

Institutional Infrastructure and Economic Performance in Portugal: 1945-1950s¹

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Introduction

The Portuguese economy has never grown as rapidly as during the postwar period, especially from 1960 to 1973, (see table 1²), and this “Golden Age” of Portuguese growth took place under a dictatorship - Salazar’s regime (1926-74).

Growth accounting exercises made by Neves (1996) and Amaral (1998) (see table II) show that Portuguese postwar growth was mainly a story of physical capital accumulation (although the contribution of the total factor productivity (TFP) increased considerably after mid 1960s). Thus, our analysis is going to focus on to what extent did the autocratic regime provide a favourable institutional environment for investment.

Institutions are normally understood as the *incentive structures* or the *rules of the game* in a society. However, in the present work we will adopt a more strict definition of institutions; we will focus our analysis mainly on those institutions that directly affect investment, namely property rights and enforcement of contracts (often referred to as economic rights). As we will see below, in autocratic regimes, because there is no separation of powers, some restriction of discretionary powers of the dictator is absolutely necessary in order to avoid arbitrariness and to provide secure property and contractual rights.

It should, however, be emphasized that underlying institutions provided by the regime not only promoted capital accumulation in the 50s, as supported pro-market reforms that took place in the 60s, which in turn increased efficiency of capital accumulation and, consequently, TFP.

¹ This paper is based on the author’s MSc.dissertation at the London School of Economics (LSE), *Institutional Aspects of Portuguese Postwar Economic Growth under the Dictatorship*, 2001.

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² Tables are placed at the end.

The paper is organised as follows. Section 2 explores why underlying institutions are crucial for economic growth. Section 3 investigates conditions under which dictatorial regimes can provide sound underlying institutions / economic rights that promote investment. Section 4 attempts to get a measure of institutional quality. To put it differently, it tries to assess to what extent did the regime provide good underlying institutions, i.e. investment promoting institutions. In the end, section 5 presents a conclusion by summarising the main arguments presented.

2. Institutions and Economic Growth

While accumulation of capital, including physical and human capital, and productivity tend to be considered as proximate sources of growth, institutions³, normally understood as the *rules of the game* or the *incentive structures*, tend to be seen as more fundamental determinants of growth.

In general, neoclassical theory focuses on both physical and human capital accumulation and technological development, but ignores the incentive structure embodied in institutions that determine the extent of societal investment in those factors.

Since the institutional framework that exists in a society will shape the set of choices of individuals, it is crucial to have institutions that reinforce incentives for individuals to engage in productive activities and to take opportunities/challenges. Often economic agents are not socially productive because the institutional framework has perverse incentives. When this is the case, individuals will devote resources to income distribution/theft instead of productivity increasing (to take rather than to make, as Olson would put it)⁴.

The problem is that productive activities, such as investment and innovation, require the rules of the game to be predictable, on the one hand, and some degree of cooperation, on

³ According to D. North (1990), institutions can be both formal (legislation, individual contracts, etc..) and informal (norms of behaviour). Informal institutions include rules that have never been consciously designed; they came from culture.

the other. It happens that this cooperation, most of the times, does not emerge automatically from individual rationality. So, institutions are needed to create the conditions necessary for cooperation/exchange to take place. One of the conditions is to reduce uncertainty, due both to incomplete information about the behaviour of the other part and the complexity of the environment, in general. Since there is incomplete information about the behaviour of possible partners in a transaction, agents have to invest resources to guarantee that the other part is not going to violate the agreement; i.e. that it is going to be respected. Thus, in general, transactions require enforcement of contracts, and this is costly most of the times⁵.

There are different ways to assure that contracts are enforced. Both formal and informal institutions can provide that commitment. One way is through the existence of a strong legal system, in which the law not only exists but is also enforced. If there is law but it is not enforceable the commitment is not credible. In the presence of impartial state enforcement, individuals can define a formal contract and easily make it enforceable. In a developed market economy characterised by impersonal complex exchange, traditional decentralised sanction systems based in reputation are not effective mechanisms of enforcing contracts and, consequently, third-party intervention is absolutely indispensable. An external sanction system provided by a strong state with coercive power is absolutely required to enforce specially multiple-party and/or long-term contracts so that complex exchange can take place.

However, in societies where there is a general expectation that others will follow the rules, and will not violate agreements, many times a formal guarantee may not be needed, since the uncertainty is much lower. This is the case of societies that have a stock of social capital⁶, i.e. societies characterised by interpersonal trust and norms of civic cooperation. Trust provides guarantee that the other part will not act opportunistically and release from obligation of defining a contract and make it enforceable. When such social capital exists, the enforcement has a distinct nature it is self-enforcement⁷. When there is no social capital,

⁴ It is important to be aware that institutions are not necessarily efficient. Especially when formal rules are created to serve the interests of those with political power. However, even if they are not efficient, it is crucial that rules of the game are predictable.

⁵ When these costs are too high the transaction may not be worthwhile any more.

⁶ S. Knack and P. Keefer (1997b), "Does social capital have an Economic Payoff? A Cross-Country investigation".

⁷ At the end, social capital reduces transactions costs and makes cooperation/transactions easier.

formal mechanisms can somehow act as a substitute, although informal ones may be more effective and less expensive⁸.

In addition to the ability to enforce contracts in an effective and low cost way, investment decisions are also constrained by the existence of well-defined secure property rights⁹. If the government does not guarantee effective protection of property/investment, and its returns, from theft by others and diversion by itself (direct expropriation of assets or confiscatory tax and regulatory systems, or even more indirect methods of expropriation of capital/property like high inflation, default on public debt or debasing the currency)¹⁰ economic agents will invest less and in an inefficient way, since they will rationally allocate their resources to projects that are more secure of the threat of diversion, namely the ones with little fixed capital and short payback periods. Thus, absence or insecurity of property rights reduces investment and efficiency of investment made and, consequently, the long-term investments specially required to high rates of growth will not take place.

Actually, these two aspects, enforcement of contracts and secure property rights (economic rights), are extremely interlinked. Only the state can effectively guarantee mechanisms to enforce contracts in market developed economies and protect private property against diversion. Nevertheless, this requires the *rule of law* to be well established, which means, as Amaral stated¹¹, (i) that it applies to all, including the state (thus, a strong state with coercive power to enforce the law and independent courts are required); (ii) that the state could not change the law/rules of the game arbitrarily according to its will; the rules of the game have to be predictable. In sum, the economic environment / the rules of the game have to be transparent and rid of arbitrariness.

The rule of law is more easily established in democratic than autocratic regimes, since in the former power is distributed among the judicial, the executive and the legislative, and it is the majority who creates the law, whilst in autocracies all the power tends to be concentrated in the autocrat. The problem with dictatorships is that this power to alter unilaterally the rules

⁸ R. Putnam (1993), *Making Democracy Work: Civic Traditions in Modern Italy*.

⁹ By property rights one means rights of individuals to appropriate their own labour and what they possess (North (1990), *op.cit.*).

¹⁰ Clague *et al.* (1996), "Property and Contract Rights in Autocracies and Democracies".

and enforce them creates scope for diversion and leaves economic agents suspicious; thus, some restriction of (discretionary) powers is absolutely needed to prevent against this diversion. The problem is to make this restriction credible in an autocratic regime where no separation of powers exists¹². Given this, credible commitment to good behaviour by the autocrat is, from my point of view, the central question in an autocratic regime; otherwise there is no way that economic rights / a predictable environment can be assured¹³.

In sum, a predictable environment (where economic rights can be guaranteed) has to be established so that productive/market-oriented activities can take place, and only a non-predatory and strong enough government (but not too much) can effectively assure the rule of law in order to guarantee economic rights effectively.

3. Dictatorships and Economic Rights

The question we should address here is to what extent, and how, can dictatorships provide secure economic rights. The particularity with dictatorial regimes is that there is no separation between legislative and executive power, since both tend to be concentrated on the government. The fact that all the power is concentrated in the autocrat's hands – basically, he is the law – creates more scope for arbitrariness/(public) diversion. Thus, in this context, the behaviour of the autocrat is even more important. Basically, everything depends on whether he has a narrow or an encompassing interest in the society. If the autocrat has a narrow interest in the society, he will seek to improve his position at the expense of the society, i.e. he will be an agent of diversion (for instance, expropriating property directly and/or indirectly, implementing confiscatory tax and regulatory systems and repudiating contracts/debts it has with private agents). In contrast, an autocrat that, although restricting political rights, has a long term perspective and an encompassing interest in the society, i.e. it is interested in the economic development of the country, will seek to provide secure

¹¹ L. Amaral (2001), *op.cit.*, p.11.

¹² According to S. Burki and G. Berry (1998), participation in international organisations is the most effective way to enhance the credibility of government's commitments, since it makes those commitments irrevocable.

¹³ The subject of autocracies will be discussed in section 2.4.

economic rights and implement long-standing policies favourable to productive activities rather than behave in a predatory way.

Thus, a first condition required so that a dictatorial regime can provide secure economic rights is that the autocrat has an encompassing interest in the society (in order not to misuse his discretionary power, i.e. not to be an agent of diversion).

However, from economic agents point of view, is needed certainty/confidence that their economic rights will be permanently respected. So, if this line of reasoning is correct, two additional conditions have to be fulfilled by the dictator. First, any dictator will inevitably have to commit himself to good behaviour. If an autocrat has an encompassing interest in the society but fails to make himself committed to goals of growth, investors may fear a future change in the rules of the game, and will invest less and in an inefficient way. However, in a regime that allows too much discretionary power, just saying that it will not be used, may be not enough. Some restriction of powers are required to guarantee credibility of the autocrat's commitments in the future¹⁴. External commitment by participation in international organisations may be an effective way to enhance the credibility of government's commitments¹⁵, since it "locks the government in" to a package of rules.

In second, it has to be a secure dictatorship/stable regime, since the quality of economic rights depends on the time the dictator has been in power¹⁶. There are two main related reasons for this. The first one is very well explained in Clague *et al.* (1996) and also Olson (2000). Because coup attempts tend, on average, to be higher in the first years of an autocracy¹⁷, the duration of an autocrat's rule is a reasonable approximation of regime stability as well as the expected duration of the regime and the rights it provides. Economic rights are only seen as secure by economic agents when they expect their protection to be guaranteed for a long time in the future (otherwise they do not start investments/projects now). If the regime has secured these rights for a long time, people take them for granted as long as the regime lasts/continues. But this expectation depends on the duration of the

¹⁴ S. Knack and P. Keefer (1995), *op.cit.*

¹⁵ As suggested by S. Burki and G. Perry (1998), *op.cit.*

¹⁶ M. Olson (2000), *op.cit.*; Clague *et al.* (1996), *op.cit.*

¹⁷ Clague *et al.* (1996), *op.cit.*

regime. So, only a longstanding regime (be it an individual autocrat's rule or a democratic system) can provide secure economic rights. In addition to this, I hypothesise that only long-lasting regimes can provide secure economic rights because it takes time to built/protect them credibly. This means that even when all conditions are present, the provision of secure property rights is not a short-term task for a dictatorship.

In sum, in order to provide the economic rights required for productive activities to take place, autocrats not only need to have an encompassing interest in the society, they also have to succeed in committing themselves to good behaviour and be in power for a long period.

It happens that, even when all these conditions are present, dictatorships suffer from an intrinsic time constraint – there will be an end and it may come with a crisis of succession¹⁸. This is why some authors¹⁹ argue that only (long-lasting) democracies can provide secure economic rights in the long run (and sustainable growth); dictatorships can well provide them, but only for the ruling span of the dictator, not across generations as democracies can.

Thus, autocratic regimes seem to have two intrinsic disadvantages in comparison to democratic ones: they assure neither predictable succession of power nor effective checks on power that restrict attempts of predatory behaviour²⁰.

4. Economic Rights in the Portuguese Dictatorship

This section starts by investigating whether the Portuguese regime fulfilled the three conditions required for an autocratic regime to be able to provide secure economic rights: (i) good behaved/non predatory autocrat; (ii) credible commitment to good behaviour (which requires restriction of discretionary powers); and (iii) long time in power/political stability. At the end, evidence/proxies of institutional quality will be presented.

¹⁸ Olson (2000), *op.cit.*, chp.2; Clague *et al.* (1996), *op.cit.*.

¹⁹ Olson (2000), *op.cit.*; Clague *et al.* (1996), *op.cit.*.

²⁰ However, I will try to make the point that these disadvantages were somewhat minimised in the Portuguese case.

4.1. Salazar - a good behaved dictator?

In order to show evidence that Salazar was not a predatory dictator and had an encompassing interest in the society, two main lines of argument are going to be followed. One related to the person of Salazar – aspects of his personal trajectory and how he arrived to power – another based in his governance, first as minister of finance and then as head of the government.

Salazar joined the government as an independent technocrat after being invited more than once to take the ministry of finance. In Portugal, it is consensual that Salazar has never taken any personal advantage of his time in power. Nobody has ever doubted his honesty. No one has ever accused him of corruption. He came from a relatively poor family and did not accumulated wealth during the forty years he remained in power.

Given this, Salazar had an encompassing interest in the society, he was not trying to increase his position at the expense of the society. Salazar's encompassing interest seems to have a patriotic/benevolent foundation because sentences like these were common in his speeches:

“Let us place above every interest the interest of all²¹”

“Everything for the nation; nothing against the nation²²”

As far as Salazar's governance is concerned, *The Times*²³ wrote at the time that “it is impossible to deny that the economic improvement recorded in Portugal since 1928 is not only without parallel anywhere else in the world, but it is also an achievement for which history can show but few precedents”. In fact, Salazar admirably managed to rehabilitate the national finances and stabilise the economy²⁴, enhancing confidence. One year after Salazar

²¹ *Ibid.*, p.107.

²² Salazar quoted in F. Egerton (1943), *op.cit.*, p.175.

²³ Quoted in M. Derrick (1938), *op.cit.*, p.49.

²⁴ He agreed to take the Ministry of Finance only on his own terms: that he would have full control over the expenditure of all government ministries. See Salazar (1939), *op.cit.*, pp. 41-47.

have taken the ministry of finance the budget experienced a 1.5% (of GDP) surplus²⁵. Commitment to long-run budget equilibrium was made a Constitutional principle. Money emission became strictly subject to a rule – it was indexed to the reserves in gold and foreign currency existent at the central bank²⁶. In 1931, the currency was declared convertible and pegged to the gold (it had been declared inconvertible in 1891). However, this return to the gold standard did not last more than a few months because the country had to follow Britain in abandoning it. Despite this, the Portuguese currency (*escudo*) was pegged to the dollar after WWII (until the end of Bretton Woods in 1971)²⁷. Inflation was kept at low levels. Until the mid 1960s inflation in Portugal was lower than the average of other European countries²⁸. During the period 1965-73, it increased at an annual average rate of 5.2%. The external floating debt was completely paid off²⁹. Gold reserves at the central bank reached 870 tons in 1973, which corresponds to one of the highest values in the whole world.

Salazar's success (internationally recognised) in stabilising the economy signalled economic agents he was committed to good behaviour, increasing the credibility of the regime. However, in investigating/checking for (any kind of) public diversion we have to take into account not only the dictator, but also the state he represents. Basically, we have to find evidence related to violations of property, namely direct expropriations (indirect methods of expropriation were absent since there was financial stability), confiscatory taxation, repudiation of contracts by the government and generalised corruption by bureaucrats.

There is no evidence that any enterprise had been expropriated under the dictatorship. At the time, important parts of the economy were in hands of foreigners (specially technologically advanced sectors, such as production and distribution of energy, public transportation and communications, were controlled by foreign investors in regime of concession)³⁰. However, despite Salazar's rhetoric on nationalism, the regime did not nationalise any foreign enterprise, not even when a new law restricting foreign

²⁵ A. Mateus (1998), *op.cit.*, p.43.

²⁶ J. Lopes (1996), *A Economia Portuguesa desde 1960*, p.317; L. Amaral (2001), *op.cit.*, p.28.

²⁷ N. Valerio (1996a, 1996 b, and 1996f), in *Dicionário de História do Estado Novo*; J. Lopes (1996), *op.cit.*, p.317; A. Mateus (1998), *op.cit.*, p.44. See appendix A.

²⁸ J. Lopes (1996), *op.cit.*, p.305.

²⁹ A. Mateus (1998), *op.cit.*, p.44.

³⁰ F. Rosas (2000), *Salazarismo e Fomento Económico (1928-48)*, p.65.

participation/control in some sectors of the Portuguese economy was implemented in 1943 (law of nationalisation of capitals). This law did not apply to existing foreign enterprises³¹. Actually, the regime was extremely aware of the importance of safeguarding private property; so, it is not surprising that expropriations did not occur. The Constitution of 1933, in its article XII stated that "The state recognises the right of ownership, and the powers of using and disposing of property that follow thereafter, as a rational necessity deduced from the nature of man...". Moreover, it is not difficult to find in Salazar's speeches references to the necessity of a strong state to restore order and stability in order to safeguard property, for example:

"For, when the weakness of governments cannot efficiently guarantee the rights of each person, the people take upon themselves individually to defend their lives, their interests, and their property, as best they can, or else they are vanquished, downtrodden, and held in terror by audacious minorities who violate justice without fear of reprisals." (73).

In 1928/29 a fiscal reform that increased receipts was enacted. However, according to Madureira³², employers did not oppose to this reform, which leads him to conclude that there were not considerable increases in taxes paid by enterprises³³. In addition, the small dimension of Portuguese public sector (the smallest in Europe since post WWII until the end of the regime), means that taxation was comparatively low; thus, not diverting resources from economic agents (see Table III).

When the dictatorship was implemented there were already many public services controlled by foreigners in regime of concession³⁴. Not only there is no evidence that the dictatorship had violated any of these contracts, as many of them were renewed (despite public services had been one of the sectors that the law of nationalisation of capitals banned to foreign control)³⁵.

³¹ L. Matos (1973), *Investimentos Estrangeiros em Portugal*, p.94.

³² N. Madureira, (1998), "O Estado, o Patronato e a Indústria Portuguesa (1922-57)", p.781.

³³ Considerable increases in tariffs were one of the main elements of this reform. A. Mateus (1998, p.43) argues that increases in receipts resulted mainly from an enlargement of the tributary base, rather than from a considerable increase in tax rates.

³⁴ F. Rosas (2000), *op.cit.*, pp.61-65.

³⁵ L. Matos (1973), *op.cit.*, p.96.

In 1931 a licensing system was implemented that required prior state authorisation for the establishment or reallocation of industrial plants, or for new investment in machinery and equipment designed to increase industrial activity. It worked as an effective barrier to entry in two ways: (i) by the impediment itself and (ii) by the complexity, bureaucracy and delay of the process. In addition to this, bureaucrats were given too much discretionary power in the process, which gave to it an arbitrary character creating scope for corruption and favouritism. Case studies in Loureiro³⁶ and Brito³⁷ confirm that decisions were made based in relationships of favouritism and influence networks, rather than in formal procedures. However, since this licensing system was largely liberalised during the 1960s (it ended in practise), the scope for corruption must have been considerably reduced in this important sphere of the economy. Nevertheless, in addition to this, Loureiro argues that one cannot talk about the existence of a real bureaucracy at the time, because “it had neither structure, nor organisation, nor even qualification”³⁸. This suggests the existence of bureaucratic obstacles in the use of economic rights.

4.2. Did Salazar credibly commit himself to good behaviour?

As it was argued before, the problem with dictatorships is that the power to alter unilaterally the rules of the game and enforce them creates scope for arbitrariness/diversion and discourages economic activity. The point here is to investigate whether the regime credibly restricted its discretionary powers in order to create a predictable environment where economic rights could be guaranteed/secured.

In 1933, Salazar established a new constitution that sets up the fundamental principles of the new regime that he named *Estado Novo* (New State). Both in the new constitution³⁹ and Salazar’s own words, things like the rule of law, order, and financial stability are clearly defined as the fundamental rules of the game without which the economy could not prosper.

³⁶ J. Loureiro (1991), *Economia e Sociedade – A Indústria no Após-Guerra, Anos 50 e 60*.

³⁷ J. Brito (1989), *A industrialização no Pós-Guerra (1948-65) – O Condicionamento Industrial*.

³⁸ J. Loureiro (1991), *op.cit.*, p.44.

“(…) we belong to the group of countries which possess a written and definite constitution, i.e. a constitution which cannot be changed by ordinary legislative authority, unless the head of the state should delegate to such an authority the powers necessary for its alteration”; “(…) a state that is strong, but moderated by principles of morality, by the rights of the people (…)”; “We have invested public administration with moral principles which will enable it to carry out the law”⁴⁰

“The Portuguese nation is an independent state whose sovereignty is only limited, internally, by morals and the law, and internationally by conventions or treaties freely signed, or by customary law freely accepted.”⁴¹

However, as it was argued before, in an autocratic regime the constitutional way does not really guarantee the irrevocability of the government’s commitments; only some restriction of discretionary powers can guarantee that.

Probably aware of this the regime took a number of measures to reduce his discretionary powers and signal economic agents he was committed to good behaviour. The most important was Portugal’s returning to the gold standard as soon as 1931 and the fact that the *escudo* remained pegged to the dollar after WWII (until the end of Bretton Woods in 1971). Salazar’s success in stabilising the currency, in particular, and achieving general financial stability enhanced the predictability of the business environment (reducing the risk of indirect expropriation) and the credibility of the regime by increasing the confidence.

In the beginning of 1960s economic development became a priority for the regime and a process of relative liberalisation of the economy is implemented. Simultaneously, the country got accession to many international organisations⁴². Portugal joined EFTA (European Free Trade Association) on its creation in 1960 and became a member of the GATT (General Agreement on Tariffs and Trade), World Bank, and the IMF (International Monetary Fund) in the early 1960s. In 1973, after the break-up of EFTA, Portugal concludes a free trade agreement with the EEC (European Economic Community).

EFTA’s membership was particularly important; it meant that Portugal (an autocratic regime) was accepted as a commercial/economic partner by a group of democratic and rich

³⁹ According to L. Amaral (2001, pp. 12-13), contrary to what happened in other authoritarian or fascist regimes of the inter-war period (such as those of Spain, Italy or Germany), the Portuguese dictatorship was the only one that sought to base its action on a new constitution.

⁴⁰ Salazar (1939), *op.cit.*, p.97.

⁴¹ Article 4^o of the 1933 constitution.

countries. This was crucial in increasing the credibility of the regime because it meant a confirmation of its recognition⁴³ and, at the same time, made it irrevocably committed to good behaviour, i.e. market oriented policies, which reduce the scope for arbitrariness by the government.

4.3. Was the regime secure?

The regime faced heavy overt and violent opposition until 1932. Although less serious, this phase can be extended up to 1937 (year that Salazar survived a bomb attack organised by a small group of anarchists)⁴⁴. This represented the last attempt to prevent the installation of the new regime (New State). It should, however, be stressed that this opposition did not come from the population, since that at the beginning the regime faced strong popular support⁴⁵.

In addition to this initial phase, there were two serious attempts to overthrow the regime. The first one took place in the new international context of the postwar period. The victory of democratic regimes in WWII marked the end of totalitarianism, encouraging internal opposition to the regime. However, everything definitely stabilised when Portugal became a founding member of NATO in 1949 and received for the first time American aid under the Marshall Plan. Accession to NATO (and also American aid) meant that the regime was definitely recognised among democratic nations, signalling that it would last. The second occurs when the war begins in Angola in 1961. In this context a (failed) *coup d'état* took place a few weeks after the war had began⁴⁶.

⁴² By that time it was already a member of OECE since 1948.

⁴³ Portugal had already got accession to Nato in 1949.

⁴⁴ A. Madureira (2000), *A Formação Histórica do Salazarismo (1928-32)*, p.19; F. Rosas (1989), *Salazar e salazarismo: Um Caso de Longevidade Política*, pp. 26-31, in A. Silva *et al.* (eds.), *op.cit.*; R. Robinson (1979), *Contemporary Portugal—a History*, pp.32-82.

⁴⁵ Although suspicious of the social consequences of too much economic development, the regime took some measures to reduce extreme poverty in Portugal. The wheat campaign was the most notorious.

⁴⁶ The attempted coup of 13 April was probably the closest Salazar came to being removed from power. The threat came from within the ranks of the armed forces as it was bound to be the case, not from civilian opposition.

From 1961 onwards, the hope of military action had gone, civil opposition was restricted to the elite (because the instruments of control and repression worked relatively well) which was too divided/fragmented. In addition, since the early 1960s economic growth had become quite evident. This context generated a feeling that as long as Salazar remained in power and the opposition was divided/fragmented nothing would happen⁴⁷. Thus, from 1961 onwards, one can talk of a resigned acceptance of the regime.

Salazar left power due to an accident, in 1968, that left him irrecoverably ill; it was not precipitated by military intervention or civil disturbance. In the same month, Marcelo Caetano took the lead (1968-74). Since he was a follower of Salazar, this succession meant a change of men rather than regime.

4.4. Did the dictatorship provide secure economic rights?

Evidence presented so far suggests that (i) Salazar was a good behaved dictator (however, one eventual predatory element may have persisted – bureaucratic obstacles to use of economic rights; (ii) he credibly restricted his discretionary powers; (iii) the regime lasted long enough to provide secure economic rights. Thus, the regime seemed to have fulfilled the three conditions required for an autocratic regime to be able to provide secure economic rights.

As it was pointed at the end of section 3, autocratic regimes tend to have two intrinsic disadvantages in providing economic rights when compared to democratic ones, since they assure neither predictable succession of power nor effective checks on power that restrict attempts of arbitrary behaviour. However, the Portuguese experience shows that autocratic regimes have ways to minimise to some extent these disadvantages. Firstly, there seems to have existed something close to established procedures for succession (within the regime). The constitution of 1933 defined how the powers of the state were distributed among the various organs of sovereignty (in practise all the power was concentrated in the Prime

⁴⁷ R. Robinson (1979), *op.cit.*, p.80-81; F. Rosas (1989), *op.cit.*, pp.23-31.

Minister - Salazar) as well as procedures for succession. The existence of established procedures for succession is confirmed by the fact that when Salazar fell irrecoverably ill in 1968, succession occurred according to established procedures - the President appointed Marcello Caetano - and there was a peaceful transfer of power. Thus, from my point of view, there was an attempt, in the Portuguese case, to somewhat institutionalise the regime⁴⁸. Secondly, we provided evidence (section 4.2) that the regime found ways to credibly restrict its discretionary powers.

So, when pro-market reforms started to be gradually implemented from 1960 on, we are talking about (i) a longstanding regime that seemed to be resignedly accepted (i.e. expected to remain in the future) and with more or less established procedures for succession which means that it was not restricted to one man rule; (ii) a long lasting regime with no register of predatory behaviour and (iii) that, in addition, reinforces its commitment to good behaviour. All these seem to suggest that the regime was in a good position to provide secure economic rights / a predictable economic environment. Thus, the next step is to look for measures/proxies of institutional quality.

Following Clague *et al.* we will use the amount of contract-intensive money (CIM)⁴⁹ as measure of economic rights. According to these authors "the rationale for this measure is that those forms of money, such as currency, that rely least on the fulfilment of contractual obligations by others will be preferred when property and contractual rights are insecure, whereas other forms of money are more advantageous for most proposals in environments with secure contract enforcement and property rights. (...) Thus the poorer contract enforcement and other institutions in a society, the smaller will be the proportion of contract-intensive money individuals will hold."⁵⁰ As the authors themselves admit, this measure does not cover all the various aspects of economic rights. Even though, it can be a good measure for our purpose when complemented with the evidence we have demonstrated so

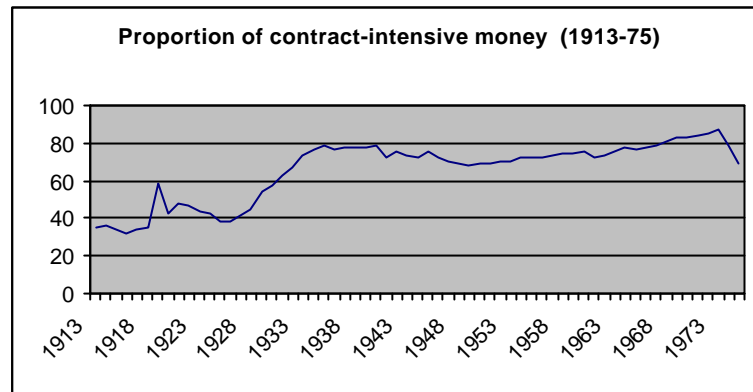
⁴⁸ However, the mere existence of established procedures for succession does not mean that autocratic regimes cannot be overthrown at any time. It may solve the succession problem and extend the regime beyond the ruling span of the original dictator, but does not present any guarantee against its overthrow.

⁴⁹ Defined as $(M2-C)/M2$, where M2 is a broad definition of money and C is currency outside banks. See appendix D.

⁵⁰ Clague *et al.* (1996), *op.cit.*, p.254.

far; namely that (i) there were neither direct nor indirect expropriations of property; (ii) important contracts with foreign agents were respected/not repudiated.

Graph I



Source: own elaboration with data from Mata e Valério (1994).

The proportion of contract-intensive money (CIM) hold in the economy (see Graph I) increased considerably (21.4%) in 1929, the year after Salazar's accession to power, suggesting that economic agents put great credibility in his governance. From 1927, the year before Salazar's accession to power, to 1934, the year after the new Constitution was implemented, CIM increased 86.5%, which suggests a considerable improvement in the quality of property and contractual rights provided. After this sharp increase, the proportion of CIM remained more or less constant (around 70%) until the late 60s. Since the late 1960s (until the end of the regime), the proportion of CIM increased slightly, reaching 87% in 1973 (its maximum)⁵¹.

Moreover, the fact that foreign direct investment (FDI) was so responsive when a more liberal policy was implemented in the early 1960s, provides evidence that property and

⁵¹ This slightly increase in CIM from mid 1960s on seems to support the argument that when policy changed in 1960s, the regime was in a good position to provide secure economic rights. On the other hand it suggests that good institutions and good policy reinforce each other.

contractual rights were relatively secure⁵². Although Portugal adopted one of the most liberal regulatory frameworks in the whole Europe, if there were not relatively secure economic rights, increase in FDI would not have been so pronounced.

However, Gwartney *et al.*⁵³ present of a more direct proxy for the quality of the institutional environment - an index that rates the degree of economic freedom in a country and is available for Portugal in 1970. Seven areas of economic freedom are combined to generate an overall *economic freedom index* (see tables IV and V). The ratings are based on a zero to ten scale, with ten being the most free and zero the least. Two main conclusions can be drawn from the tables. First, according to this index, the regime was achieving a degree of economic freedom in 1970 higher than the democracy (established in 1974) was achieving a decade after it was established. On one hand, this makes us realise that what the regime was achieving in terms of economic rights was not bad at all. On the other, supports the idea that, whatever the regime is, it takes time to provide secure economic rights. So, shifts from autocracies to democracies do not imply necessarily, in the short or medium term, an improvement in the provision of economic rights. Secondly, the high rates achieved in the areas of *monetary policy and price stability* (9.5) and *legal structure and property rights* (8.3) (see table V) confirm the evidence presented here.

On balance, evidence presented in this section suggests that the regime provided relatively secure economic rights; to put it differently, the economic environment was relatively predictable.

5. Conclusion

Evidence presented in section 4 suggests that the regime provided a relatively good institutional infrastructure, in which economic rights were secure. This predictable economic environment gave confidence to investors, fostering investment. Consequently, accumulation

⁵² Entry of long-term capital into the private sector was in the period 1961-67 ten times more than between 1943-60. The volume of FDI doubled between 1963 and 1965, and it continued to grow ever since. N. Poulantzas (1976), *The Crisis of the Dictatorships*; L. Matos (1973), *op.cit.*.

of capital increase at a higher rate. Although, good underlying institutions foster investment, they do not guarantee that productive factors are used/allocated in an efficient way. Enterprises may not face risk of expropriation of any kind, but still do not have incentives to increase productivity. Thus, underlying institutions have to be complemented with market-oriented policies in order to productive factors to be accumulated/used efficiently. Unfortunately, in the 1950s, there were too many (market-contrary) interventionism⁵⁴, distorting the use/allocation of productive factors. In such an environment, even new technology/technical progress embodied in capital might not be used in an efficient manner.

Paradoxically, in the 1950s, we have in Portugal a predictable institutional environment that encourages accumulation of capital (the main source of economic growth during this period) complemented with too many barriers to the full functioning of markets that restrict an efficient accumulation of that capital. That is why, despite the existence of relatively good institutions, the Portuguese economy only experienced fast growth when the openness of the economy, from 1960 onwards, liberalised gradually some of the previous distortions. As a result, not only economic growth accelerated, as it became more based in TFP, suggesting an increase in efficiency of the economy (TFP was responsible for 40% of GDP growth in the period 1965-73).

On the other hand, it should be emphasised the role of the existing institutional setting in supporting the pro-market reforms implemented in the 1960s. There can be no market-based activities when property rights are not secure and mechanisms to enforce contracts are absent. Thus, one can say that market-oriented policies implemented during the 1960s were successful because relatively good underlying institutions were present. There was a relatively fertile soil (institutions) where high yield crops (pro-market policies) could be planted. So, although spectacular economic growth coincides in time with pro-market reforms, its roots have to be found some decades earlier when the task of institutions building was accomplished.

⁵³ Gwartney, Jim and Robert Lawson with Walter Park and Charles Skipton. Economic Freedom of the World: 2001 Annual Report. Vancouver: The Fraser Institute, 2001. Data retrieved from <http://www.freyheworld.com>.

⁵⁴ Trade barriers, industrial conditioning and administrative pricing were the most obvious.

Finally, as far as the regime type is concerned, the Portuguese experience provides evidence that autocratic regimes can, under certain conditions, provide a growth-promoting institutional infrastructure in which property and contractual rights are relatively secure. However, despite the attempt to institutionalise the regime (for instance, by establishing procedures for succession), it did not last much longer after his founder's death. This supports the idea that only (long-lasting) democracies can provide secure economic rights in the long run (and sustainable growth).

Table I
Economic Growth in Portugal

	GDP Growth rate (%)		GDP growth rate (%)
1938-47	1.86	1946-58	4.1196
1947-60	3.64	1959-65	6.2220
1960-73	7.12	1966-73	7.4930
1973-92	2.05	1974-79	3.3922

Source: Maddison (1995)

Source: Neves (1996).

Table II
Growth accounting for phases: Portugal, 1951-73

	1951-73		1951-58		1959-65		1965-73	
	Annual growth rate	Growth rate %	Annual growth rate	Growth rate %	Annual growth rate	Growth rate %	Annual growth rate	Growth rate %
GDP	5.75	100	4.06	100	6.18	100	7.47	100
GI	-0.32	-5.57	-0.34	-8.37	-0.27	-4.37	-0.34	-4.55
Hc	1.47	25.56	1.23	30.30	1.65	26.7	1.61	21.55
Pk	2.83	47.13	2.23	54.93	3.03	49.03	3.2	42.84
Fp	3.98	67.12	3.12	76.86	4.41	71.36	4.47	59.84
TFP	1.77	30.78	0.94	23.15	1.77	28.64	3.00	40.16

Note: GDP – gross domestic product; GI – gross labour; Hc – human capital; Pk – physical capital; Fp – factors of production; TFP – total factor productivity.

Source: Amaral (1998).

Table III
Public expenditure as a percentage of GDP

	1955-57	1967-79
France	33.5	39.4
Germany	30.2	33.1
Italy	28.1	35.5
UK	32.3	38.5
Spain	17.0	21.4
Sweeden	28.5	41.3
Portugal	14.5	18.9

Source: Amaral (2001).

Table IV
Economic freedom index - Portugal

	1970	1975	1980	1985
Summary ratings	5.8	3.3	5.6	5.6
Rank	36 of 57	72 of 83	40 of 107	46 of 115

Table V
Components of economic freedom

	1970	1975
I. Size of Government (a) government consumption (b) transfers and subsidies	7.0	6.7
II. Structure of the Economy and use of markets (a) government enterprises (b) price controls (c) top marginal tax rate (d) conscription	2.1	1.0
III. Monetary policy and price stability (a) annual growth money (b) inflation variability (c) recent inflation rate	9.5	7.4
IV. Freedom to use alternative currencies (a) ownership of foreign currency (b) black market exchange rate	5.0	0.8
V. Legal structure and property rights (a) legal security (b) rule of law	8.3	0.3
VI. International exchange (a) taxes on international trade i. taxes as a percentage of exports and imports ii. mean tariff rate iii. standard deviation of tariff rates (b) size of trade sector	6.9	5.9
VII. Freedom of exchange in financial markets (a) private ownership of banks (b) extension of credit to private sector (c) avoidance of negative interest rates (d) capital transactions with foreigners	3.2	3.3

Source: Gwartney *et al.* (2001).

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