The Portuguese economy in the 1980s: structural change and short-term upheavals

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Abstract

The performance of the Portuguese economy during the 1980s was conditioned by two main factors: structural changes imposed by the decision to join the European Economic Community and external shocks and short-term fluctuations in the world economy. The first half of the 1980s Portugal’s economic performance was dominated by short-term macroeconomic problems, while international economic recovery after 1985 created a positive background for Portuguese economic growth and a convergence path that was followed in the EEC/EU context.

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Keywords: Portugal, Economic policy
Plan

1. Introduction

2. Structural aspects: main impacts of Portugal’s accession to the EEC/EU on the Portuguese economy
   2.1. A new economic system
   2.2. The sectoral effects of integration in the EEC/EU

3. Short-term upheavals: from negative to positive external shocks

4. The 1980s: an aggregate assessment

5. Final remarks

References
1. Introduction

This paper seeks to explain the performance of the Portuguese economy during the 1980s, illustrating how it was conditioned by two main factors: structural changes imposed by the decision to join the European Economic Community and short-term fluctuations in the world economy.

The significant structural changes brought about by Portugal’s undertaking to become a full member of the European Communities (EEC) during the first half of the decade, together with the Portuguese preparations to be able to respond to the EEC’s transformation into the Economic Union (EU) during the second half of the decade, constitute one of these determinant factors. The main economic impact of this process was a definite transformation of the Portuguese economic system into a capitalist market economy similar to the system that prevailed in the EEC economies and in the highly developed economies worldwide, and which was increasingly showing its neoliberal character. The role played by the financial transfers from the EEC/EU financial system, which helped to overcome certain features of the country’s economic backwardness and to promote economic and social cohesion among its members, was also a relevant factor in ensuring a relatively high growth rate in Portugal during this period.

On the other hand, during the 1980s, Portugal was particularly sensitive to the short-term impact of international shocks and international economic fluctuations, as was to be expected from a small-sized, increasingly open economy, and as had already occurred before. Internal factors further exacerbated the short-term impact of the international context.

Section 2 deals with the structural changes implemented during the 1980s in order to accomplish the political choices adopted by Portuguese society and by most political parties in the aftermath of the revolutionary period of 1974-1975. The choice to join the EEC and to accompany it along the path towards the formation of the EU was inevitably the central condition for the implementation of such transformations. Section 3 deals with the short-term economic evolution of the 1980s, showing how the economic policy implemented in the first half of the decade and Portugal’s subsequent economic performance were dominated by short-term macroeconomic problems, while international economic recovery after 1985 created a positive background for Portuguese economic growth. Section 4 produces an aggregate evaluation of the Portuguese economy during this decade. The paper ends with some final remarks.

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1 International Workshop Southern European Socialism in the 1980s, SEESOX/LSE @DEAS, Florence (EUI), 2014.
2 Henceforth, for the purposes of convenience, the abbreviated form EEC will be used.
3 In actual fact, financial pre-accession assistance had been transferred to Portugal since 1980.
2. Structural aspects: main impacts of Portugal’s accession to the EEC/EU on the Portuguese economy

The process of joining the EEC and the preparations to adapt to the Communities’ transformation into the EU were decisive factors in creating the basic conditions for achieving political stability and fostering economic growth, as well as for the country’s real convergence to the average standard of living of the EEC/EU (to be dealt with in Section 4).

This process began soon after the First Constitutional Government of the Third Republic, headed by the Socialist Party leader Mário Soares, took office in June 1976 and was never questioned by any of the subsequent prime ministers from either the Socialist Party or the Social Democratic Party, which alternated in power thereafter. The political option of immediately seeking to deepen the country’s relationship with the EEC was a sound one: by September 1976, the 1972 Additional Protocol to the Agreement between Portugal and the EEC had been renegotiated and signed, while, at the same time, the intention was stated to request accession to the EEC. The formal request was presented on 28 March, 1977, and was accepted on 6 June of the same year. The negotiations necessary to complete the accession process were complex, lasting from 1977 to 1985 (Chaves, 2013: 45-170); on 1 January, 1986, Portugal, together with Spain, became a full member of the EEC. To add to the structural fragilities of the Portuguese economy, negotiations took place within a context of resilient short-term macroeconomic disequilbria (to be examined in Section 3) and were conducted along a relatively parallel path to the one followed in the Spanish process of accession (a much more difficult dossier). Consequently, negotiations led to extended periods and derogations in order to accomplish the transposition to Portugal of Community Law, namely in relation to the Common Agricultural Policy (CAP) and to trade policy (the removal of import duties and import quotas). The intention was to reduce the expected negative impacts on fragile, low productivity sectors, above all the agricultural sector. Special programmes to support structural transformations and to modernise agriculture and industry led to transfers of structural funds, mainly from the European Agricultural Guidance and Guarantee Fund (EAGGF), the European Regional Development Fund (ERDF) and the European Social Fund (ESF), amounting to 93% of the total value transferred in the first six years of Portugal’s accession to the European Communities.

5 Portugal had signed an agreement for associate status with the EEC in 1972, establishing that a free trade zone for industrial goods would be implemented in 1985.
6 In fact, in the beginning, Greece’s accession process remained an ongoing affair, as Greece only became a full EEC member in 1981.
The main influential structural changes introduced in the context of Portugal’s accession to the EEC were basically determined by the more or less explicit conditionality inherent in the transposition of Community Law. The progressive dismantling of customs tariffs that still remained in place in 1986 (a process that was finally completed in 1993), the elimination of quantitative import restrictions and import licensing arrangements, the progressive alignment of Portuguese tariffs with those of third countries in the context of the common external tariff (including the preferential agreements and conventions in force) were the most striking aspects. The implementation of comprehensive reforms of the fiscal and financial systems and the creation of an active capital market deserve to be underlined. However, all these aspects were actually part of the fundamental transformation taking place in the Portuguese economic system as a whole.

2.1. A new economic system

In the aftermath of the Revolution of 25 April, 1974, especially during the period between March 1975 and June 1976, there was extensive nationalisation of the basic industrial and transport sectors, parts of the agricultural, fishing and mining sectors, most of the financial (banking and insurance) sector and the two existing investment funds. This process was aimed mostly at large private firms and the holdings of the main Portuguese private economic groups, but it indirectly gave rise to the total or partial nationalisation of many other firms of a relatively small size, since the former either owned or had significant shareholdings in the latter (Nunes et al., 2004). Meanwhile, severe restrictions were imposed on current international transfers. Import quotas and import licensing were introduced, together with exchange rate controls on current international payments and transfers. An administered price policy designed to control the prices of basic goods, namely foodstuffs, ended up affecting many other goods and services besides and thereby indirectly controlling wages. This economic system and its inherent economic policy were obviously incompatible with belonging to a common market, such as the EEC, or to the Single European Market in the near future.

Beginning in July 1977, just a month after the first Socialist-led democratic government took office, successive legislation was enacted that resulted in the establishment of a very different economic system from the one that had been created in the previous two and a half years. Its basic characteristics were implemented during the 1980s, namely a much less interventionist state in terms of regulatory mechanisms and a much smaller public sector7. The first type of legislation sought to establish the limits of the public and private sectors, guaranteeing freedom to private enterprise in an increasing number of industries (Law 46/77, of 8 July 1977; Decree-Law 406/83, of

7 By 1980, a significant part of the Portuguese economy (roughly 23% of gross added value, 19% of employment, and 43% of gross fixed capital formation) was under state control in the form of public enterprises.
19 November 1983; Decree-Law 449/88, of 10 December 1988, and, more recently, Law 88-A/97, of 25 July 1997). Soon after Portugal’s accession to the EEC, this issue no longer amounted to a question of limiting the number of sectors reserved exclusively for public enterprise, but instead became a question of reprivatising the nationalised enterprises (and the land that had been expropriated in the context of the agrarian reform8) in order to complete the transition to Community Law, whose deadline was brought forward to 1993 (instead of 1995), the year when the Economic Union was created. Law 71/88, of 24 May 1988, and Law 84/88, of 20 July 1988, introduced some legal devices that would allow for the creation of mixed firms, albeit in a very limited number of cases, as well as for the sale of public sector firms. However, only with the revision of the constitution through Constitutional Law 1/89, of 8 July 1989, did ‘the reprivatisation of ownership or the right to exploit means of production and other assets nationalised after 25 April 1974’ become legal under the terms of a framework law (Law 11/90, of 5 April 1990) approved by an absolute majority of the members of parliament. According to this law, public enterprises could be transformed into joint-stock companies and could be privatised either through the sale of shares or through capital increases effected by means of a public call for tenders, a public offer for sale, a public subscription, a restricted call for tenders or a direct sale. A framework was established whereby enterprises could be handed to Portuguese or foreign economic groups, in combination with a scheme of popular capitalism. After that, the privatisation process and foreign investments were sustained by responding to market opportunities and international pressure in particular contexts, namely excessive deficits. In some cases, for strategic reasons, golden shares were established, allowing the government to retain some control over the destiny of these enterprises (Nunes et al., 2006). In the context of the country’s accession to the EEC (and later to the European Monetary Union (EMU), the opening of the public sector to private enterprise and the beginning of the privatisation process, the Portuguese banking system underwent significant changes from the middle of the 1980s onwards. Firstly, in order to adapt to Community Law (i.e. legislation on external financial transactions in 1985 (Valério (coord.), 2010: 286), and the new status of the Central Bank in 1990 in the context of the first phase of the implementation of the EMU (idem: 291)); secondly, as a consequence of the reprivatisation of the vast majority of banks after the end of the 1980s, leading to the creation of Portuguese financial groups and allowing for the entry into the market of cross-border financial groups9. Meanwhile, new types of financial intermediary firms were created, (idem: 302).

In the end, a capitalist market economy was created, very much in keeping with the prevailing economic system in the EEC countries, which was considered to be a prior requisite for becoming a

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8 Law 77/77, of 29 September 1977, had already imposed limits on agrarian reform, requiring the evacuation of occupied lands and the end of those economic units that were working on expropriated land, as well as indemnities paid to the previous landowners in order to compensate them for their losses.

9 The reprivatisation of banks was made possible by legislation enacted in 1983 and 1984, which opened up both the banking and insurance sectors (among others) to private enterprise: namely Law 11/83, of 16 August 1983; Decree-Law 406/83, of 19 November 1983; and Decree-Law 51/84, of 11 February 1984.
full member of the Communities and deepening the European process of integration, which would eventually lead to the creation of the EMU.

2.2. The sectoral effects of integration in the EEC/EU

The most apparent effects of accession to a common market are reflected in trade creation and the gains to be expected through trade liberalisation, namely in terms of specialisation, productive structural change, productivity, economic growth and convergence.

In 1985-1992, the average annual growth rate of imports and exports, measured in terms of their volume, amounted to 14.0% and 8.8% respectively, far above the corresponding EEC-12 growth rates, and they attained the highest ratios to GDP at current prices (45% and 37% respectively) to be recorded in the second half of the 20th century in Portugal (Lopes, 1996: 151; Amadeu and Cabral, 2014: 192). Accession to the EEC progressively dismantled the protectionist impediments to trade that were still levied on some commodities entering Portugal from other European economies (Spanish commodities benefited the most); meanwhile, favourable terms of trade and the real appreciation of the escudo, as well as the country’s more expansionist policy, all fed the increasing import levels (see Section 3, below). As far as exports are concerned, the benefits accruing from access to the EEC/EU markets were, once again, significant and offset the real appreciation of the Portuguese currency. Meanwhile, foreign direct investment (FDI) soared from a level below 1% of GDP (averaging $500 million in the first half of the decade) to peak at 4.5% of GDP (around $3,200 million) in 1992. From 1986 to 1992, more than 2/3 of overall FDI reinforced investments in firms that were already operating in Portugal, and around 2/3 to 3/4 was cross-border investment coming from EEC countries (Lopes, 1996: 168-174).

After the 1980s, the geographical structure of trade changed significantly: there was an increase of 12 percentage points in the share of the EEC/EU area in terms of both exports and imports in the 1980s (amounting to 76% of exports and 63% of imports), and, above all, there was a remarkable increase in the Spanish market, which in the 1990s became the most important supplier of commodities to Portugal and the second largest recipient of Portugal’s commodities (Afonso and Aguiar, 2005).
FIGURE 1: Shares of the main destinations for Portuguese exports (1960-2011) (%)

Amador and Cabral (2013: 210)

The period under analysis is far too short for us to be able to capture significant effects of specialisation and inherent changes in the industrial economic structure in the new context of the country’s economic integration into the EEC/EU. In fact, no significant changes in industrial specialisation were to be noted in the years immediately after accession to the EEC.

The different methodologies used to assess these impacts have generally converged to reach the conclusion that there was a reinforcement in the shares of the traditional sectors and specialisation in Portugal until 1992. Portugal’s comparative advantages derived basically from its favourable production costs, based either on low wage levels, particularly in textiles, cloth and footwear, or on access to some raw materials, namely wood (paper pulp), cork products (agglomerates) and copper. So, a rather concentrated industrial sector continued to follow the export structure: the low technology, low added-value industrial sectors continued to increase their comparative advantages in exports (rising from an index of 194 to 220 between 1980 and 1990, while the high technology sectors declined in importance during the same period, falling from an index of 58 to one of 47), and middle-technology industries displayed a mild increase (rising from 37 to 42) (Lopes, 1996: 161). However, metal mechanic manufactures and electrical machinery and equipment increased their share of total exports, a consequence of the increased activity of multinational affiliates in Portugal, especially in terms of assembly lines in the car industry.
In terms of imports, the share of manufactured products increased significantly from 18.4% of GDP (49.9% of total imports) in 1985 to 27.3% (76.3% of total imports) in 1992 (Lopes, 1996: 158). The most relevant among these were capital goods, which are essential for increasing gross investment and fostering productivity gains, since they embody technological progress. As the standard of living was increasing, the share of durable consumer goods increased as well.

Another significant aspect concerns the relevance of intra-EEC trade. As was implied above, during this period Portugal did not experience the effects of integration processes that are normally associated with advanced industrial economies. There was no evidence in Portugal of a clear intensification of intra-sectoral specialisation (while continuing to pursue significant industrial diversification) until the beginning of the 1990s, making it apparent that the Portuguese economy was still gaining in maturity. The increase in the share of intra-sectoral trade only became relevant after the gradual dismantling of the multi-fibre arrangement in the 1990s, which had a huge impact on the clothing industry in Portugal, inducing a deep crisis in the sector in the short run and gradually leading to a fairly successful specialisation in more sophisticated products. Not surprisingly, scale economy gains were not significant in this period either.
A complementary picture of the evolution of the industrial sector may be painted from the differences in relative productivity gains (losses) and their contribution to industrial and overall productivity. A long-term detailed study on this perspective can be found in Aguiar and Martins (2005: 185-226). Unfortunately the periodisation used by the authors is not the most convenient for analysing the period considered here. Nonetheless, it is apparent that the deindustrialisation process in Portugal started in the early 1980s, but that gains in productivity were only reached after the middle of the decade. The main explanations for the relatively high levels of productivity in 1985-1995 (an average growth rate of 3.69%) are to be found in both the more stable and predictable macroeconomic environment (see section 3, below) and the social-economic paradigm (see Section 2.1, above), as well as the effects of the country’s accession to the EEC/EU: expansion of foreign trade, FDI, external public transfers to support private investment and the modernisation of infrastructures, and legislation. However, in 1985-1995, the effect of structural change on productivity gains shows that somehow the intra-sectoral growth effect was offset by both static and dynamic effects, since there was a reallocation of the labour force from industry to the service sector, where productivity gains were lower. In this period, manufacturing was responsible for 79% of the average growth rate of the industrial sector as a whole. A detailed analysis of the different manufacturing industries again underlines the importance until 1992 of the textile and footwear sector for gaining internal productivity in the context of the initial benefits deriving from Portugal’s accession to the EEC/EU.
TABLE 1: Sectoral structural change (gross added value %)

<table>
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<tr>
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<tbody>
<tr>
<td>Primary sector</td>
<td>13.0</td>
<td>10.1</td>
<td>5.7</td>
<td>2.8</td>
</tr>
<tr>
<td>Manufacturing, mining, electricity, gas and water</td>
<td>20.2</td>
<td>27.0</td>
<td>22.1</td>
<td>17.7</td>
</tr>
<tr>
<td>Construction</td>
<td>7.1</td>
<td>5.7</td>
<td>6.4</td>
<td>6.6</td>
</tr>
<tr>
<td>Services</td>
<td>59.7</td>
<td>52.2</td>
<td>65.9</td>
<td>72.9</td>
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<tr>
<td></td>
<td>100.0</td>
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</tr>
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Alexandre and Bação (2013: 100)

The Portuguese agricultural sector (including fishing) was particularly sensitive to the integration process. On the eve of Portugal's accession to the EEC, it was apparent that the country would be unable to compete with its future partners within the new free trade environment. If it had to adapt suddenly to the lower prices prevailing in the EEC, the loss of income in the sector would be very significant, since Portuguese producer prices during 1976-1984 had increased significantly as a consequence of the depreciation of the Portuguese currency. Agricultural issues were the subject of extremely difficult negotiations, and the fact that these negotiations were undertaken jointly with Spain, a much more sensitive dossier, only made matters worse. Portugal and Spain did in fact end up with different clauses in their respective agreements. In broad terms, Portugal benefited from a transition period of 10 years for joining the CAP and a financial contribution from the EAGGF of 700 million ECU during that period. However, according to Mateus (1998: 152) and Marques-Mendes (1994: 21-24), the transfers from the EAGGF to Portugal were insignificant because the CAP favoured crops that were not relevant in the Portuguese context. Estimates produced by the European Commission in 1997 showed that “one of the most negative aspects of Portugal's accession to the EEC/EU was the impact of the CAP” (Mateus 1998:153), a situation that was to worsen in the second half of the transition period, after 1991: this negative impact was equivalent to 13% of the gross added value (GAV) of agriculture in 1989, which was 30% on average during 1991-199411. After 1992, the still prevailing barriers to free trade were abolished, the escudo was overvalued against the ECU (the currency unit in which prices were fixed), and the compensatory aid that was provided led to a decrease in incentives to production. To make matters worse, in 1992, the CAP reform reduced cereal and livestock prices in order to bring them into line with international prices.

10 For more details on this topic see Chaves (2013: 190).
11 During these years Germany, Belgium/Luxembourg, and the UK experienced the largest negative impacts while Greece and Ireland enjoyed the greatest benefits.
The number of farms fell by 1/3 during the 10 years after accession to the “EEC, though their average area increased by some 12%; the average annual decrease in the GAV of the sector in 1980-92 was -1.6% (-1.4% in fishing). The 4% average annual increase in productivity in 1980-1989 basically resulted from a decrease in inputs (an average annual decrease of 3% in employment); however, by the middle of the 1990s, the net added value (NAV) at factor cost per worker was less than 40% of the EU average. In 1993, the agriculture sector had a share of 5% in total GAV (Soares, 2005: 157-183).

3. Short-term upheavals: from negative to positive external shocks

Portugal endured a serious balance of payment crisis at the beginning of the 1980s. This problem was basically the result of a significant deterioration in the terms of trade, largely fuelled by the second oil shock of 1979 and the subsequent international economic recession, rapid increases in external indebtedness and a significant expansion in domestic demand. In view of this unfavourable international context, Portuguese economic policy proved unable to cope with the situation immediately, and the government in power in 1980, led by the Social Democrats (in coalition with the Christian Democrats), acted counterproductively by implementing a counter-cyclical expansionary policy. Domestic demand expanded as the growth in nominal wages accelerated, and the public deficit increased to 12.5% and 8.5% of GDP, in 1981 and 1982 respectively. At the same time, the Portuguese currency was revalued by 6% in February 1980. This exchange rate policy had a mildly positive short-term effect on the inflation rate, but a negative effect on the competitiveness of Portuguese exports. The escudo’s exchange rate against the dollar and a significant increase in international interest rates further exacerbated the sudden increase in the external debt and debt-servicing costs that had taken place between 1979 and 1982. In this latter year, the Portuguese external debt amounted to 252% of the total exports of goods and services, the current account deficit amounted to 13.5% of GDP (Lopes, 1996: 137), and there were also significant foreign exchange losses.

An adjustment programme was introduced by the International Monetary Fund (IMF) in accordance with a stand-by arrangement negotiated under conditionality and implemented from October 1983 to February 1985 by a coalition government led by the Socialist Prime Minister Mário Soares.12 The instruments used were very much in keeping with the IMF’s traditional programme, which basically focused on controlling domestic demand in order to reduce imports and divert production to exports, moderating nominal wage increases, and controlling the public deficit. This was achieved by increasing tax revenue and significantly increasing a large range of subsidised

12 Similar problems had been experienced (and a similar solution endured) in the second half of the 1970s, and, once again, a Socialist government under the leadership of Mário Soares was obliged to face an adjustment process in 1978-1979, again according to a letter of intent negotiated with the IMF (Nunes, 2013).
prices, together with freezing the public sector investment programme. Restrictive monetary policies, which imposed limits on credit expansion and increased interest rates, were also introduced in order to achieve the stabilisation goals. A flexible exchange rate led to an aggressive monthly devaluation rate through a crawling-peg system that increased from 0.75% to 1%, after a previous discrete 12% devaluation, and this was to prove a crucial element in the adjustment programme (Nunes, 2013: 168-175). Moreover, in view of Portugal's forthcoming accession to the EEC, the government had started to promote a series of structural reforms, mainly the ones that were referred to above. According to the letters of intent, these reforms were also supposed to make a decisive contribution towards preventing the recurrence of similar crises, while, at the same time, increasing efficiency in resource allocation and achieving sustained growth.

The outcome of the adjustment programme was quite successful. Its main aim, which was to bring a huge external deficit (13.5% of GDP) under control, was achieved within the space of two years, with a small surplus being reached in 1985 (1.9% of GDP). The costs were relatively high, but did not last too long in the context of a moderate international recovery. In 1983 and 1984, the economic growth rate was negative (-0.2% and -1.8%), although it recovered to 3% in 1985; private consumption, and investment in particular, underwent a significant contraction, as did real wages; unemployment rates remained above 8%; and inflation rose to 24.6%. However, public deficits also remained relatively high (over 8% of GDP).

From 1985 onwards, Portugal benefited from a series of positive short-term shocks (Lopes, 1996: 148-150). The terms of trade benefited from the anti-oil shock in 1985-1986, which almost halved the price of oil (falling from $28 to $15 per barrel), while the dollar was devalued from 2.9 DM to 1.7 DM. This positive effect on prices compensated for the negative impact of the 1973-1974 and 1979 shocks, and, in spite of a relaxation in the control of both domestic demand (which increased at an average annual growth rate of 6.2% between 1985 and 1992) and the exchange rate policy (a decreasing rhythm of the crawling-peg regime until 1989, a real revaluation of the escudo, and a stabilisation of its nominal value against the European currencies in the years to come), the balance of payment remained under control.

Given this sound international and European recovery – in the context of the Portuguese European integration process and the inherent international trade effects – the volume of imports increased at an annual growth rate of 14%, as compared with the 8% rise in the volume of exports, but the gains in the terms of trade meant that the ratio of the (negative) balance of trade to GDP did not worsen from 1984 to 1992. Meanwhile, the reduction in emigrants’ remittances was almost completely offset by the financial transfers from the EEC, which amounted to 3.6% of GDP by 1992. As for the capital balance, it recorded a significant surplus, as foreign direct investment soared, especially from 1989 onwards, when a restrictive monetary policy (high interest rates and exchange

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13 As had happened before and as was expected by the IMF, the Portuguese authorities implemented a prior package of economic and financial measures.
rate stabilisation) was imposed in order to prepare for Portugal’s accession to the EMU, which increased the expected returns within the context of small transaction costs.

4. The 1980s: an aggregate assessment

As far as the aggregate evolution of the Portuguese economy is concerned, two main aspects are worth emphasising during the ‘long’ 1980s (in the context of a larger time span): the clearly marked fluctuations in GDP throughout this decade; and the overall performance and convergence path that was followed in the EEC/EU context.

In section 3 above, we underlined the main short-term reasons for the market variation in GDP growth rates, which was more pronounced in the first half of the decade. The explanation for this situation is to be found in external impacts, namely variations in the terms of trade resulting from (negative and positive) external shocks and European fluctuations, and short-term political choices, namely an anti-cyclical expansionist policy aimed at winning the parliamentary elections in 1980-1982 and a deflationary policy aimed at accomplishing the required targets for joining the EMU after 1990. Meanwhile, the first half of the decade was a period of political instability, while the second period benefited from political stability and the positive effects of accession to the EEC. According to Lopes (1996), the average annual growth rate of GDP in 1980-1984 was 0.4%, while the corresponding value in 1985-1989 was 4.4% (Lopes, 1996: 47-49). The overall value for the decade was 3.3%, as compared with 2.3% for the EU15 (Alexandre and Bação, 2013: 86).

From 1986 to 1992, GDP per capita increased at an average annual growth rate of close on 5%, since when it has followed a path of gradual deceleration (3% in 1994-1999 and almost stagnating in the first decade of the 21st century). While real GDP per capita rose 83% in 1986-2010, half of this gain had already been achieved by 1992. The rate of productivity gains has also fallen gradually, averaging an annual growth rate of 4% during the 1986-1992 period, but falling by a half in 1994-1999 and again in 2000-2010. (Mateus (coord.), 2013: 57). Disposable income and private consumption rose above the GDP per capita growth rate, while the unemployment rate fell from 8.7% to 4.1% and social security transfers and retirement pensions rose significantly.

As far as real convergence to the CEE/EU is concerned, a corresponding path can always be detected. After a relatively stable phase from 1976 to 1985 (despite some short-term fluctuations), during which the Portuguese GDP per capita remained at around 65% of the EU27 average, it reached a value of 79% in 1992. Only in 1995-1999 did Portugal gain just a couple of points more in its path of convergence, having diverged greatly since then14.

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14 The values in Bento (2009) are different, but they tell the same story: in 1976-85, the figure was around 56%, reaching 66% during the convergence period and with the marginal increase from 1995-1999 resulting in a score of 67%.
FIGURE 4: GDP per capita in Portugal and the converging path to EU membership (1986-2010)

Mateus (coord.) (2013: 51)

FIGURE 5: GDP per capita and productivity rates in Portugal: 1986-2010

Mateus (coord.) (2013: 59)
In comparison with the rest of the initial cohesion group, Portugal's performance in terms of GDP per capita was better than Spain's and Greece's, and even better than Ireland's until 1992. However, it has since diverged from this position. One significant fact is that the distance between Portugal and its partners in this group is less pronounced if disposable income (and especially consumption) is taken into account.

FIGURE 6: Convergence perspective: comparison between Portugal and the other original cohesion Countries

The reasons for the relatively good performance of the Portuguese economy in the 1986-1992 period are related to 'proximate' causes and 'ultimate' causes for growth, or, in terms of growth accounting, the input of the physical factors of production and total factor productivity (TFP). Econometric analyses differ in their time spans, methodologies and results, but some general findings seem to be largely consensual.

Physical capital was a relevant aspect. The level of total investment reached 27% of GDP; domestic saving was still significant in this period, as were remittances (19% and 7.8% of GDP respectively), while European funding reached 2.1% of GDP and the share of foreign saving was negative (-1.8% of GDP). There is no denying the low level of human capital and its relatively slow progress, according to both the standard quantitative indicators (i.e. the average number of years of schooling of the population aged 25 and above, the rate of early school leavers, the graduation rate in tertiary, and especially secondary, education) and the qualitative indicators (PISA assessment on the basic combined capabilities of the share of 15-year old pupils) (Mateus (coord.), 2013: 355). However, some growth accounting exercises show the significant impact of human capital in
fostering growth in the last quarter of the 20th century, especially after 1985. According to Mateus (2006: 129), the development of human capital accounted for some 38% of overall growth between 1985 and 2000, a value that was above that of physical capital (35%) and far greater than TFP (22%). As for labour, the average growth rates of employment in the 1980s were too small, approximately 0.4%, to have any significant impact on growth. The relevance of the residual TFP derives mainly from the degree of openness, the macroeconomic stability, and the other institutional aspects that we dealt with above. It is indisputable that during the 1980s, significant improvements were achieved in these fields.

However, in the medium term, these factors were unable to prevent the negative impacts of bad political choices or to overcome certain resilient factors inherent in the Portuguese economy and society, some of which inevitably took some time to be reversed and to produce a positive economic impact. This difficult situation has been apparent whenever the Portuguese economy has had to face international economic slowdowns, crises and depressions. It was particularly evident when Portugal decided to join the EMU and the Euro Zone as a founding member: an inadequate exchange rate was fixed for the conversion of escudos into euros, overvaluing the national currency. In this context, Portugal found itself in a process of “fade out” in relation to its convergence path, and, since the beginning of the 21st century, it has been enduring a situation of almost complete stagnation, consequently diverging from the average standard of living in the EU.

As far as nominal convergence is concerned, the pictures shown below are highly elucidating.

FIGURE 7: Inflation rates (consumer price index), Germany, Greece and Portugal

— Portugal — Greece …… Germany

Simões et al. (2013: 157)
During the first half of the 1980s, macroeconomic disorder and adjustment policies led to fluctuations in inflation rates, interest rates and exchange rates, which remained at comparatively high levels. However, since 1986, a sustained convergence path has been apparent. At first, nominal convergence was the positive outcome of the successful adjustment programme
implemented in 1983-1985, with a positive effect on the terms of trade being achieved in the context of the transformations brought about by Portugal's accession to the EEC and the upturn in European economic growth. Soon, however, the Portuguese commitment to join the EMU, which started in June 1989, when Delors' Plan was discussed in Madrid, forced the Portuguese government to implement economic and monetary policies designed to achieve sustained nominal convergence according to the quantitative rules defined in the protocol to the Maastricht Treaty. This effort reached its peak in 1992, leading to an economic slowdown in the context of the European exchange rate crisis in 1993.

5. Final remarks

After a period of apparent hesitation in the mid-1970s, in the aftermath of a revolutionary period that had overthrown an authoritarian regime and dismantled its colonial power (through a rapid process of decolonisation), Portugal chose to become a democracy, to rely on a capitalist market economy and to reorient its international economic relationship with the EEC in a most assertive way. In the 1980s, Portugal implemented a most significant part of the transformations required in order to accomplish that project. These were to have a far-reaching impact on its economy and society in the long run, even if some of those changes somehow fell short of the expected outcome.

Meanwhile, short term upheavals also played their role. The Portuguese economy in the first half of the 1980s was negatively influenced by external factors, namely the (second) oil shock in 1979 and the high international interest rates being charged within the context of an overvalued dollar. The internal political cycle further exacerbated a (second) acute balance of payment crisis in 1983. A coalition government led by the Socialist Party under Mário Soares implemented an overly successful adjustment programme, designed in conjunction with the IMF, at considerable cost to its political popularity. The Social Democrats, who then remained in power for 10 years, until the mid-1990s, reaped the benefits of that programme. In fact, their political success was also based on the important economic midterm benefits accruing from access to the EEC/EU, especially in 1986-1992, a process that had, once again, started under the leadership of Soares, in 1976. The positive oil shock of 1985-1986, the significant decrease in international interest rates in the context of a significant devaluation of the dollar, and an A-phase of the economic cycle in Europe, also contributed to the second most important period of Portuguese real convergence to the European standards of living and a more sustained nominal convergence.

However, in the long run, Portugal displayed a “fade out” in terms of its economic performance and convergence, showing that the structural changes introduced, which were basically associated with the European integration process, were not enough to guarantee that prosperity would be sustained. Portugal was unable to sustain relatively high levels of productivity; its poor economic policy choices, slow structural change and institutional rigidities were to blame. Its
inability to withstand international competitiveness has basically resulted from a real exchange rate
that has been overvalued since 1992, and in particular since 1999, throughout the process of EMU,
but also from economic structural fragilities. It is therefore not surprising that the Portuguese
economy has been relatively more sensitive, in the European context, whenever a crisis has broken
out (Bento, 2009; Lopes, 2013).
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