1967, was involved in the reduction and consolidation of duties achieved within the Kennedy Round. Important benefits could be obtained with these negotiations: already in 1964, the liberalized imports represent 365 millions escudos of imports and obtained tariff reductions on 2 827 million escudos of exports (see ATA-Table 6).

The accession to EFTA and to GATT did not lead during the sixties, to a decrease in the overall level of effective protection during the sixties. Indeed, either as an effect of a political purpose of the authorities to keep the Portuguese economy with higher protection, despite the liberalizing agreements in which the country was engaged, or as an effect of the lobbying of some groups, designed to defend their own interests. There was an increase in effective protection from 24.8 to 27.8 percent, between 1964 and 1970, in spite of a decrease in the overall level of nominal protection, from 19 to 13 percent.

Trade Agreements with the EEC and the ECSC
trade that had begun with EFTA.

Earlier the purpose of following UK had led the Portuguese authorities to apply for membership. This occurred in 1961 and 1967, but at that time, mainly due to the French opposition, the negotiations were not successful.

Only after the Hague Summit in 1969, it became clear that UK (together with Danemark, Ireland and, as expected, Norway) was going to become a member. But, at that time neither Portugal nor the other EFTA countries requested membership. Instead, these countries negotiated a trade agreement, according to article 113 of the Treaty of Rome.

Both agreements, with the EC and the ECSC, established a timetable for tariff reduction and tariff removal, from the beginning of 1973 until 1977 (see ATA-Table 7). Remaining quantitative restrictions were also to be removed.

In the agreement with the EC, additional protocols were signed, establishing special regimes. To favor Portugal, a slower tariff reduction schedule was drawn according to which the final removal of duties on about 50 percent of Portuguese imports from the EC would be set between 1980 and 1985 (see ATA-Table 8). The final removal would be simultaneous to the one of former EFTA member countries, but the reductions already achieved within EFTA could be maintained. Quotas for some products, namely automobiles, were allowed. In the agreement with the ECSC —
In another protocol, protectionist interests of the EC countries were safeguarded through the fixation of quotas for some "sensitive" products, such as textiles and clothing, paper pulp, tomato concentrate and minerals. These products turn out to be among the most important Portuguese exports.

Some departures from the tariff reductions schedules have occurred. Several liberalizing steps were taken ahead of schedule, but they favored Portuguese exports rather than imports.

In the first years of the seventies, some decrease in the overall level of effective protection did already occur, probably as an effect, not so much of the EEC and ECSC agreements (effective since January 1, 1973) but mainly of the previous agreements (EFTA and GATT accessions) and of other factors (namely, the declining incidence of the Portuguese specific tariffs). The average level of nominal protection was lowered from 12.2 percent in 1970 to 4.4 percent in 1974, and the average level of effective protection from 27.8 percent in 1970 to 12.1 percent in 1974.

Further Revisions of the EEC and of the ECSC Agreements
Communities, some steps were given in the movements towards trade liberalization.

The first step was the 1976 revision of the EEC - 1972 agreement. There was then an extension - through a Financial Protocol - to financial cooperation, and also an extension to the protection of Portuguese emigrant workers in the EC countries. The Aditional Protocol, concerned with the trade issues, allowed Portugal to obtain further protection for some industries, through the transfer of some products from list A to list B.

Moreover, the Aditional Protocol admitted, in article 6, that additional import duties could be applied to a list of industries in difficulty at the time. This disposition was therefore called the 'senescent industry clause', as an extension of the 'infant industry argument'.

In the following year, on the 28th March, Portugal presented the formal application for membership to the EC. Since then the implementation of some policies can be already seen as preliminary steps in the process of integration. Such is the case with the Complementary Protocol of 1979 and with the Transition Protocol of 1982. In some cases, quicker liberalization steps were given, specially with the removal of residual restrictions. In other cases, it was felt the need to postpone the removal of existing restrictions, in sectors in which it was felt that the economies were not yet prepared to
Adhesion was signed, in 1985. This is the case, for instance, with the special regime for the automobile industry in favor of Portugal, and the special regime for the textile and clothing sector, in favor of the other EC members.

EFTA - Spain Agreement

Of special importance for Portugal was the trade agreement achieved between EFTA and Spain, on June 26, 1979.

Spain had not been involved in any of the earlier movements of trade liberalization in Europe. Also, no agreements were achieved between Spain and Portugal at the bilateral level. This explains that still at the end of the 70's the general level of nominal protection of Portugal against Spain was 17.1 percent, and of Spain against Portugal of 23.1 percent, leading, of course, to much higher levels of effective protection. On the other hand, different non-tariff instruments of intervention were also used between the two countries. These high levels of trade were of course main reasons to the small share of protection between the two countries; in 1978 Portugal exported to Spain 2.9 percent of her exports and imported from this country 5.8 percent of her imports (being much smaller the role, for Spain, of trade with Portugal).
a special regime was negotiated according to which the steps of liberalization between Portugal and Spain were slower than the steps of liberalization between Spain and the other EFTA countries.

For these other countries, there was an immediate reduction to 40 percent of the level of the previous duties, on almost all products imported from Spain (and smaller or no reductions for the remaining products). It was much smaller the share of products, imported to Spain, on which an immediate reduction to 40 percent was accorded: being higher the share of products on which there was a reduction only to 75 percent.

The reductions accorded to Portuguese imports from Spain and to Spanish imports from Portugal can be seen in ATA-Table 9: the reductions accorded by Portugal were lower than the reductions accorded by the other EFTA countries, and also lower then the reductions accorded by Spain to Portugal. However, this last refference did not avoid the increase in the Portuguese bilateral trade deficit which occurred during the following years (Álvares, 1986, pp. 147-9).
REFERENCES


LIST OF TABLES IN ANNEX ON TRADE AGREEMENTS (ATA)

1.- Import Liberalization announced Schedule With EFTA, EEC and Spain (Tariff rates as percentage of original rates)
2.- Export Liberalization Schedule of the Agreements with EFTA, EEC and Spain (Tariff rates as percentage of original rates)
3.- Liberalization Percentages (1950-1958)
4.- EFTA Tariff Rates (as percentage of original rates)
5.- Regimes in the Stockholm Convention (as percentage of foreign trade in 1960)
6.- Kennedy Round - Volume of Trade Negotiated by Portugal - 1964
7.- Free Trade Agreement with the EEC and the ECSC: Main Regime Both for Imports and for Exports (tariff rates as percentage original rates)
8.- Free Trade Agreement with the EEC and with the ECSC: Special regime for portuguese imports (tariff rates as percentage of original rates)
9.- EFTA - Spain Agreement (tariff rates as percentage of original rates)
Table ATA - 1
Import Liberalization announced Schedule With EFTA, EEC and Spain
(Tariff rates as percentage of original rates)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1973 (April)-</td>
<td>80</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td>-</td>
<td>60</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>-</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1976</td>
<td>30</td>
<td>20</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1977</td>
<td>- 20*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>0</td>
<td>0</td>
<td>40-15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td>Agreed to maintain</td>
<td></td>
<td>50-10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>quotas</td>
<td></td>
<td>60-20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td></td>
<td></td>
<td>60-5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td></td>
<td>Removal of the 20% tariff on &quot;infant&quot; industries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Trace liberalization State Monopolies</td>
</tr>
<tr>
<td>1986</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Adoption of competitive lans and VAT</td>
</tr>
<tr>
<td>1989</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Removal of Import Licensing</td>
</tr>
<tr>
<td>1990</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Removal of Licensing of Foreign Investment</td>
</tr>
<tr>
<td>1994</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Adoption of the CET Labor Mobility</td>
</tr>
</tbody>
</table>

* This was set to zero in the original agreement. In the 1976 revision, tariff elimination was delayed to 1980 and even beyond for some products.

** These are ranges of tariff reduction of the 1979 tariff for each year. Products are subject to different reductions.
Table ATA - 2
Export Liberalization Schedule of
the Agreements with EFTA, EC and Spain
(Tariff rates as percentage of original rates)

<table>
<thead>
<tr>
<th>Years</th>
<th>EFTA - 1959 -</th>
<th>EC - 1972 -</th>
<th>EC - 1978 / 85 -</th>
<th>Spain* - 1979 -</th>
<th>Other Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1972</td>
<td></td>
<td>Quotas set yearly</td>
<td></td>
<td></td>
<td>Interest rate and fiscal incentives</td>
</tr>
<tr>
<td></td>
<td></td>
<td>on &quot;sensitive&quot; products **</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1976 - 1977</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1977 (July)</td>
<td></td>
<td>Removal of &quot;barriers&quot; on <strong>non-sensitive</strong> products</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td></td>
<td></td>
<td></td>
<td>65 - 10</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td></td>
<td></td>
<td></td>
<td>70 - 10</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>Volume growth up</td>
<td></td>
<td>10-15% for quotas on textiles and clothing ***</td>
<td>80 - 10</td>
<td>Removal of interest subsidies and fiscal incentives</td>
</tr>
<tr>
<td>1984</td>
<td>Tariff removal for paper products</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>From 1982</td>
<td>Larger volume growth for quotas on textiles and clothing to 10-15% yearly</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>up to after integration</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Covering tariffs and excise taxes. Ranges of tariff elimination covering different products.
Table ATA – 3
Liberalization Percentages
(1950-1958)

a. Intra-OECE Trade (1949=100)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td>61</td>
<td>84</td>
<td>85</td>
<td>93</td>
<td>93</td>
<td>94</td>
<td>94</td>
<td>94</td>
<td>94</td>
</tr>
<tr>
<td>Total*</td>
<td>67</td>
<td>61</td>
<td>65</td>
<td>77</td>
<td>83</td>
<td>86</td>
<td>89</td>
<td>83</td>
<td>89</td>
</tr>
</tbody>
</table>

b. Trade with U.S. and Canada (1953=100)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td>NA</td>
<td>NA</td>
<td>–</td>
<td>NA</td>
<td>–</td>
<td>53</td>
<td>NA</td>
<td>53</td>
<td>53</td>
</tr>
<tr>
<td>Total OEEC</td>
<td>NA</td>
<td>NA</td>
<td>11**</td>
<td>NA</td>
<td>44</td>
<td>54</td>
<td>NA</td>
<td>64</td>
<td>73**</td>
</tr>
</tbody>
</table>

* Excluding Greece.

** Including autonomous liberalization measures not notified to the OECE.

Source: Van Meerhaeghe (1980).
Table ATA - 4
EFTA Tariff Rates
(as percentage of original rates)

<table>
<thead>
<tr>
<th>Date (January 1st unless otherwise noted)</th>
<th>Common Regime (article 3)</th>
<th>Annex G (paragraph 4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960 (July 1st)</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>1963</td>
<td>70</td>
<td>80</td>
</tr>
<tr>
<td>1964 (July 1st)</td>
<td>60</td>
<td>80</td>
</tr>
<tr>
<td>1965</td>
<td>50</td>
<td>70</td>
</tr>
<tr>
<td>1966</td>
<td>40</td>
<td>70</td>
</tr>
<tr>
<td>1967</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>1968</td>
<td>20</td>
<td>60</td>
</tr>
<tr>
<td>1969</td>
<td>10</td>
<td>60</td>
</tr>
<tr>
<td>1970</td>
<td>0</td>
<td>50</td>
</tr>
<tr>
<td>1980</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Table ATA - 5
Regimes in the Stockholm Convention
(as percentage of foreign trade in 1960)

<table>
<thead>
<tr>
<th></th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common (article 3)</td>
<td>22.8</td>
<td>87.3</td>
</tr>
<tr>
<td>Tax duties</td>
<td>16.7</td>
<td>0</td>
</tr>
<tr>
<td>Annex G</td>
<td>65</td>
<td>0</td>
</tr>
<tr>
<td>Annex D</td>
<td>2.4</td>
<td>12.6</td>
</tr>
<tr>
<td>Annex E</td>
<td>2.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>(billion escudos)</td>
<td>3.2</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Adapted from Correia (1969, p.28).
### Table ATA - 6
Kennedy Round - Volume of trade negotiated by Portugal -1964 -

(million escudos)

<table>
<thead>
<tr>
<th>Concessions</th>
<th>Total</th>
<th>Reduction</th>
<th>Consolidation</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>more than</td>
<td>Free of duties</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>50%</td>
<td></td>
<td>Not free of duties</td>
</tr>
<tr>
<td></td>
<td></td>
<td>less than</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Given by Portugal</td>
<td>367</td>
<td>177</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Given to Portugal</td>
<td>2827</td>
<td>-</td>
<td>320</td>
<td>69</td>
</tr>
</tbody>
</table>

### Table ATA - 7

Free Trade Agreement With the EEC and the ECSC: main regime, both for imports and for exports (Tariff rates as percentage of original rates)

<table>
<thead>
<tr>
<th>Date</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973, April 1st</td>
<td>80</td>
</tr>
<tr>
<td>1974,</td>
<td>60</td>
</tr>
<tr>
<td>1975,</td>
<td>40</td>
</tr>
<tr>
<td>1976,</td>
<td>20</td>
</tr>
<tr>
<td>1977, July, 1st</td>
<td>0</td>
</tr>
</tbody>
</table>
### Table ATA - 8

Free Trade Agreement with the EEC and with the ECSC: Special regime for Portuguese imports (Tariff rates as percentage of original rates)

<table>
<thead>
<tr>
<th>Date</th>
<th>EEC Agreement</th>
<th></th>
<th>ECSC Agreement</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>List A</td>
<td>List B</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>EEC and</td>
<td>UK and</td>
<td>EEC and</td>
<td>UK and</td>
</tr>
<tr>
<td></td>
<td>Ireland</td>
<td>Denmark</td>
<td>Ireland</td>
<td>Denmark</td>
</tr>
<tr>
<td>1973, April 1st*</td>
<td>80</td>
<td>40</td>
<td>80</td>
<td>40</td>
</tr>
<tr>
<td>1974</td>
<td>70</td>
<td>40</td>
<td>70</td>
<td>40</td>
</tr>
<tr>
<td>1975</td>
<td>50</td>
<td>30</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>1976, February, 1st</td>
<td>40</td>
<td>30</td>
<td>50</td>
<td>40</td>
</tr>
<tr>
<td>1977</td>
<td>20</td>
<td>20</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>1980</td>
<td>20</td>
<td>0</td>
<td>20</td>
<td>0</td>
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<tr>
<td>1983</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>1985</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

* January 1st for UK and Denmark
Table ATA - 9
EFTA - Spain Agreement
(Tariff rates as percent of original rates)

Part A
Reductions on Portuguese imports from Spain

<table>
<thead>
<tr>
<th>List</th>
<th>Agreement's date</th>
<th>1 year later</th>
<th>2 years later</th>
<th>3 years later</th>
</tr>
</thead>
<tbody>
<tr>
<td>List A</td>
<td>60</td>
<td>50</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>List B</td>
<td>85</td>
<td>80</td>
<td>75</td>
<td>70</td>
</tr>
<tr>
<td>List C</td>
<td>100</td>
<td>90</td>
<td>80</td>
<td>70</td>
</tr>
<tr>
<td>Other products</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>95</td>
</tr>
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</table>

Part B
Reductions on Spain imports from Portugal

<table>
<thead>
<tr>
<th>Products on which Spain gave to the other EFTA countries a reduction to 40 percent</th>
<th>Agreement's date</th>
<th>1 year later</th>
<th>2 years later</th>
<th>3 years later</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td>30</td>
<td>25</td>
<td>20</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Products on which Spain gave to the other EFTA countries a reduction to 75 percent</th>
<th>Agreement's date</th>
<th>1 year later</th>
<th>2 years later</th>
<th>3 years later</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td>65</td>
<td>60</td>
<td>55</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Products on which Spain gave to the other EFTA countries a reduction to 80 percent</th>
<th>Agreement's date</th>
<th>1 year later</th>
<th>2 years later</th>
<th>3 years later</th>
</tr>
</thead>
<tbody>
<tr>
<td>80</td>
<td>80</td>
<td>80</td>
<td>80</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Products on which Spain gave to the other EFTA countries a reduction to 90 percent</th>
<th>Agreement's date</th>
<th>1 year later</th>
<th>2 years later</th>
<th>3 years later</th>
</tr>
</thead>
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<th>Agreement's date</th>
<th>1 year later</th>
<th>2 years later</th>
<th>3 years later</th>
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