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1975 CONSULTATION WITH PORTUGAL

Basic Document for the Consultation
on the Portuguese Import Surcharge

ANNEX I TO THE BASIC DOCUMENT

The Portuguese Economic Situation¹

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I. Recent developments and prospects for 1975

1. The overall picture of the current situation of the Portuguese economy has been determined, in very broad terms, by the cumulative influence of long-standing structural imbalances and by internal and external conjunctural factors which have resulted into a particularly difficult economic situation since the beginning of 1974.

¹Supplied by the Portuguese Authorities.

*English only/anglais seulement.

2. The main problems arising from this situation are:

- (a) Decrease in the growth rate of economic activity in 1974 (the GDP growth rate was about 2.2 per cent¹, as compared to 7.8 per cent in 1973 and 6.2 per cent in 1960-72).
- (b) Substantial increase in the unemployment rate which is estimated at 5.6 per cent of the labour force at the end of 1974, that is about 180,000 persons (in the past such unemployment rates have never been experienced, due to high level of emigration as well as to the presence of a considerable number of soldiers in African colonies).
- (c) Increasing rate of inflation; (the rate of price increase for the whole of 1974 was 25 per cent and this corresponds to almost the double of that for the previous year - 13 per cent).
- (d) High external imbalance which meant an over-all balance-of-payments deficit of 16.5¹ billions of escudos in 1974, that is about 5 per cent of the GNP (this is the first debit balance since 1964²).

3. The complex economic situation which appeared or was aggravated in 1974 and the nature of which we tried to summarize took place in a decisive period for national life. In fact, the replacement of the political system in force until 25 April 1974, led to the beginning of a fundamental change in the Portuguese socio-economic context and this obviously involves a process of readaptation to new institutional realities which have been or will be created.

4. Thus, it is no wonder that, in spite of Government's efforts to put into operation an economic policy that will decisively solve the great economic problems with which the country is faced, the prospects for the current year have to be considered as generally more unfavourable. The growth rate of the GDP is forecast to be negative. In fact, besides the stagnation in the over-all investment in 1974, which is expected to decline this year, there are other factors such as a very modest evolution of exports, "temporary" production discontinuance in many firms (both due to labour conflicts and to the need of reconversion of production) and the stand-by attitude of private entrepreneurs due to the speeding up of domestic political changes and to uncertainties in the international markets.

¹Provisional estimates

²Before 1965 does not exist comparable information.

5. Unemployment has been increasing and it is estimated that there are already more than 200,000 jobless persons.¹ In addition to the low level of production already mentioned, one must bear in mind that there are still difficulties in employing those people who have lost their jobs not only due to dismissals but also due to the unemployment resulting from an unusual inflow of people into the domestic labour market. That inflow is due to the demobilization of soldiers, to the return of settlers from the overseas territories under Portuguese Administration and also to the fact that the high level of emigration has not been maintained because of the persistent international economic crisis and especially the economic recession in Europe.

6. During the first months of the year price rises were high but it is expected that they will not reach last year's rate (25 per cent) not only because of the freeze of house rents but also because of the establishment of fixed prices for most essential foodstuffs in accordance with the Price Programme. Although exact figures cannot be forecast, inflation will still be high this year.

7. In 1974 the rate increase in salaries was about 30 per cent for the private sectors and 39 per cent for civil servants. This evolution was due not only to the implementation of a minimum salary² at national level but also to the results obtained from new collective labour agreements which meant a significant progress for the medium and low groups. However in the current year the minimum salary has already had to be raised to Esc 4,000 (a rise of about 20 per cent) in order to compensate for the deterioration of the purchasing power of the less favoured classes of the working population. Nevertheless since there are still serious conflicts in labour relations and that the classes with the lowest salaries (although higher than the minimum national level) are still fighting to improve their purchasing power, it is expected that the general evolution of salaries will again produce a high growth rate which may reach 20 per cent. This is in spite of the efforts made by the authorities so as to reduce claims as much as possible.

3. As to the balance of payments, especially the current account, the forecasts for 1975, which are mentioned in another document, show a high deficit and therefore in this field also the country will have to face a strong deterioration of the situation as compared with last year.

¹The last figures available - 250,000 persons - correspond to an unemployment rate of 8 per cent.

²The minimum salary of Esc 3,300 set in 1974 covered about 50 per cent of the workers.

9. The complexity of the background to the main economic problems of the country, outlined at the beginning of this report, shows that the efforts towards global action to revive national economic activity can only be made by stages and could lead to positive results in the medium term.

II. General guidelines of the economic policy

10. The political events of 11 March 1975 led to a deep change in the Portuguese socio-economic structure. In fact, a certain number of nationalizations took place immediately and at present cover the following sectors: banks, insurance companies, electricity production and distribution (high tension), oil refining and distribution, metals, cement, cellulose, tobacco, railways, air and sea transport, electricity distribution (low tension) and large road transport companies. Moreover, control measures will be taken, which may include the nationalization of the mining sector, the brewery industry, fertilizers, sodium products and paints, petro-chemical industry, heavy metal-working industry, ship building and pharmaceutical products. In agriculture, irrigated areas of more than 50 ha. will be nationalized and dry areas of more than 500 ha. will be expropriated.

11. As a consequence of the political evolution a great part of the Programme of Economic and Social Policy published at the end of February 1975 should be considered as outdated. In order to solve some priority problems, five emergency programmes have already been published covering employment, prices, agrarian reform, control of basic industrial sectors, transport and communications. These programmes will be included in the Economic Plan for 1976-78, under preparation. The Employment Programme - the first to be published as it relates to the priority problem within the present socio-economic context of the country - includes a number of short-term objectives for better employment of available human resources and covers a certain number of programmes or projects involving the creation of new jobs.

III. Main policies

(a) Production

12. As a consequence of the increase in the incomes of the working classes which did not previously have access to some essential welfare benefits, domestic demand will again tend to expand faster than national supply. In fact, the objectives which, with the implementation of the agrarian reform, should be aimed at by the agricultural sector and which involve a higher capacity in this sector for the

production of essential foodstuffs, both through the expansion of traditional production (meat, milk, rice, wheat, maize, olive oil, fruit and vegetables) and through the launching of new crops (sugar beet, carthame and sunflower, soya bean, cotton, tobacco, etc.) will only have significant effects in the medium term. The action to be taken by the reconversion of the fishing sector so that production targets can be progressively higher will also not have significant effects in the short term. Therefore the country's dependence on imported foodstuffs will still be high this year.

13. The manufacturing sector is no doubt the sector which shows most deeply the effects of the measures of nationalization and control of economic power mentioned above. Although an exact assessment of the State's direct or indirect participation in economy activity is still being carried out, it is believed that it has increased considerably. In addition to industries already nationalized, the nationalization of banks and insurance companies has allowed for the control by the State of a large number of firms in various sectors.

14. The industrial policy to be defined should take into account sectors which are directly or indirectly controlled by the State and also the changes in the prices of capital and labour together with abnormal behaviour in their supply, i.e. surplus of labour and shortage of funds for investment. All this involves a certain delay in investment decision-making by the private enterprise, a transitional situation which will last until the Government's policy is defined for each sector. The announced publication of the Law on Foreign Investment, which will set the conditions for direct and indirect foreign investment, will also be of the highest importance.

(b) Measures aiming essentially at correcting the external imbalances

15. Various measures have been adopted in order to reduce the adverse effects on prices and on the trade balance caused by the inability of domestic production to meet the increasing demand for consumer goods, they are:

- (a) restriction of credit to the commerce of consumer goods, particularly in relation to less essential goods;
- (b) more regulations to restrain hire purchase;
- (c) alterations in the Transaction Tax so as to increase the rates on purchases of less essential goods (this is being prepared);
- (d) the energy restraint plan is being modified so as to achieve greater efficiency. A number of austerity measures to restrain consumption (i.e. in the supply of petrol for private cars, public lighting, expenditure on shows and television programmes, etc.) are under consideration.

16. Moreover reference should be made to some measures which, aimed at cutting the purchasing power of consumers, will reduce the growth of domestic demand:

- (a) increase in the progressive nature of the Complementary Tax as from quite low echelons;
- (b) freezing, until the end of the year, of salaries over Esc 12,000 per month;
- (c) setting up a national maximum salary of Esc 48,900 which corresponds to Esc 35,000 net;
- (d) measures to stimulate private savings and their attraction to banks (the interest rate for deposit accounts was increased in December 1974 and a considerable number of Treasury bonds was issued in the beginning of 1975).

17. Among the measures which have a more direct impact on the current account deficit, special attention is given to those concerning export development, i.e. preferential credit, technical and financial assistance (especially for medium and small firms), expansion of exports to new markets (particularly to socialist countries and to Arab and African countries). As to restrictions on exports of currency, it has been decided to limit to Esc 20,000 per annum the amount each person going abroad is allowed to carry. Moreover, a more efficient control over the flight of capital will be carried out through a more strict supervision of over- and under-invoicing. Finally, measures will be taken in order to stimulate money remittances by emigrants and to channel them towards investment.