

## **STABILIZATION POLICIES AND DEVELOPMENT — SOME LESSONS FROM THE PORTUGUESE EXPERIENCE (\*)**

*Manuela Silva*

Since 1974, the Portuguese economy has many times been shaken. On occasion this was due to inside shocks, among them the economic consequences of rather important political changes; other times this was determined by the radical changes in external environment, among them the effects of the so called oil crisis of the early 70's and their direct and indirect impacts on national economies. To such dramatic changes, national economic policy had to provide answers which were formulated according to different and sometimes contradictory analyses and based upon even more diverse sets of economic measures.

Perhaps the period of only 7 years is still too short to enable to draw well-grounded general conclusions and, being a participant observer, I may greatly risk making a biased evaluation of the overall situation. However, the accumulated experience is already so vast and its variety is so rich that it will not be a loss of time, I think, to look at it, attentively, in order to learn more about the performance of economic systems and their capacity to adapt themselves to change and to development, through economic policy. Obviously, I am not intending that the Portuguese case may offer the only interesting common ground to investigate different performances of recent economic policy paradigms concerning stabilization and growth. On the contrary, it is surprising how many similarities one may discover among the particular case studies in respect of so many aspects. Yet, it seems to me that the Portuguese case presents such a mosaic of problems in so short a period that it offers stimulating background material to focus the debate on the issue «stabilization policies and development» — the theme chosen for this conference.

My paper aims at establishing a starting point for discussion on the linkages between stabilization policies and development, within the context of a peripheral and not fully industrialised economy.

I anticipate the argument by saying that, in my view, the present controversy on the choice between stabilization and development is a fallacy. Even the idea that stabilization must precede development is not acceptable either. At least, such is the case of Portugal, where major short run

---

(\*) This lecture was delivered at University of Ghent and University of Liege, in April 1982. I am grateful to Dr. Michael G. Fuller who kindly reviewed the English.

disturbances cannot be isolated from their respective structural roots. In other terms, in order to meet the imbalances in the short run functioning of the overall economic system, one has to consider alternatives for corresponding changes in its structural components. Similarly, a consistent medium run strategy and policy towards development cannot ignore the constraints that short run imbalances may, eventually, present to that aim.

It is my conviction that, up to now, there is not enough consensus among economists of different strands of thought concerning the absolute need for the simultaneous management of stabilization strategies and implementation of development policies. Left wing economists tend to underestimate the relevance of financial equilibrium and, consequently, they tend to care less about stabilization policies; on the other side of the spectrum, economists of the right overestimate the financial equilibrium of the overall economy and assume that development will occur spontaneously, through market mechanisms, at a later stage, when imbalances may be overcome.

Section one of this paper argues that the position of left wing economists on this issue is not acceptable. There is empirical evidence that one must not rely on the assumption that what is materially possible is financially feasible. The Portuguese case of 1974-75 is a good example to show the relevance of financial equilibrium problems and how the deterioration of economic functioning mechanisms may lead even to political changes. Allende's Chilean experience had already shown the validity of such an assertion in more dramatic terms.

Section two deals with another situation, where a clear preference is given to stabilization financial policies and where development and structural policies have been marginalised. With the exception of very short political periods, the different governments, in Portugal, since late 1977, have built up their economic policy on stabilization aims. It is not an exaggeration to state that, since the second half of 1977, the main concern of the Portuguese economic authorities has been the external equilibrium. Against such orientation, one may argue as follows:

Firstly, lacking a medium term planned development strategy and underestimating structural changes, the adopted stabilization policies cannot reach their own specific aims, in a consistent way and at length;

Secondly, such policies lead to destructuring effects on the already desintegrated national productive system and originate heavy costs in respect of further development;

Thirdly, they have negative impacts on equity concerning income distribution as well as well being conditions;

Finally, such policies have aggravated, in a structural way, the degree of external dependence of the national economy and helped to re-inforce the call for chronic stop-go policies.

At this conference, I cannot, obviously, deal in depth, with all the aspects above mentioned. But I shall try to develop some of the dimensions of the problem.

### **General background**

Between the second half of the 60's and early 70's, the Portuguese GDP, at market prices, grew at an average annual rate of more than 6 %.

At that time, it was recognised that, compared with other NIC's, Portugal remained far behind their respective economic growth performances, and some voices, at the time, called for the need for still higher rates of growth. Only a few critical economists dared to warn public opinion and the government itself about the main distortions of the productive system and, particularly, they complained of the systematic backwardness of agriculture and the poor living conditions of rural people. Inequalities in income distribution and welfare opportunities were also a motive for criticising the development strategy implemented by the economic authority at the time. Regional disparities were so conspicuous that even those who were close to governmental positions were ready to acknowledge the need for their correction by any means. Other structural and institutional weaknesses like low savings, low investment rates, low productivity and so on, were concealed by the rather impressive economic performance as measured by GDP growth rates.

Among the main hindrances, one has to refer to the extreme low level of wages and the lack of capacity of the overall economy to generate enough employment in order to absorb the manpower surplus in agriculture and other less productive sectors. As is known, during the 60's, Portuguese emigration to Europe reached impressive figures — more than 1 million of persons emigrated to the countries of industrialised Europe.

Certainly, the most positive side of economic performance before 1974 was the quite solid financial position. In fact, the balance of payments till 1974 always presented substantial surpluses, which had enabled the accumulation of considerable gold stock and foreign exchanges reserves at the Central Bank. On the eve of the Revolution, the accumulated foreign exchange reserves at the Central Bank reached the high level of \$1.7 billion and the stock of gold was about 28 millions ounce. The total gold and currency reserves amounted to 6 billion US dollars, at 1973 prices. The external debt, at the time, was irrelevant. The escudo was considered a strong currency.

Similarly, the current budgets of the 60's and early 70's did not experience deficits, although the effort required of public finances by the colonial war lasted more than 12 years, and absorbed, in its late phase, more than 50 % of current public expenditure. It is important to remember that such a strong internal and external financial position was reached at the expense of

a low and very uneven level of income with all its foreseeable consequences on the overall functioning of the economy and on the level of the satisfaction of basic needs.

#### **The revolutionary period (1974-75)**

Owing to revolutionary changes in the regime that took place after April 1974 and owing to the internal consequences of the international economic crisis of the early 70's, major changes occurred in the Portuguese economy, as is revealed by the main macro-economic indicators.

According to the conventional analysis, the main changes may be presented in the following terms:

- Decrease in GDP growth rate, which was negative in 1975/74;
  - Large deceleration of industry sector growth, especially in manufacture and construction; industrial output decrease 10 % in 1975/74;
  - Sharp decrease in investments (20 % in 1975/74);
  - Sharp decrease in exports due to external market losses in the former colonies as well as in the recession plagued OCDE countries; total decrease of exports was about 10 %;
  - Private consumption increase as a main consequence of the high income redistribution in favour of low income groups of population that immediately followed the Revolution;
  - Imports decrease in consequence of lagging manufacture, although at a slower rate than the export trend;
  - Trade deficit rise, which, on the contrary to the past experience, was not fully covered by emigrant transfers;
  - Change of sign in the balance of official payments; with a surplus of 337 million US dollars in 1973, the external payments balance closed, in 1974, with a deficit of 569 million US dollars and exceeded a deficit of 1 billion US dollars, in 1975;
  - Dramatic acceleration in inflation rate, as measured by consumer price index;
  - Employment emerged as a visible phenomenon, as main consequence off the domestic economic activity decrease and emigration fall;
- The financial situation of most enterprises was upset.

Against this picture, the economic authority of the time adopted an important set of short run economic policy measures (law against dismissal, a neutral credit policy and an expansionist fiscal policy). However, the economic authority, at the time, was not able to draw up any overall strategy for medium term development. Political forces were then too much absorbed by immediate efforts to get or to hold political power. The important reserves of

the Central Bank allowed a careless operation of the overall economy. Financial equilibrium was clearly underestimated.

When the left took office in late 1974, institutional reforms got absolute priority, in accordance with the apparent political interests. The hegemonic power, at the beginning of 75, was such as to succeed in bringing about radical institutional reforms such as the land reform in Alentejo (a latifundio region) and full nationalisation of the main sectors of activity, banks and financial groups included.

However, the instability and weakness of the political power, on the one hand, and the increasing problems concerning the current management of national economy, on the other hand, far from contributing to overcoming the understandable difficulties of a transitional period, contributed to worsening them.

It is, in this context, that one may argue that responsible economists at the time (on the political scene as well as within the technostructure) had not enough vision and understanding in respect of the relevance of financial and macro-level equilibrium problems and, clearly, underestimated the urgent need for seeking an economic and financial strategy for the medium term in order to be consistent with their own political aims. Some people will think that such an alternative would not in any case be possible within the context of the concrete situation at the time, characterised by a great political uncertainty. I obviously don't deny the validity of such an argument; however, I am inclined to think that a more accurate view of the way of functioning of a concrete economy in the transition to socialism would have helped to find out more reasonable policies. The same view is expressed, in general, by D. Seers in the preface he wrote to Stephany Griffith-Jones' book on «The role of finance in the transition to socialism» (1). I quote: «A pattern is visible in the life history of socialist regimes: grasping the levers of state power generates euphoria in the leadership. Now at last they can raise wages, subsidize food prices, launch housing schemes, increase social services, build schools and hospitals, etc. There is of course very good justification for such measures. [...] But a terrible price has to be paid. Typically the economic situation deteriorates rapidly, leading eventually to political crisis and often a reversal of social gains.» This is not the moment to enter into details. Yet it is my conviction that in the Portuguese case some alternative economic measures would have contributed to achieving better overall economic and political performances. Among them, I should like to point out the following:

- a more gradualist income distribution policy, within a pre-established time table following production and productivity evolution;
- adequate measures to relate part of the incremental personal incomes to savings;

---

(1) S. Griffith-Jones (1981), *The role of finance in the transition to socialism*, ed. Frances Pinter Ltd. London.

- a better tradeoff between private consumption and public consumption, with preference for the latter;
- idem between individual and collective needs satisfaction;
- high priority for measures to stimulate growth in internal output and productivity, mainly in sectors orientated towards basic needs satisfaction;
- better control of macro-economic equilibrium, through strict financial policy;
- more attention paid to the productive system as such, mainly by providing the right mechanisms for the correct functioning of the new nationalised sector;
- higher sensitivity to market mechanisms, as is appropriate in a mixed economy framework, where the private sector represented, at the peak of the revolutionary process, more than 2/3 of national output;
- tighter control in respect of credit facilities, mainly in respect to borrowing from external sources.

In order to summarise my view of the experience of this short period of two years, I dare say that Portugal missed then a historic opportunity to implement an alternative strategy of development orientated towards basic needs and an introverted outlook, by mobilising internal resources and underutilised domestic capacities.

Why do I speak of a historic opportunity? Because, at the time, there were favourable factors to make viable such an approach:

- a considerable political freedom concerning external relationships (the change of regime had opened up a lot of possibilities in several directions, western democracies and eastern democracies as well as towards the third world);
- internal social support and a favourable attitude of public opinion towards considerable radical changes, mainly those leading to greater equity;
- underutilised productive capacity;
- administrative structures for economic planning and for governmental intervention in important productive and commercial sectors of the national economy;
- last, but not least, the solid position concerning external reserves.

Instead of the positive elements, it was the negative ones that prevailed:

- indetermination of political power and consequently high level of political struggle and underestimation of economic and financial issues;
- inability of economists to understand the economic situation and global functioning of the economy;

- lack of experience and knowledge of the new ruling elite in the economic field when faced with the expertise of those who, remaining in hidden leading positions, were against political changes;
- immature and inconsequent institutional reforms whose impact in the short run meant dismantling the previous economic units.

The military putsch of November 1975 was not only against the increasing political power of the communists, as it is presented often, but also against the apparent economic chaos of the national economy.

#### **The Government of Socialists (1976-1977)**

When the socialists came to power, under the 1st Constitutional Government, in July 1976, the overall economic situation was chaotic from various aspects and visibly in respect of the balance of payments. Since 1974, the balance of official settlements presented high deficits which were met by a decrease in external reserves and by drawing on the credit available from the IMF. But the persistence of a large deficit and the depletion of the foreign exchange reserves led to borrowing more on international financial markets. In August 77, the official external indebtedness of Portugal amounted to \$2.8 billion or, nearly, 17 % of GDP; external debt totalled more than \$4.2 billion.

According to the OECD Report of 1977, «Portugal has been confronted by three major problems throughout the last few years; an adverse trend in employment accompanied by steeply rising unemployment, a very high rate of inflation [ . . . ] and a very large current account deficit». One may say that, in OECD's view, the three devils of neoclassical economic policy concern were present.

At that time, the establishment of democratic institutions seemed to create the right moment to look for strategies for the medium term. In fact, an attempt to look into medium run possibilities was made and a great deal was put into elaborating a development strategy for next four years. In spite of an apparent interest and concern, the socialist political leaders were not able to understand the real scope of such an effort and were not prepared to foresee the value, even in political terms, of an alternative approach to development based on priority for basic needs and employment as well as on an inward and more selfreliant approach. On the contrary, squeezed by on one hand political compromises in order to succeed in institutional reforms and on the other by external payments constraints, the socialist government of 1977 did not pay enough attention to development strategies. In some sectors of government, a great deal was put into pursuing this aim but, lacking political support, the major options for development in the medium term plan presented to Government and receiving even its formal approval were, in practice, no more than a framework for intellectual reasoning and uncommitted discussions, without any real direct impact on economic policy.

On the contrary, economic policy after 1977 became more and more guided by the short run aims and measures and remaining in the hands of the Ministry of Finance and the Central Bank.

#### **Under IMF Guidance**

In 1978, Portugal signed an agreement with the IMF by which the Portuguese economic authorities engaged themselves to devalue the escudo and to follow a recessive policy in order to curb demand, in exchange for getting more credit facilities from the IMF and International Banks to meet external deficits and debt responsibilities (interest and repayments as well that, at the time, had already reached considerable amounts).

The economic measures proposed (or imposed) by the IMF to the Portuguese authorities were no different from those adopted in similar situations in other countries:

- discrete devaluation of the escudo followed by a crawling peg devaluation;
- restriction on internal credit through administrative measures of higher rates of interest and discount as well as ceilings for the concession of credit to the private and public sectors;
- restrictive budgetary measures, through a clear cutoff in public expenditure, mainly on subsidies for basic goods and public enterprises;
- liberalisation of imports.

Like other OECD countries, Portugal left behind national economic policies for development and moved towards short run policies. However, in contrast with the developed countries, the main issue for Portugal is still to achieve a sustainable and coherent development pattern that may enable her population to achieve a decent standard of living through access to enough paid and productive jobs.

Internal resources (natural and human) are far from being fully utilised and, in many sectors, the predominant technology is obsolete and a major factor responsible for low productivity levels and lack of competitiveness in trade.

The consideration of such aspects of the Portuguese economy leads one to think that the great efforts already made towards the re-equilibrium (or better, reduction in deficits) in the balance of external payments are more or less lost, without a certain radical change in economic structure. Recent economic policy has entered into a dangerous process of stop-go which enhances the main causes for imbalances and hinders further development.

Let us take an example concerning the external balance situation. Since 1977, the concern with external deficit became the main issue of the



economic policy debate. A few months ago, a former socialist minister responsible for economic policy during 1978, wrote: «the most relevant constraint that, at macro-economic level, has conditioned Portuguese economic growth in the last few years is that resulting from external disequilibrium. As for many other countries, it will be so in the more or less near future»<sup>(2)</sup>.

The persistence of this view has, in the same way, paralysed those responsible for economic policy in searching for and implementing coherent development strategies. The agreement signed with the IMF in 1978 had precisely as a point of honour to reduce substantially the external deficit, without paying any direct attention to structural imbalances.

At the end of 80 and even before the horizon established by IMF, the Portuguese balance of payments had reached an equilibrium position. Such a fact was hailed by some sectors as a success of the IMF prescription<sup>(3)</sup>. I shan't enter here into details by commenting how such an equilibrium was reached and what to extent such an equilibrium is connected with the policies adopted or if, on the contrary, it was the result of exogeneous causes. The most important point that I would like to stress here is that one must not evaluate the accuracy of a certain policy without analysing the causes of the situation to which such a policy is addressed. If such causes have been unchanged or indeed aggravated as a consequence of the policies adopted, how may one consider positively the result reached? Most probably, one is not solving any problems, but is entering into a process that will need increasing numbers of instruments in the future, without expecting to reach even the same positive results. Such is the case with the Portuguese economy concerning the reduction in external deficit policy. Such a correction, in the short run, cannot overcome, but only, to postpone real difficulties. In fact, the Portuguese external deficit is a consequence of multiple structural factors among which one may call to mind the following: the triple dependence on food, energy and technology; the productive structure being too biased towards a few branches and presenting, in general, comparatively low levels of productivity; the biased trades, in terms of geographical areas and tradable goods; high level of underutilisation of national resources, mainly agricultural capacities.

The international environment and its changes that have occurred since 1973 reinforce these internal causes for external imbalance for the following reasons:

- the comparatively higher price of energy has made internal costs of production much higher and requires urgent and dramatic structural adjustment in the production pattern;

---

(2) Vítor Constâncio, preface to Abel Mateus (1982), *Crescimento Económico e Dívida Externa, o Caso de Portugal*, IED.

(3) H. Schmitt (1981), «Economic Stabilization and growth in Portugal», FMI, *Occasional Paper*, n.º 2.

- the recession in European economies, along with increasing penetration of NIC's in the European market, has made it more difficult to sustain or to improve the Portuguese shares in these markets, to which more than 50 % of Portuguese exports are sent and thus requires trade diversification both in products and geographical areas;
- the increasing internationalisation of capital and its impact on the Portuguese economy makes it more and more difficult to control capital flows and technology dependence and implies big efforts towards achieving some degree of delinking of the national economy from international cyclical fluctuations.

The recent short run policies, far from minimising this situation, have aggravated it. One example may illustrate this point:

The devaluation of the escudo implies the tendency to reinforce an export orientated model of development in so far as it makes possible, in the short run, comparatively higher profits in this sector. Other economic policy measures have been meant to reinforce this trend too. One may think of the incentives to investment granted in order to stimulate the export sector or what happens with relatively higher credit facilities. Between 1977 and 1980 the export growth rate was 13.4 % a year, 8.7 points higher than national economic growth during the same period (4.7 % year). Considering import elasticity in relation to exports and existing differences in the terms of trade, one may conclude that only structural changes can meet the resource gap in the Portuguese economy.

Through this brief analysis, I have come to the conclusion that the stabilisation policies followed since late 1977 under the guidance of the IMF have not reached the success that they aimed at, even in respect of their particular goal concerning the external balance. On the other hand, I would like to stress the negative effect on income distribution of such so called stabilisation measures. This is a topic that, in general, is hidden by the official reports. However, a recent paper shows, clearly, how much the stabilisation policies have operated through real income transferences from labour income, mainly wage shares, to assets and ownership income recipients<sup>(4)</sup>. The abovementioned article by Mateus shows how «in average terms, income transferences from wages towards increased assets and ownership incomes represented in 1977-79 12 % of GNP at factor cost or 22 % of global labour income».

---

<sup>(4)</sup> Augusto Mateus (1981), «Política económica. dinâmica de inflação e repartição do rendimento em Portugal» (1974-1979), in *Estudos de Economia*, vol. 1, n.º 3, Maio-Agosto.

I have had no time, in this presentation, to refer to other dimensions in order to evaluate the stabilisation policies in respect of their own efficiency and their impact on development, in the case of a not fully industrialised country like Portugal. However, let me mention pro memoria, at least, some of the main directions in which look:

- the impact on des-structuring internal productive systems;
- the impact on the existing employment level and employment creation capacity;
- the impact on the extent of the public sector and eventually the risk of its dismantling;
- the impact on overall external dependence as already mentioned above;
- the impact on the national capital accumulation process and its relationship with external sources and consequent increase in external dependence for the future.

Some research is going on about these and other topics, starting from the idea that a close linkage exists between macro financial equilibrium and economic development.

Through a couple of examples, I hope to have shown how stabilisation policies as considered up to now cannot overcome the main problem of a peripheral and not yet developed economy, like the Portuguese, where the main causes for imbalance are due to structural elements and therefore need to be met at that level through adequate development policies.

For those who are familiar with the systemic approach, the above conclusions is by no means a surprise. The systemic nature of a concrete economy leads one to think in terms of link between sub-systems within an overall economic system and to become aware of capture the inner effects of the environmental changes.

For those who are familiar with an economic approach that does not separate political power from economic reasoning, the main statements of this conference are not unforeseen, either. However, there are a lot of questions that call for deeper study.

March 1982.

