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"PUBLIC EXPENDITURE AND ECONOMIC GROWTH  
WITH SPECIAL REFERENCE TO PORTUGAL".

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degree of

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by

V. X. Pintado, M.A., Economics,  
University of Lisbon.

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## P R E F A C E

The present study is an attempt in applied research to examine the growth of the public sector in a developing economy. All the analysis, from the collection of the original data and its treatment, has been directed towards the determination of the factors which contributed more significantly to that growth, and to establishing its relations with the historical (economic, political and social) events in a particular country: Portugal.

In the end, an interpretative scheme had to be evolved to explain the phenomenon observed. However, apart from the relations which emerged, and the value of the explanations advanced, there is a service for which we believe we can lay claim: that of having taken the pains of collecting and grouping the thousands of items of the Portuguese government accounts since the beginning of the century in categories suitable for the analysis of the economist; and this did not represent the minor effort in our task.

Such a work had not been undertaken before, and no similar study, even of a smaller coverage, or for a shorter period of time, existed. We hope it will contribute to throw some light into the process of the transformation of the Portuguese economy during the last six decades.

In presenting the data for the period after 1930, it has been possible to find in an almost adequate form, a breakdown of the expenditures of the central government into economic and functional categories, in "Estatísticas Financeiras" - a publication of the National Institute of Statistics. For the period up to 1930, we had no other solution but to go through the two annual volumes of the original accounts of the state, which in their old form, and in the expression of the legislator who reformed them, "cost one thousand escudos, weight 12kg., have two thousand pages, and nobody reads them". In addition to that, many data on

expenditures which, by every meaningful criterion or definition of the public sector belonged to that sector, but due to administrative or some other reason had been excluded from the formal structure of the "unitary" budget and remained scattered through a series of publications and reports (or not published at all), had to be collected separately or obtained from the archives and through kind co-operation of the bodies concerned. Now they are, at least, put together and systematically classified. If the interpretations can be challenged, we hope that the result of this effort of classification will remain, inviting new explanations and further research. The first step has been done.

This work would not have been possible without the help, guidance and co-operation of some people and institutions. For them I truly feel a great debt.

I am indebted, first of all, to Professor Alan T. Peacock, who first suggested the exploration of the subject and gave incentive and advice, and whose encouragement and criticism have been invaluable throughout all the stages of the work. I also profited extremely from the comments and suggestions of Mr. Douglas Dosser, who accompanied the preparation of the manuscript along its different phases and read it more than once, indicating weak points, suggesting developments, and pointing out some slips. The discussions with Mr. Jindrich Veverka and his experience in the field, proved also very helpful in the practical work of allocating the different items of expenditure through the various economic and functional categories, as well as in ensuring comparability of data with the studies being undertaken as part of the project on "Comparative Fiscal Systems".<sup>1</sup>

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1. A project being conducted by Professor Alan T. Peacock of the University of Edinburgh, and Mr. Jack Wiseman of the London School of Economics and Social Science, under the auspices of the Ford Foundation.

I am indebted to other members and friends of the Department of Political Economy of the University of Edinburgh, as well, who read the manuscript and made suggestions which greatly contributed towards improving its form, and to the members of the Political Economy Seminar of the University of Edinburgh whose friendly criticism helped a good deal the revision of my ideas on many points.

None of them, of course, is to be held responsible for what I have written, and for the faults that still remain. Without their help there should be still more.

I also wish to express my appreciation for the facilities made available by some institutions, and without which this work would not have been possible. The Calouste Gulbenkian Foundation and the Portuguese Instituto de Alta Cultura, with their grants, permitted me to concentrate my whole attention during two complete years on this analysis. For their generous and disinterested help I am particularly thankful.

Finally, various public bodies and government departments and their staffs, contributed to render easier the task of assembling the data needed. It is difficult to name all of them here, but the General Direction of Public Accounts, the Administrations of the Harbours of Lisbon and Oporto, the Post Office, the Commissariat for Unemployment, the Board of Export Promotion, and the "Fundos" of Social Assistance and of Supply, deserve a special mention for their willingness in assisting a transient student in the midst of their daily tasks.

The staff of the University Library of Edinburgh also was very helpful and co-operative.

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## I N T R O D U C T I O N

### 1. The Study of the Growth of the Public Sector and the Analysis of Economic Growth.

(A) Almost every writer who has dealt with the growing influence of the state in economic life and the concomitant widening of the frontiers of the public sector which has taken place in the last fifty years, acknowledges that this extraordinary broadening of the sphere of the public economy represents one of the biggest changes, if not the most impressive change, which has occurred in the structure of the mixed economies of the Western world<sup>1</sup> since the turn of the century.<sup>2</sup>

The acknowledgment of the importance of this development, and of the relevance of the study of the growth and changes experienced by the public sector in a developing economy has focused the attention of economists on this phenomenon, and created a good deal of interest on the problems of the public sector and of its growth.

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1. By the structure of the economy we mean the complex of elements and relations such as the institutional framework, the share of the different sectors and branches of industry in the national product, the technical coefficients of production, the capital-output ratios, etc., which are fairly stable for short periods (i.e. one year or so). In contrast to other elements of the system, such as the rate of interest and the ratio of gold and foreign reserves to imports, they do characterise the type of economy rather than reflect mere "conjunctural" aspects.
  2. William Ashworth, for instance, dealing with the problem in his "A Short History of the International Economy, 1850-1950", London, Longmans Green and Company, 1959, says that "The change which took place between 1875 and 1950 in the relation between government and economic life is probably the most fundamental of all changes in social organisation in the period". (p.162); and U. K. Hicks emphasises that in the seventy-two years which go from 1880 to 1952 there had been striking changes, but "In few fields, however, have the changes been more fundamental than in that of public finance". (In: British Public Finances, 1880-1952, Oxford University Press, 1954, p.1)

(B) The theme has such importance in the understanding of the process of change of the so-called "market economies", that it can well be placed among the major problems of analysis which fall within the field of the student in public finance.

The institutional and functional transformation which accompanies the growth of an economy, cannot be properly understood without analysing the nature of the forces which determine the alteration of the public economy within the national economy, and of the changes brought about by this process in the structure of the public sector. Hence the interest of the investigations relating to the structure and the size of the public sector for the analysis of economic growth. This, indeed, places the study of the relationship between the growth of the public sector and the development of the economy among the basic problems that call for the attention of the economist.

(C) The theme of the enlargement of state action, expressed by its more obvious manifestation - the increasing share of public outlays in national expenditure - in the presence of phenomena such as urbanisation, industrialization, and the growing complexity of the social organization, has received a good deal of attention from economists since 1893, when Adolph Wagner formulated his well-known "law" of growth of public expenditures.

Since then, however, the problem has grown in importance and acuteness. Not only has the impact of public action upon the economy broadened considerably, but also the interest which has developed around the theme of economic growth has conferred on this impact considerable significance. The analysis of economic growth has been closely concerned with institutional problems, and recent discussion of theories of economic development has just emphasized the importance

of a detailed study of the past behaviour of the aggregates which determine the pattern of growth.<sup>1</sup>

At the same time that a study of the public sector's growth in more rigorous terms was required, the improvement of the tools of macro-economic analysis, which took place after the Second World War, and especially the flowering of national income accounts and analysis, gave the economist the means to carry this study considerably further. In particular, the estimates of the national product over long periods of time (50 years or more), undertaken in some countries, enabled the economist to go far back in the analysis of the phenomenon, permitting him to draw a more precise relationship between its manifestations and the growth of the economy.

2. The Analysis of the Growth of the Public Sector and the New Insight of Public Finance.

(A) All these factors have contributed to some extent to the renewal of interest in recent years among the students of public finance in the basic problem of the determination of the wants to satisfy through the mechanism of the budget. But while classical analysis looked upon this problem mainly from a normative or

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1. See: A. T. Peacock and J. Wiseman, Economic Development and the Growth of the Public Sector: The British Case, 1890-1955. (mimeographed). In a similar sense Domar points out: "Whether a satisfactory theory of growth in the broad sense will ever be developed, I do not know. It certainly cannot be created from models only. It requires a mass of empirical work". (Essays in the Theory of Economic Growth, New York, Oxford Economic Press, 1957, p. 12). Although Domar is very critical of "blind extrapolations of past events" and the "abuse of historical parallels", he considers the work of the statistician the other source of material in addition to that of the model-builder or the theorist - which makes possible the work of the "sage" in analysing economic growth. Our task here is mainly that of supplying some of this statistical material.

prescriptive point of view, in which the welfare school insisted; modern analysis tries to judge state action according to more objective criteria. Not speaking of some attempts to define an optimum level of state activity, deduced from some debatable average or typical cases, the study of the size and pattern of public expenditure in relation to the particular context of economic and social structures in which they are observed, helps the determination of the needs which really tend to be satisfied by the state in given economic, social and political conditions.

Instead of value judgements concerning the scope and limits of state action, and of attempts to discover "laws" of universal validity, the analysis has been directed towards the search of the functions that the state tends to fulfil in certain historical conditions. This seems to be a valuable way of tackling the problem of the functions of the state from a scientific point of view, and is probably the most suitable way of dealing with the problem of the size and the structure of the public sector for the purposes of the analysis of economic growth.

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1. To be fair, we have to acknowledge that the latest attempts to establish a "theory of optimal public expenditure" on the basis of modern welfare economics tried to extricate themselves from the sinking sands of value judgements taking as given a social welfare function embodying the problem scientifically intractable of ethical preferences or that of interpersonal comparisons of utility. See: Paul A. Samuelson, "The Pure Theory of Public Expenditures", Review of Economics and Statistics, Vol. XXXVI, No. 4, November 1954, pp. 387-9; "A Diagrammatic Exposition of a Theory of Public Expenditure", same Review, Vol. XXXVII, No. 4, November 1955, pp. 350-6; "Aspects of Public Expenditure Theories", same Review, Vol. XL, No. 4, November 1958, pp. 332-8; Julius Margolis, "A Comment on the Pure Theory of Public Expenditure", same Review, Vol. XXXVII, No. 4, November 1955, pp. 347-356; and Robert H. Stroz, "Two Propositions Related to Public Goods", same Review, Vol. XL, No. 4, November 1958, pp. 329-31.

(B) But there is still another relevant change in the emphasis of the analysis of the activity of the state to be noted in this context: Namely the change from the short-term to more long-run considerations. In effect, the analysis of the impact of the state economic transactions upon the economy, partly diverted the economists' attention from the short-run problems, on which it had been concentrated after the great Depression and the appearance of the General Theory of Keynes, for a more long-term insight. The action of the state tended to be judged, not only by its effects on the conjuncture, but also by its incidence upon the rate of growth of the economy.

This new development which appears to be gaining ground, will probably contribute to a more suitable integration of the analysis of the short-run effects of public income and outlays, on income, employment and prices, in the long-term perspective of the result of budgetary policy on the economy. If so, it is to be hoped that a more satisfactory inclusion of the public sector in the models of economic growth will be obtained.<sup>1</sup>

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1. The attempts made up to now for introducing the state into the models of economic development have proved rather awkward. (On that point see, A. T. Peacock - "The Public Sector and the Theory of Economic Growth", in Scottish Journal of Political Economy, February 1959, pp. 1 - 12.)

The most reasonable explanation for this fact is probably the innate difficulty of treatment of public revenues and expenditures in such models, but it is also due to the very fact that the theory of fiscal policy formed the main centre of interest in the analysis of the transactions of public authorities for the last twenty years, and that this was confined almost exclusively to the search for the short-run effects of taxes, expenditures and public debt, upon income, employment and prices, with an almost complete disregard for their impact on the rate and pattern of growth of the economy. And this arose principally because the analysis of the economic effects of state budgetary operations developed basically as a response to the problems raised by the Great Depression of 1930s., and the stimulus given by Keynesian theory to the study of the cycle. To that, one has to add the poor results of the efforts of the theory of public finance in finding a solution for the problem of maximizing social activity and in integrating it in a global analysis of the economic effects of taxation, borrowing and outlays. (continued)

(C) For all that, however, a better knowledge is necessary of the manner by which the public sector reacts and fits into the phenomenon of the growth of the economy; not only of the forms by which the state can accelerate the pace of the growth of the economy, but also of the way in which it adjusts its own pattern to the process of transformation inherent to that growth. This is a kind of knowledge that cannot be obtained, but by historical and statistical search of the factors that determine the growth of public sector and of the changes experienced by its structure.

We say historical research, because the growth of the public sector is essentially connected to the social setting and the particular conditions of time and place; and we say statistical, because what is required for the purpose of a convenient understanding of the phenomenon, is not so much an enumeration of the causes which contributed to produce it, but a search of the impact of everyone of those causes or factors, and of the relationship between them and the relevant historical events. And for that, statistical analysis (because some kind of measurement is needed), supplemented by an economic interpretation, is necessary.

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1. (continued)

(For this argument vide: P. J. Strayer - "An Appraisal of Current Fiscal Theory" in American Economic Review, Papers and Proceedings, 1952 pp. 132 and seg.) The public sector has shown itself to be as Domar points out - the most troublesome element in the analytical models of economic growth (see: Essays in the Theory of Economic Growth, op. cit. p.20), causing the majority of these models to be constructed almost exclusively in terms of individual decisions. See: R. F. Harrod, "An Essay in Dynamic Theory", in Economic Journal, March 1959, pp. 14-33; and Towards a Dynamic Economics (London, MacMillan and Co., 1948); E. D. Domar, "Capital Expansion, Rate of Growth and Employment", Econometrica, April 1956, pp. 137-147; and "Expansion and Employment", American Economic Review, March 1947, pp. 34-35; R. Eisner - "Underemployment, Equilibrium and Rates of Growth", American Economic Review, March 1952, pp. 43-58; H. Pilvin, "A Geometric Analysis of Recent Growth Models", American Economic Review, September 1952, pp. 594-599. We do not pretend to suggest that studies like ours can contribute to a better treatment of the state in such models, but we think they can help a better understanding of the true process of economic growth and change.

3. Need for Further Research into the Field of the Growth of the Public Sector.

(a) In these means of combining quantitative research with economic analysis, a wide investigation on the size, the time-pattern of growth, and the changes in the structure of public sector along the time, has been undertaken on behalf of the National Bureau of Economic Research in recent years.<sup>1</sup>

The results of these investigations, and the attempts made by them to check certain hypothesis regarding the growth of the public sector in the present century, together with the analysis of some other economists working individually,<sup>2</sup> projected some light upon the nature and the aspects under which the phenomenon appears. However, the test of these hypothesis in different economic conditions, and the degree in which the factors represented as determining that growth were operating in various economic and social settings, require a wider range of investigations.

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1. As part of this study, the N.B.E.R. has already published the following analysis: Solomon Fabricant, The Trend in Government Activity in the United States since 1900, New York, N.B.E.R., 1952; M. Slade Kendrick - A Century and a Half of Federal Expenditures, Occasional Paper 48 (Revised), New York, 1955; Moses Abramovitz and Vera F. Eliasberg - The Growth of Public Employment in Great Britain, Princeton University Press, 1957, and another has been undertaken: Alan T. Peacock and J. Wiseman - The Growth of Public Expenditure in the United Kingdom, 1890-1955 (N.B.E.R., 1958, mimeographed).
  2. See, namely: U. K. Hicks - British Public Finance - Their Structure and Development, 1880-1952, London 1954, and R. A. Musgrave and J. M. Culbertson, The Growth of Public Expenditures in the United States, 1890-1948, National Tax Journal, June 1958.

Unfortunately, although the various aspects and manifestations of the phenomenon of the growth of the public sector could be systematically examined for some industrial countries, very little is known in relation to countries which are now starting their own industrialization.<sup>1</sup> Many questions may be asked about them on this point. Does public expenditure in those countries follow a similar path of growth to those of industrial countries in their process of development, or can we speak of a "demonstration effect" concerning public expenditures? Is the actual composition (economic as well as functional) of State expenditures in countries on the way to development, similar to that of industrial countries when they were in a corresponding phase of development? (If there is some sense in which one can speak of corresponding phases of development in different epochs). In other words: in what degree does the temporal-pattern of public expenditure of the present underdeveloped countries, and in countries in an intermediate phase of development, approach the observed historical evolution of the same expenditures in industrial countries?

(b) This is a question to which only a series of empirical (historical) investigation can give an answer. Only the study of the phenomenon, through its particular manifestations in countries of different structure and levels of economic development can help to provide an answer.

The discovery of the factors which determine the **size** and pattern of public expenditure and the way in which they work in different historical situations, as

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1. In actual fact, the only study which is known concerning the growth and changes in the composition of public expenditures for a long period of time in a country with a low degree of industrialization, is that of Ernest F. Patterson, "The Extent and Pattern of the Expenditures of the Argentine National Government", Public Finance, Vol. XI, XI year, (1956), pp. 36-54.

well as, of their relationship with the phenomenon of economic growth, is not a type of analysis which can be developed abstractly, departing from sociological premises, or proceeding by generalization of the results of observations in a particular country or group of countries. It does not seem indeed, as Wagner's law might lead one to think, that conclusions drawn from the behaviour of public expenditure observed through different phases of growth in a modern industrial country can be extended without further analysis to countries which are now at different and lower levels of development.

Comparative analysis of the size of the public sector in relation to the level of economic development, even in very general terms, and for relatively short periods, can hardly be said to reveal an identity of response of the public sector to the structural changes implicit in the process of growth of an economy. On the other hand, they suggest the existence of important relations between the development of the economy and the broadening of the sphere of state action.<sup>1</sup>

Some relation seems to exist, but a relation that is neither simple nor uniform.<sup>2</sup>

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1. See, for instance: Harry T. Oshima, "Share of Government in Gross National Product for Various Countries", American Economic Review, Vol. XLVII, No. 3, June 1957, pp. 381-390 and Alison M. Martin and W. A. Lewis, "Patterns of Public Revenue and Expenditure", in The Manchester School of Economic and Social Studies, Vol. XXIV, No. 3, September, 1956, pp. 203-244.
  2. On this subject, see the comparison made by Moses Abramovitz and Vera Eliasberg between public employment in Great Britain and in the United States for the period of 1900-1950 in The Growth of Public Employment in Great Britain, already quoted, Chapter VII.

The conditions in which the public economy has to operate have changed greatly during recent decades, and it is a widely accepted fact that the lines on which the economic growth of industrial countries developed through the XVIII<sup>th</sup> and XIX<sup>th</sup> centuries was very different from the patterns of growth of the non-industrial countries of our time.<sup>1</sup> A series of economic and non-economic factors which were unknown, or had little importance in the first decades of this century and in preceding periods, are now acting with extraordinary vigour upon public expenditures in most countries. How did these factors work under different economic, social and ideological conditions?

4. The Aim of the Study.

(a) The purpose of this work is to throw light on this point by means of an analysis of the growth of public expenditures in Portugal since the beginning of the century, and the study of the changes occurring in its economic and functional composition throughout this period.

Such a study, relating to a European country with a basically agricultural economic structure, which is now embarking upon a process of industrialization, is perhaps, capable of clarifying some points left in abeyance by the analysis which has been undertaken hitherto. The fact that Portugal did not participate in World War II, and only partially bore the charge of maintaining its forces during World War I (where it played a not very active part), should greatly reduce the effect of wars on its public expenditures.

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1. For that reason, the historical study of the conditions in which economic development of industrial countries took place contributes to the understanding of the nature of the phenomenon of the growth, but it helps only in a very limited extent to find the way in which actual underdeveloped countries can promote their own development. In a similar manner, there is nothing to ensure that the factors which worked upon the size and pattern of public expenditures in the past are operating in the same way on those of the actual underdeveloped countries. In consequence, a special study of their case is needed for drawing conclusions about them.

It is to be expected that the effect of wars - which has been presented as one of the most decisive factors of the growth of public expenditures<sup>1</sup> in modern times, be less perceptible in countries like Portugal, which did not find itself involved in the struggle, and only partially felt its effects.

While it is certain that no country could avoid feeling the impact, direct or indirect, of a war of the dimensions and the length of the Second World War, its incidence upon public expenditures must be very different in countries which had to bear the expenses of joining battle, and of proceeding at the end to the reconstruction of their domestic economies, from those which only felt its effects through the changes produced by it in the world economy.

(b) But even in another aspect, the Portuguese case seems capable of providing some interesting elements in the interpretation of the growth of public expenditures and of the causes which, in the long-run, operate in this growth: that of the influence of political factors and of the prevailing social philosophy.

After 1910 (the year in which the Republican regime was established) Portugal knew two completely different periods regarding political conditions. The first, which went up to 1926, was a period of complete governmental instability, with an attempt to adapt the country to the new republican institutions, and in which Parliament exercised a considerable influence in the shaping of the budgetary policy. The second, which is still in force, has been one of exceptional stability, with a wide concentration of power in the hands of the Executive (particularly in budgetary matters), the Finance Minister having an almost complete control on the expenditures of all ministries.

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1. See: A. T. Peacock and J. Wiseman, The Growth of Public Expenditures in the United Kingdom 1890-1955, op. cit.

In that period, not only was parliamentary initiative concerning expenditures completely abolished, but the financial system remained practically unchanged.

A comparison of the behaviour of public expenditures in these two periods will probably provide some evidence regarding the influence of political factors upon the growth of the public sector.

(c) In the course of this second period, Portugal prepared and carried out its first development plan and outlined the second.

The analysis of the expenditures of the Government during the period of execution of the first, and the forecasts regarding the second, will allow us to appreciate the incidence of development expenditure, and of the idea of accelerating the pace of growth of the economy, on the public outlays.

Finally, it is worth mentioning yet another factor. This is one peculiar to Portugal (at least after the war) and greatly influenced the development of the public sector in the last quarter of the century. It is the adoption by the Portuguese State of the particular type of political and social organization called "corporative".

Apart from the short and only incipient institution of "corporations" known by France during the Vichy regime, which were set up at Maréchal Petain's instigation, the only realization of the "corporative" idea on a national scale known in modern times were the Italian, with the special colour which it received from its association with the Fascism, and the Portuguese, now on the way of being completed.

This particular form of organization, which aims to provide, not only a different solution from that offered by the negotiation between pressure groups

with clashing interests, to the problem of the relations between employees and entrepreneurs, but to create a whole different set of relations between the various groups of interests in the nation, and between those and the State, has deep implications for the structure of the public sector. It affects, not only to a considerable extent the distribution between the State and that other taxing power which is the Corporative Organization, of the resources diverted from the sphere of individual decision, but it also modifies the structure of the mechanism of regulation of the economy. In reality, it transfers from the domain of private decision to a particular sphere of decision - collective and semi-public - the resolution of many a problem which in the majority of the economies are solved either in a strictly private way, or by public decisions.

The transfer of control from the private sector to the decision of the Organization of an amount of funds which almost offsets that of the revenue of the central Government, cannot fail to have important affects on the economy, as well as upon the development of the public sector, restricting its expansion and, eventually, altering its shape, given the fact that certain functions that in other countries are fulfilled by the State are in Portugal carried out by the "Organizaçã~o Corporativa".

This phenomenon has not yet received, either in Portugal or in other countries, an adequate treatment, and the few studies devoted in Italy to the so-called "corporative finance"<sup>1</sup> neglected almost completely its economic aspects which are the most important in our case.

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1. From which the most representative are those of Professor Emanuele Morselli on the Italian "parafiscalità" referred to in the Conclusions.

CHAPTER I.

EXPLANATIONS OF THE GROWTH OF THE PUBLIC SECTOR

In this chapter we intend to examine the possible causes of the growth of the public sector on the basis of previous studies undertaken in this field. It aims to prepare the ground for the explanation of the growth and pattern of the Portuguese public expenditure in the last sixty years. It will provide hypotheses to be checked in the Portuguese case and it will certainly help to pose the meaningful questions which are raised by this problem of growth.

In this study it seems to be useful to separate, as far as possible, three distinct, though interrelated, aspects of the problem:

- (a) that of the absolute growth of public expenditures when an economy develops;
- (b) that of the relative growth, i.e., the relation between the rate of growth of public expenditures and the rate of the growth of the National Product;
- (c) that of the time-pattern of the growth.

This we shall try to do throughout our study.

1. Is the Growth of Public Expenditure a Concomitant of Economic Growth?

(a) The first attempts to explain the growth of public expenditures in a systematic way, involving a dynamic version of the process of determination of State activity were, as is well known, those of Adolf Wagner and Henry C. Adams.

They are summarised in their laws of "increasing State activities among progressive

peoples" and of "public expenditures for progressive peoples".<sup>1</sup>

Wagner's formulation of the trend towards an increasing State activity in a developing economy, is the best known of the two. His empirical verification that the sphere of State action widened when an economy developed, and the explanation given by him for this phenomenon, formed the most outstanding attempt of classical thought to grasp the essence of the way in which the State acts, and it embodied a model of the evolutionary process of the public sector. But, however great the merits of Wagner's law might be, in directing the attention of economists towards a phenomenon which obtained its full significance only some decades later, and in the surprising realisation of his predictions, the validity of his often quoted "law" remains circumscribed by the scope of the observations which provided its basis, and by his political and philosophical assumptions.<sup>2</sup>

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1. Adolf Wagner, Grundlegung der Politischen Oekonomie, Leipzig, Erster Theil, Zweiter Halband, 1893, p. 894; Henry C. Adams, The Science of Finance: An Investigation of Public Expenditures and Public Revenues, New York, Henry Holt, 1898, Part 1, Book 1. Adams does not go further than to state that public expenditure tends to expand with economic progress; but Wagner suggests that this increase is not only in absolute terms; a growing proportion of the community's output would be allocated to the satisfaction of public needs.
  2. In fact, Wagner's "law" is an example of arriving at a general conclusion drawn from partial information without taking into consideration the limited character of the evidence on which the conclusion was based. The fault incurred by him was of taking part of a process for which it had been possible to obtain statistical data and then, on the basis of some philosophical assumptions, of extending the findings far beyond their limited context, and of making them the subject of an empirical "law" for which unwarranted validity is claimed. Malthus' thesis regarding the growth of population, Pareto's laws of the size-distribution of incomes and the long-term projections of the growth of the capitalistic economies made by the Classical and the Marxian schools, provide other outstanding illustrations of such overgeneralizations drawn from limited segments of historical experience.

However, criticisms of Wagner's law have been made,<sup>1</sup> and it is not our intention to enter into that discussion. However, there are good grounds for making reference to the way in which Wagner conceived the process of growth of public expenditure, as part and parcel of the development of the economy, and related it to a series of factors implied in that development: industrialization, urbanisation, the increasing complexity of economic life, and the tendency towards monopoly.

His explanation has still a value now-a-days, as is manifested in the renewal (even if in somewhat different terms) of his argument by almost every writer who deals with the problem.<sup>2</sup> The main weakness of his argument lies in the pretention of deducing a law of general validity from the observation of the data concerning a number of countries with a similar structure and in a given historical epoch. In contrast with him, we think that it is preferable to renounce any general explanation of the phenomenon for all conditions of space and time and try to limit its discussion to a precise historical situation.

With the limited knowledge we have of it - only for a short period of time - scarcely a century and a half in the best of the cases,<sup>3</sup> and for a small number

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1. See: A. T. Peacock and J. Wiseman, Economic Development and the Growth of the Public Sector: The British Case 1890-1955, I.I.F.P., Proceedings, 1959.
  2. Some authors have spoken of "... the increased cost of government activities necessary to maintain the social fabric", and "... the increased cost of operating the economy, the other side of the shield of economic progress". Simon Kuznets - "Government Product and National Income", Income and Wealth, Series 1, Bowes and Bowes, Cambridge, 1951, p. 194.
  3. Slade Kendrick's extensive study covers in fact a century and a half years for the United States, but there is no similar study for other countries, and the material used by him served to be very rough, mainly for the first 50 years of the period covered by his study.

of countries with rather similar structures - it does not seem that a formulation which aspires to universality could be achieved on scientific grounds. For that reason, we consider it more useful and feasible, by the very recourse to the conclusions which are possible to draw from factual analysis, to restrict the search to the behaviour of public expenditures in a given historical context: that of the passage of an economy from the rural type, which was characteristic of all European countries in the first half of the XVIII<sup>th</sup> century, to the industrial capitalism, which constitutes the prevailing type of economy in Western Europe now-a-days.

If, in this particular context, it becomes possible to determine with reasonable precision the "permanent" influences which have produced the growth of State activity and the effect of historical disturbances on it, a contribution will have been made to enlightening the process of growth of the capitalist economies in an important phase of their development.

There are good reasons for doubting the interest and validity of universal laws such as those formulated by Wagner and Adams. First, if they mean that the amount of public expenditure grows in the long run in absolute terms when the community's output grows, without regard to what happens to population and other factors, those statements are barely interesting. In effect, on the basis of available data, everything points to the fact that in the course of the growth of an economy, none of its major sectors, including that of agriculture, suffered an absolute contraction in the long run, whether expressed through the total amount of production, or in output per head. On the other hand, it is to be expected that the absolute level of public expenditure will tend to rise when population and per capita income grows.

Under those conditions it would not be of great interest to establish a law of growth of public expenditure in absolute terms.

If, on the contrary, what these economists wanted to suggest, as it seems to be the case with Wagner, is that the relative importance of the State in economic life, measured by the total amount of resources of the community which are allocated to public uses, increases when the economy develops, such a formulation without further specification, appears to be too bold.

There is no evidence at all that the action of the State in economic life has been increasing continuously since man has come to live in politically organized societies. On the contrary, historical analysis seems to indicate that more intensive State action was known in the ancient Rome (where the State was accustomed to fulfil functions such as distribution of wheat to the poor and the organization of public spectacles, which were thereafter unknown for centuries), than in the Middle, and even probably, in the Modern Ages. But without going so far back in time, and confining ourselves to the XIX<sup>th</sup> century, it does not appear that the position of the State in the economy has been of uninterrupted growth. Conversely, at least in Great Britain, where there was a strong feeling that "government is best which governs least", it seems that for about half a century after Waterloo, government played a diminishing part in economic affairs.<sup>1</sup> There exists some statistical evidence that, for two decades at least, public expenditures were more or less stationary.

On the other hand, if we were willing to accept a general trend towards uninterrupted growth of the share of the State in the nations' output, we should

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1. See: William Ashworth, A Short History of the International Economy, 1850-1950, London, Longmans, Green and Co., 1952, pp. 131-2.

have to admit that the growth observed in the last sixty years was much greater than all that occurred in the preceding nineteen centuries, at least judging by the fact that at the beginning of the century public expenditures in modern industrial countries did not exceed in general one-tenth or so of their national product, while in recent years they amounted to about one-third in many of these countries.

Whatever the circumstances may be, one thing is certain: the quick expansion of the public sector, which makes the study of the phenomenon so important, is essentially one of the present century. And even if the factors which determined it are plunged more deeply in the historical past, it is that expansion which, above all, demands an explanation. There is, in fact, a point which requires clear explanation. Not only is it not a priori evident that we should expect public expenditures to represent a rising fraction of national income, but it is important to inquire whether the fast growth of the public sector which occurred in recent decades was due to peculiar factors of that period, or was the result of permanent influences that one must expect to continue.

(b) It is in this particular historical context of the emergence of industrial capitalism, and of large-scale production units with urban concentration, that the concomitant factors of economic development gain special relevance as part of the explanation of the expansion of State activity, and the Wagner's argument fits particularly well. But, even there, it does not give us the whole explanation of the phenomenon and leaves without explanation important aspects of it, e.g. its time-pattern.

It was quite reasonable, indeed, to expect that urbanization, concentration of the production in large units, growing complexity and interrelation of the

economic and social life, lead to an increase in the number of needs which could be more properly satisfied collectively through the mechanism of the State than individually.

Not only does one of Wagner's main arguments - that of the need for greater expenditure on "environmental services" - fit perfectly well into this context, but other important conditions work in the same sense.

First of all, as was already pointed out,<sup>1</sup> the idea of economic growth is associated with those of industrialization and urbanization, and "this requires the institution of common services such as roads, street lighting, public health, etc., and the technical skill necessary to promote the growth of industry requires particular attention to education".<sup>2</sup>

The secular trend of the emigration of populations from the rural areas to the urban ones, which was associated with the relative decline in agriculture and the increasing importance of industrial production, has affected the activity of the State in many ways. Inter alia it has raised the need for services such as sanitation, waste removal, water supply, sewage, local transportation and recreation parks, which were more or less unknown in rural areas. Industrialization also increased the risks and dangers to which workers are exposed, and left those in

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1. A. T. Peacock and J. Wiseman, Economic Development and the Growth of the Public Sector: The British Case, 1890-1955, I.I.F.P., Proceedings 1959, pp.

2. Ibid., same page.

advanced age under worse conditions.<sup>1</sup>

In many cases the services required could only be supplied by the State by covering them through taxation, given the indivisible character of their consumption. In other cases they would be more efficiently fulfilled collectively than individually and the allocation of resources improved if social interest was taken into consideration.

Such are those activities like education, sanitation, and others, which provide a direct separate benefit to individuals and, at the same time, produce an additional benefit to society as a whole. For these activities, even if the marginal private benefit of their services is positive, that benefit forms only part of their total marginal utility.

Their social marginal benefit is greater than the private or individual one. So, if those services were provided by private enterprises, they would be produced in quantities too small in terms of the optimum allocation of resources, since private enterprises cannot but charge a price for the personal benefits the consumer derives from them. Only a political body or collective authority can evaluate the benefits society receives from such services and pay for them.

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1. This refers only to the direct consequences of the technological and organizational changes embodied in the process of industrialization and leaves aside the effects of the disintegration of the institutions and values of the old societies which were strongly based on family and group loyalties.

With such a disintegration the family showed itself unable to carry out many functions which depended upon its ability to discipline its members and to compel them to contribute to the common good. The particular loss of family control over its younger members results in a situation in which there is no surety that care and affection lavished upon children will be reciprocated in the parents' declining years. Consequently the need appeared for a "searching and shifting of alternatives to determine who now should assume old family responsibilities". On the development of this idea see: Fred Cottrell, Energy and Society, (New York, McGraw-Hill Book Company, Inc., 1955) Chapter II, on "Enlargement and Concentration of Political Power".

In these cases, production on a profit-making or market basis, does not ensure the optimum allocation of resources in terms of social appreciation, and its collective production can improve that allocation.

The number of services which enter into this category increases when people live together.

But there were still other factors which were part and parcel of the development of the economy, or at least accompanied that development, which determined or favoured the growth of public expenditures. Thus the greater longevity of individuals and the decline of the birth rate, led to the ageing of populations and, as such, accounted for the increase of outlays on old age pensions. Greater instability of the conditions of work in industrial economies and dependence on social factors raised new problems of assistance and social security. The improvement in the standard of living, leads to claims for better standards of service. In addition to all these factors, the growth of income per head, leaving a larger part of revenue to spare, increased the taxable capacity of contributors.

If these factors cannot explain by themselves why the share of public expenditures in national income grew in almost every country in recent decades, they supply a good argument to lead one to expect public expenditures to rise, at least in absolute terms (and probably even in relative terms) in a phase of industrialization and of urban concentration of a country.

Since the multiplying of collective or social wants (which according to a school of thought in public finance forms the proper domain of State activity) is just the result of life in organized societies, it is not surprising that the development of closer relations between people - to which urban concentration leads - enlarge the

number and the intensity of such wants.<sup>1</sup>

Economic growth and the increase of the interdependence of various economic units also go together. Not only does agricultural exploitation become more dependent on the price mechanism and on price fluctuations when its products go to the market, but mutual dependence of different production units increases when industry acquires importance and specialization becomes a necessity of the system. Then, as S. Fabricant points out,<sup>2</sup> not only individuals become more dependent of one another, but they also feel that increased dependence. And that favoured the change of climate of opinion in the sense of a growing claim for government activity to meet problems as diverse as sewage, public health, resource preservation and development, economic regulation and public assistance.

The realization of that interdependence, together with the development of social sciences and with a better knowledge of the conditions of life of populations, strengthened the wish for the solution of many problems through public action.

All this suggests, indeed, that the transition of an economy from the rural stage to the industrial and urbanised one, and the rise in per capita income, which has accompanied it, produced an extension in the number and intensity of the needs which required collective satisfaction, and hence, it exerted pressure in the sense of increased public spending.

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1. There is a strong suggestion that the development of urban civilization brought about by industrialization, generating a series of diseconomies by the fact of concentrating large masses of population in limited areas, formed one of the main factors accounting for the extension of the so-called "social" or "collective" wants.

2. S. Fabricant; Op. cit., p. 144.

That such a pressure exists, is suggested by the results of the comparisons between the share of public sector in national income of different countries in different stages of economic development.

Such a comparison shows, in fact, that there exists certain relations between the degree of economic development and the portion of the community's output diverted to the satisfaction of public wants.<sup>1</sup>

However, not only does the comparison in general terms of public expenditures in countries with different per capita revenues and levels of development point in that direction, but also comparisons of expenditures per head in different American States show that inter-state differences in the level of public activity are mainly explained by the operation of three factors related to economic development: per capita income, degree of urban concentration, and population density.<sup>2</sup> But whatever the correlation between the level of economic development and the share of total output devoted to public uses may be, it is obvious that the growth of the public sector observed in our century cannot be fully explained in terms of

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1. On this point see: H. T. Oshima, "Share of Government in Gross National Product for Various Countries", American Economic Review, Vol. XLVII, June 1957; and W. Lewis and Alison Martin, "Patterns of Public Revenue and Expenditure", The Manchester School of Economic and Social Studies, September 1956, pp. 203-244.
  2. See: Arnold Brecht, "Three Topics in Comparative Administration - Organization of Government Departments, Government Corporations, Expenditures in Relation to Population", Public Policy, Harvard University Press 1941; L. Elderberg, A. L. Horniker, B. Kaufman and C. D. Stewart, "Public Expenditures and Economic Structure in the United States". Social Research, February, 1936, pp. 57-77; and J. Berolzheimer, "Influences Shaping Expenditures for Operation of the State and Local Governments", Bulletin of the National Tax Association, March, April, May, 1947; and also S. Fabricant, *op. cit.*, p. 121 and seq.

the action of the concomitants of economic development alone.<sup>1</sup>

It is more or less granted that those concomitants played an important part in the expansion of the activity of the State in almost every country. But, as it is possible to see, even in the analysis accomplished by authors who tried to explain that extension basically in terms of concomitants of economic growth, as was the case of Fabricant,<sup>2</sup> and of Abramovitz and V. Eliasberg,<sup>3</sup> those concomitants supply only a partial explanation of the phenomenon, and leave without explanation many facts such as that of the time-pattern of the growth.

The comparison of the evolution of public employment in Great Britain and in the United States, for instance, if it suggests the working of a powerful common force - and it is difficult to dissociate it from the process of economic growth in both economies - also shows that despite the similarity of the economic and political institutions in the two countries, many differences of behaviour can be noticed in their growth of public employment. These differences are not easily

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1. The analysis undertaken by Fabricant still shows that urbanization only in a very small extent contributed to the differences in the per capita expenditures of the States considered, and that those differences are mainly connected with the level of income. (See: Op. cit., Chapter VI, especially pp. 123 and foll.)
  2. S. Fabricant, The Trend of the Government Activity in the United States since 1900, New York, N.B.E.R., 1952, op. cit., especially pp. 148 to 152.
  3. M. Abramovitz and Vera F. Eliasberg, The Growth of Public Employment in Great Britain, New York, N.B.E.R., 1957.

reconcilable with the relative levels and pace of economic development.<sup>1</sup>

As a conclusion, it appears that the farthest we can go without abandoning the strict ground of factual analysis, is to state that a good deal of the factors which operated in the sense of broadening the sphere of activity of the State, and hence the growth of the relative importance of public expenditures in the national product, was closely related to the process of economic development.<sup>2</sup>

But the enlargement of the public sector to the extent we noticed it in this century, and particularly its time-pattern, cannot be fully explained by the mere operation of such factors.

Unless we are prepared to accept a pure materialistic interpretation of the historical process in Marxist terms, explaining all developments of the political and ideological superstructures, as well as events such as wars, as determined by the economic structure, it is difficult to see how to explain the growth of the public sector by the action of economic factors alone.

Economic and non-economic forces appear to be operating all the time, so as to exercise a pervasive influence on government activity, both having been inter-related and acting as joint causes.

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1. On this point see Chapter II. of the book by Abramovitz and V. Eliasberg, *op. cit.*, especially the conclusions drawn up at pp. 128-129 about the comparison between the United States and Great Britain.
  2. "The developments underlying our economic growth disturb the security of individuals and groups ... and posed serious social and economic problems of adjustment and protection; ... multiplied problems of monopoly and industrial relations and finance; created new and enlarged old costs involved in the operation of urbanized society; ... spurred demand for the services - educational, recreational, health - that expanded with increasing income, and further swelled the number of activities in which the private return, but not the social return, compares favourably with its cost." S. Fabricant, *op. cit.*, p. 149.

2. The Enlargement of the Public Sector - A Joint Result of the Operation of Different Kinds of Factors.

(a) Departing from this conclusion, it does not seem to be of great interest to discuss whether the growth of public expenditure was the result of changes involved in the process of economic growth, or if it has to be explained, in part at least, by factors exogenous to that growth, such as wars and ideological revolutions.

Whatever the position we assume - either considering social philosophy and the international situation as a by-product of the economic framework, or admitting that they are only conditioned, but not determined, by economic institutions and their operation - any distinction between factors related and non-related to economic development is extremely difficult and debatable.

Must what Schumpeter called the "growing hostility" to the system of private enterprise and the predisposition towards "interventionism" and increasing regulation and protection, be considered a result of economic development?

And must we consider in the same way the raising of the nation's standards of responsibility for the welfare of the people, which stimulated the production of new services to meet the multiplying of collective wants? Whatever the view we adopt, it is doubtful that such a distinction can help to interpret the data of the analysis in order to obtain a more consistent explanation of the phenomenon.<sup>1</sup>

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1. The mental operation consisting in the separation of the elements which intervene in a given process in endogenous and exogenous, depending on whether or not they enter into the system of mutual determination which is being considered, has shown itself extremely useful in the task of model building, where the main purpose is to reach simplicity and a high level of abstraction. But since this distinction depends on the delimitation one makes of the field of analysis, and even on the length of the period, when time is considered, it often does not reveal adequate when one's purpose is to explain what really happened, instead of looking for some kind of operational scheme.

(b) In our interpretive scheme - if it is necessary to have one - relative growth of public expenditure, as well as that of public employment, and of the use of capital by the public sector, can only be fully explained by the operation of a series of factors of different nature, acting sometimes simultaneously and sometimes in succession. It was the combination of those factors which, in our view, produced the extraordinary expansion of public activity during the last half century.

In Great Britain, as well as in the United States, it seems that a lag took place between the change in the structure of the economy - which created a pressure in the sense of the extension of State activity - and the ideological transformations which sanctioned that extension.

When the 19th century drew to a close, as Abramovitz and V. Eliasberg point out, the role of government in Great Britain, as well as in the United States, and most other countries, was still small by modern standards; but "1890 does not represent the beginning of the great changes which in the next sixty years would produce a multifold increase in the share of the labour force used by government".<sup>1</sup> Conversely everything seems to suggest that the structural changes which took place in the economy, and which prepared the ground for the subsequent expansion of the public sector, had begun far earlier.

It was in the course of the 19th century that Great Britain acquired its characteristics of industrial and urbanized society.<sup>2</sup> For some time, however, a number of forces, prevented the government from meeting the new needs created by

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1. Op. cit., pp. 8 - 11.

2. In 1890, indeed, agriculture and forestry occupied no more than 10% of total labour force of Great Britain and 62% of the people of England and Wales lived in urban areas with a population over 10,000.

the emergence of the industrial capitalism through a gradual extension of its activities. However, the legal transformations which contributed to that response had begun long before.<sup>1</sup>

There are various signs that in Great Britain and the United States, the public sector began at an early stage to feel the effects of the change introduced by industrialization and urbanisation.

Nevertheless, "as the century opened with people largely against government interference and paternalism", the social and political environment was to form for a long time a strong factor in limiting the expansion of public expenditure. Consequently, some influences which even were apparent a long time before the end of the 19th century, could not fully work themselves out before the second quarter of this century.

All through the 19th century, the growth of the urban centres called for new facilities to meet their needs of water supply, sewage, street police and fire protection, as well as for a number of health measures. The prevailing views about the duties of the State, however, prevented the public sector from meeting many of those needs as far as they became apparent. It was only in recent decades that some forces which for a long time had contributed to check the increase of public expenditures, began to weaken, mainly through the effect of the change in the distribution of political power.

Up to 1867, indeed, the franchise was very limited in Great Britain, and only those who possessed some property could vote in Members of Parliament, and till

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1. Namely the Parliamentary Reform Act of 1832, which broadened the franchise and adjusted the distribution of the seats to that of population, making Parliament a more responsive organ of public opinion; and the Municipal Corporation Act of 1835.

1884 the universal suffrage of the householder was not known.<sup>1</sup>

Even after the extension of the franchise by the legislation of 1867 and 1884, various decades were required for the labour organization to acquire any real political power.

Coinciding with the alteration of the balance of political power, the prevailing conceptions about the duties of the State were gradually modified. The Benthamite ideal and the laissez faire concept began, not only in Great Britain, but also abroad, to fall into disfavour and a climate of opinion which demanded growing intervention by the State in the social and economic fields, was created in its place.

A number of social aims such as a guarantee of national minima of income, medical assistance and education, and the reduction of the risks of industrial capitalism, which were vigorously expressed in the programmes of socialist parties, received wider acceptance throughout the century.

(c) Many of these viewpoints received considerable support from Keynesian thought. The Keynesian school gained ground amidst the crisis of confidence in the power of market forces to ensure automatic economic stabilization which was brought about by the Great Depression and it spread the belief in the possibility of reducing unemployment and economic instability through adequate governmental action.

A number of factors may serve to explain the fact that only in recent times

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1. The acceptance of the principle "one man, one vote" which is basic to the political organisation of democratic societies, was not without significance for changing the equilibrium in the balance of power where the rule "one pound, one vote" had given rise to a quite different distribution of power in society.

has the State met many needs that had been felt for a long time. It is a characteristic of "collective" wants, that although they are felt by individuals in the same way as "private" wants, it is only collectively that they can be met. And since they must be met through the budgetary mechanism they need to be politically expressed. For that, various conditions are necessary, such as the knowledge of the extent of the problems which caused them, the means for solving them by the government, and the political power to give active expression to those means. In the 19th century, almost none of those conditions was fulfilled. The social sciences, which could supply knowledge on the conditions of life, and show the social origins of much of the people's suffering, were still in their infancy at the beginning of the present century, and regular information about those conditions was extremely scarce. So, even in relation to problems socially as repugnant as generalized unemployment, it was very difficult to determine with precision their relative magnitudes as well as their causes and remedies.

In these circumstances, social responsibility for many evils resulting from the system of social organization was difficult to establish and still more to present in conclusive terms.<sup>1</sup>

It was the accumulation of factual information about social conditions and its collection in a systematic way, associated with the development of the economy and of the other social sciences, which made it possible to determine the origin and the nature of the problems and to propose a cure. It also led to the conferment on the State of the responsibility for fighting against the misfortunes which

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1. Unemployment caused by cyclical depressions has been observed since, at least, the middle of the 18th century, but as Abramovitz and V. Eliasberg note, a clear relation between both facts was not established till the end of the 19th century, and only after 1930 the measures proposed to combat depressions gained wide support. (Op. cit., p. 23)

originate social maladjustments.

The multiplication of studies like that of Charles Booth's Life and Labour of the people of London, by the impression they produced in influential circles, greatly contributed to the abandonment of the position of non-intervention in the face of social problems. Furthermore, they armed social movements with powerful arguments, which gave substantial political support to their claims.

In connection with this series of transformations in the structure of the economy and the social life by the events of the present century, we should also mention the difficulties felt in the economy after the First World War as a consequence of the financial strain that followed the armed conflict, and which disorganized the economic life of various European States. They revealed the shortcomings, if not the total inadequacy of orthodox economic policy, in overcoming depressions and galloping inflation.

The emergence of heavy unemployment, mainly during the Great Depression, forced the State to extend its activities with the aim of restoring stability, to provide temporary relief for unemployed workers, and to extend the system of social insurance. Many expedients to protect industry and trade from fluctuations of economic activity were then introduced.<sup>1</sup>

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1. The impact of the Great Depression upon the ideas on public expenditure and fiscal policy, mainly in the United States, are well documented by the contrast between the proposed policy of the defeated President Hoover in 1933 and that which the Roosevelt Administration was compelled to follow. In the Spring of that year, with more than 20 million unemployed, President Hoover fought for a balanced budget which he called an "absolute necessity", "the most essential factor to economic recovery", "the imperative and immediate step", and "the first necessity of the Nation", and which he proposed to enforce by cutting further expenditure and levying a Federal sales tax. When President Roosevelt was elected, the plea was still for greater economies in the public sector. Nevertheless, events proved so strong, that the new Administration, after starting with a tight control of expenditures, abandoned its attempts to balance the budget and allowed 70% of Federal expenditures to be covered by borrowing in 1934. Thereafter, government borrowing was firmly introduced as a tool of fiscal policy to combat unemployment. (See: R. W. Lindholm, Public Finance and Fiscal Policy, New York, 1950, pp. 574-575, and Arthur M. Schlesing The Crisis of the Old Order, Boston, Houghton Mifflin, 1956, p. 232.)

Two other historical facts have proved decisive in that change of attitude regarding the scope and the level of public activity. The success of economic regulation which had been experienced during the First World War, and the introduction of the socialistic regime in Russia.

The latent forces which were to expand the activity of the State into new fields, gained considerable strength with the experience of the wars and the adjustment of the economy to the problems of peace.

The First World War had already demonstrated the feasibility of governmental regulation of the distribution of resources; World War II, with its almost total mobilization of the resources of the nation, has fully revealed that possibility.

Although it was generally felt that the system of controls during the war years was not compatible with the working of the institutions of a democratic society in normal times, it has been acknowledged that a more intensive government intervention during the Second World War enabled the cost and sacrifices of the war among different social groups to be distributed more equally.

But more than that, the two great wars exercised profound and lasting influence upon the activity of the State by releasing forces which demanded a more strenuous governmental action to diminish differences in the living conditions of various classes. They operated mainly as a catalyst of political forces and social ideas leading to a revision of the current conceptions of the functions of the State in a free society.

At the same time, the Russian revolution showed that the organization of a whole centralized economy, and the overcoming of many difficulties initially supposed insurmountable were at least, feasible. Afterwards its material achievements spread the idea that socialism was a practical means of meeting many

of the problems for modern societies and suggested that a greater degree of government intervention and planning might ensure a better utilization of resources in economy. In this way it was instrumental in forcing democratic governments to make a strong effort to oppose socialism by a "positive programme of democracy".

Thus, a series of factors of different kinds seem to have been operating towards the expansion of public activity in recent decades.

Summarising our ideas, the emergence of industrialization and urbanization, associated with the change they produced in the structure of the economy, gave rise to a number of needs which required public action. However, experience showed that the mere existence of those needs did not provide a sufficient condition for immediate expansion of public expenditure. A lag occurred between industrial development and urbanization, and the provision of public facilities to meet the new needs. Subsequently, a number of independent or exogenous factors combined in their influence with the concomitants of economic development to produce a change in the accepted political philosophy, and to produce the expansion of government activity which followed.

In their concatenation they appear to have been linked in the following way: industrialization, urban development and increasing interdependence of the markets and of the economic units, give rise to a number of needs which were difficult, if not impossible, to meet privately. Many of these needs could not be met gradually as they appeared, because of the imperfect knowledge of their social origin and the inadequacy of political support resulting from the distribution of political power.

It was the better knowledge of the problems raised by the emergent structural change, and of their social origin, as well as of the means of solving them

by collective action (supplied by the development of social sciences) which, associated with the shift in the balance of political power, made possible a considerable extension of State activity.

Some historical events, such as the two World Wars and the establishment of collectivism in Russia, also worked as a powerful external influence in addition to the process of economic growth and to its concomitant factors in producing a strong global effect on the share of public expenditures in the national income.

### 3. Technological Change and the Growth of Public Expenditure.

(a) Another factor which has sometimes been presented as having contributed to the growth of public expenditures in this century, and which requires a separate analysis, is that of the technological change which accompanied the development of the economy.

There is no doubt that certain alterations in technique brought about some increase in the cost of public services or produced new needs, as was the case in the development of the means of transportation. But, it is also reasonable to expect that many of those alterations have resulted in the increased productivity of public services as well.<sup>1</sup>

What, on the whole, was the net result of the two probably opposite influences on the trend of public expenditures?

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1. S. Fabricant, having examined the problem for the United States, concludes that an analysis of the main factors capable of influencing productivity in the public sector "leaves the impression that labour savings have been made", and that it does not appear these savings reflect merely an increase in the volume of other resources used, but that even output per combined unit of all resources appears to have risen in government. (Op. cit., pp. 98-99)

Did they account for an increase in the share of public expenditure in the national income, or did they produce, coeteris paribus, a decrease in that share?

Is it true, as it is widely believed, that the productivity of public services (even if it has increased, thanks to the typewriter, the telephone, the book-keeping and calculating machines, the electronic computer, and to a number of other devices) has on the other hand, lagged in relation to the productivity in manufacturing and in agriculture?

If this was so, and if the amount of public services produced was a function of income or output, there would be a tendency for the share of national income spent in public services to rise. But these are mere hypotheses.

What the analysis shows is that an increase in productivity in the economy, associated with technological change, does not affect in the same way the different sorts of public services. On the other hand, there is no evidence that the amount of public activity is tied to income or output by some kind of functional relation, or that the income-elasticity of demand for public services in general, is positive.

The extent and direction in which technical change by itself affects the proportion of public expenditure in the national income, depend rather on the direction and amount by which this change influences the relative productivity of the resources used in the public and the private sectors of the economy. Consequently, it does not seem possible to arrive at any general conclusion valid for every period and country regarding this matter. Even in the analysis of a specific case, like that of Fabricant, one must emphasise the uncertainties surrounding the conclusions, because of the impossibility of weighing all the factors affecting productivity.<sup>1</sup>

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1. S. Fabricant, op. cit., p. 99

As a result, the most one can do is to try to trace the influences that technical change has had on the amount of public expenditure in particular sectors.

(b) With this more limited problem in mind, we can say that one of the fields in which technical change appears to have contributed to a considerable extent to the increase of public expenditure is that of defence.

Adam Smith noted that "in modern times many different causes contributed to render the defense of the society more expensive", stating that "the unavoidable effects of the natural progress of improvement have, in this respect, been a good deal enhanced by a great revolution in the art of the war, by which a mere accident, the invention of gunpowder, seems to have given occasion".<sup>1</sup> The volume of resources devoted by modern nations to the art of war, and the speed with which arms have become obsolete in recent decades, appear indeed, to be an important factor contributing to the increase of expenditure on defence. As William Ashworth emphasises,<sup>2</sup> there was scarcely another field where premature obsolescence and heavier capital expenditure, as a result of technical inventions, has been so acute since 1875, as in naval operations.<sup>3</sup> But the problem was not exclusive of naval architecture and of the gun-power as we must realise from the revolution occurring in air arms after the Spanish Civil War.

In the First World War the air forces had not yet become powerful, and expenditure on aircraft was marginal in the conduct of the war; in the Second World War

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1. Adam Smith, Wealth of Nations, Book V, Chapter I, Par. I, Vol. II, p. 202 of Cannan's edition.
  2. Op. cit., p. 15.
  3. That fact well emerges from the British Naval estimates from 1870 up to the First World War, which amounted to £9mn. in 1870; to £27.5mn. in 1900, and to £51.5mn. in 1914., op. cit., same page.

they accounted for a very considerable part of the huge military expenditures. At the present moment, conventional forces, including aircraft, seem to be losing their importance very quickly and becoming obsolete. Meanwhile, rockets and atomic weapons are increasing considerably the amount of resources devoted to defence and to research in connection with defence.

At the beginning of the century, the rapid pace of invention made whole fleets obsolete in ten years or less, forcing governments to replace them completely in order to maintain their superiority. Now-a-days armed supremacy depends to such a great extent on costly research, that the preservation of peace has become an even more expensive task.<sup>1</sup>

Another technical change which accounted for an important part of the increase in public expenditure in the first decades of our century, and became a powerful influence in the shift of expenditure from the local to the central level in Great Britain, and in the United States from the local to the State level, was the revolution which occurred in the means of transportation.

The advent of motoring produced so deep a change in the means of transport, that highways formed for a long time one of the main items of the expenditures of local authorities and, later on, accounted for a good deal of the capital expenditures of central governments.

As Abramovitz and V. Eliasberg point out, the provision of roads had been much neglected during the Railway Age and the coming of motor transport required an extension and improvement of the highway system which must have accounted for the

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1. A fact which well illustrates how expensive the arms race is to-day and how technical change has increased the cost of war tools, is that the estimated cost of a single missile has increased more than fifty times from about \$35,000 in 1949 to some \$2 million in 1957. Albert Wohlstetter - "The Delicate Balance of Terror", in Foreign Affairs, January, 1959, p. 216.

rapid extension of public (mainly local) employment and, as a consequence, of expenditures, after 1900.<sup>1</sup>

It would, certainly be possible to find in many other fields examples of the influence of technical change on the growth of public expenditure. But even the most complete list of ways in which that change gave rise to an increase in government activity, would probably be no more conclusive, mainly if it were balanced by a description of the influences which worked in the opposite direction.

Mention should be made of the two outstanding influences which worked in this way: namely the developments which occurred in the postal system and in the collection and treatment of statistical data in the census bureaux and statistical offices. Both illustrate the number and variety of mechanical devices and improved techniques introduced in order to quicken operations and to save work, all accounting for a sure increase in productivity.<sup>2</sup>

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1. Abramovitz and V. Eliasberg, op. cit., p. 75 .

2. In the postal system, the mere introduction of improved machines to cancel and postmark letters permitted the handling of 600 letters per minute compared with 1,500 per hour with hand cancellation. (See Fabricant, op. cit., p. 86)

This is but one example among many in the revolution which occurred in the Post Office with the introduction of stacking and cancellation machines, conveyor belts, pneumatic chutes, wells, elevators, floor trucks, check writing and rate computing machines, automatic telephone and time-recorders, which permitted the handling of billions of operations that otherwise would have required big battallions of employees.

In statistical offices and census bureaux, the introduction of sampling methods and the use of punch cards, tabulating equipment and electronic computers enabled a multitude of facts to be collected and to be combined in different ways which, without this equipment, would have been extremely difficult, and would require thousands of civil servants to achieve.

It does not seem feasible, anyhow, to determine what the net result of technological change in public expenditure was in toto. If one is willing to accept the fact that it affected the relation between resources used by the government and the services produced by it in the sense of increasing productivity, as seems probable, there still remains a certain doubt as to how the volume of services required from the public sector was affected by the technical revolution.

4. The Impact of Wars on the Growth of the Public Sector.

(a) Another particular type of influence on the growth of the public sector deserves a word: that of the impact of wars upon the size of government expenditures.

The statement put in its old form, that it was war-related expenditure, and particularly the charges of public debt contracted during wars, which mainly accounted for the growth of government expenditure in the long-run, fell short as an explanation for the huge increase of public spending in modern times, particularly after World War II.<sup>1</sup>

(b) If, however, we consider wars through their indirect effects upon ideas as to the "right" level of State activity and of the tolerable burden of taxation, i.e., as "shocks" to the currently accepted social philosophy, making possible a revision of policy and an enforcement of new experiments, it seems difficult to deny the value of the argument of the effect of wars mainly in explaining the

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1. At least for Great Britain since 1890, and even for the United States since the turn of the century, the increase in government expenditure, either in absolute or in relative terms, cannot be explained by the growth of war-related expenditures alone. See: A. T. Peacock and J. Wiseman, "The Growth of Government Expenditures in the United Kingdom, 1890-1955," and R. Musgrave and Culbertson, *op. cit.*

time-pattern of the growth of the public sector.

The emphasis one must put on the argument itself as an independent explanation of that growth, and the extent to which it must be considered as an "accident" which merely induces a chain-reaction of forces which have been dormant, is a matter of interpretation.

It is true that the impact of wars which one can observe on government expenditure differs considerably from country to country, even between countries with similar political and social conditions as Great Britain and the United States. And its manifestations are different too. As a consequence, the relative value of the argument as an explanation of the growth of public expenditures in given conditions is likely to be very different from case to case. But it is hard to expect that, even in countries which did not find themselves involved in the struggle, the effect of major wars (and particularly of World War II, with the profound alterations it produced in the social ideas and setting) was not deeply felt. But, if the argument is to be applied in a general sense to countries with very different social and political conditions, one must bear in mind a fact which is of great importance to its proper understanding. That is: if the so-called displacement effect is the closing by wars, and other major disturbances, of the gap between the ideas that citizens and government hold about the desirable level of public activity and taxation, one must expect that the magnitude of the effect will not depend only on the magnitude of the disturbances themselves, but also on the ideas which governments have about the best level of

activity to undertake.<sup>1</sup> Or, putting the problem in slightly different terms, if the burden of taxation considered worthy of support by the nation, is determined by the power of different economic and political groups - as the sociological theory of public finance would alledge - the possibility of increasing that burden is a function of, among other variables, the political structure of the country and the distribution of political power among different income strata.

There is, indeed, no perfect equivalence between the groups which bear the tax, and those which receive the benefit. One can speak in a certain sense of a net benefit or burden of government spending and taxation in relation to different groups of individuals, even if it is not possible to measure them in rigorous terms.<sup>2</sup>

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1. The concept of the displacement-effect was first introduced by Professor Alan T. Peacock and Mr. J. Wiseman in The Growth of Government Expenditures in the United Kingdom, 1890-1955, and means the change produced in people's ideas regarding the "desirable" level of taxation by major disturbances such as big wars, or long depressions, and whose impact on public revenue and expenditure results in shifting them from their previous level to a new and higher one. For the discussion of this argument as an explanation of the growth of public expenditure in Great Britain, see op. cit.
  2. An attempt to measure the relative benefit withdrawn by the various income groups from the undertaking of the State, and to compare it with their share in the total cost of public services in order to determine the new "profit" or "loss" of those groups taken as a measure of the redistribution made through public finance is being attempted for France by the Service des Etudes Economiques et Financiers of the French Ministry of Finance under the direction of Claude Ganson. Studies in the redistribution effects of public finance in Great Britain are those of Tibor Barna, Redistribution of Income Through Public Finance in 1937, (Oxford, Clarendon Press, 1945). A. T. Peacock and P. R. Browning, "The Social Services in Great Britain and the Redistribution of Income", in Income Redistribution and Social Policy, (ed. by A. T. Peacock), London, Jonathan Cape, 1954; and A. M. Carter, The Redistribution of Income in Post-War Britain - A Study of the Effects of the Central Government Fiscal Program in 1948-49, New Haven, Yale University Press, 1955.

Not only does the way in which the cost is distributed of the public services, and the areas in which the main weight of their benefit fall, depend on the distribution of political power, but the point up to which it is possible to bring the net distribution of the community's output depends on the power of different groups.

This, I think, must account for the explanation of part of the differences of the displacement effect of wars to be found in comparisons between different countries.

#### Conclusions

According to what has been previously said, it seems that we have to renounce a monistic explanation of the growth of the public sector, such as that which tries to present it as a concomitant of economic development. And this must be so even if we limit our search to that particular stage in the development of the Western economies which corresponds to their passage from the rural type prevailing in the first half of the 19th century to the industrial capitalism of large units which prevails now-a-days.

A complex variety of different influences seems to have been instrumental in producing the global effect of that large increase of public expenditure which has been evident in most countries in the last fifty or sixty years.

Many of them may be considered as more or less "permanent" and closely related to the process of economic growth (industrialization, urbanisation, growth of income per head, the appearance of large-scale industries and monopolies, and the development of tendencies towards greater instability within the system), and may be expected to operate in every country which industrializes. Others, such as

the evolution of social philosophy and the attitudes regarding State intervention and support, the development of social sciences, and the distribution of political power can be related to economic growth only in a more indirect way, and the time of their operations bears a very slight relation to the pace of growth. It appears that external shocks or disturbances, that is, factors exogenous to the process of growth, had a much more powerful effect in their operation.

Both series of factors, however, are found working as joint causes, partly conditioned by the special political and social features of each country, to produce a "resultant" which varies in some extent from country to country.

Nevertheless, the permanent factors of growth and the great world disturbances such as the two World Wars have had so powerful an effect that in many countries the growth of public expenditure has followed a comparable path. Whether or not this path has been kept in countries with a lower level of development is a matter for investigation.

CHAPTER II.

METHODOLOGICAL PROBLEMS.

1. The Concept of the Public Sector.

There is no single or "unique" definition of the public sector; thus the concept to choose depends on the purpose for which it is to be used. One can be interested mainly in the process of decision-making or in the degree of control exercised by the political powers (Executive, Parliament, Local Authorities), or in the nature of the activity fulfilled (administrative activity, for instance, as opposed to "entrepreneurial-type" activity). In each case a different concept of the public sector must be taken.

Our interest does not lie so much on the degree of control the Government holds on the economy as a whole, but on the influence it exerts on the final use of resources through its budgetary mechanism and policy, that is, on a certain type of public activity.

The concept of the public sector, or of government activity we are interested in, is that commonly labelled "administrative", "non-industrial", or "non-productive". We understand as such, those activities of the Government which are undertaken in a non-profit making basis and in a non-trade type way. They include, besides the activity of the bodies which carry the "classical" functions of defence, law and order, public education and all the range of indivisible services (either technically, socially or economically indivisible), many regulatory functions and the supply of numerous goods and services of collective as well as individual consumption.

There is no single criterion or definition for establishing the frontier between these services and the commercial or "productive" activities of the State. But some combination of characteristics or criteria is bound to produce a reasonable boundary fringe for the purposes of statistical research.

Leaving aside the broad, general characteristics of satisfying "collective" or "social" wants, and those of the compulsion or power which backs public activity (by contrast with the aim of satisfying individual wants and the "contractual" or quid pro quo basis of private activity) - there are two main criteria which, wisely combined, seem capable of producing a reasonable dividing line between the public and the private sectors of the economy. The first one relates to the way the different bodies or undertakings cover their costs of production, and the second - which keeps a straight connexion with this - refers to the process of decision-making or the motives underlying the decisions in the public and private units.

As is often pointed out - and national accounting takes this characteristic as its main criterion of delimitation of the public sector - public administrative services are covered by tax revenues, and not by prices. If we neglect the cases of fees and direct charges, we can say that public services are offered free, and, in any case, their supply is never subject to the principle of specific retribution from the individual beneficiaries. Thus, an important criterion to decide whether a given body or undertaking must be placed in the sphere of the Government or in the private sector, consists in the way its costs are covered (by the price they charge, or by taxes).

Nevertheless, the existence of government subsidies to some industries and of

hybrid cases difficult to disentangle, invite further qualification or the presentation of supplementary criteria. Following this line of thought, it is possible to clarify the distinction looking at the motives and the processes of decision-taking in the public administrative sector and in private activity.

It has been emphasised that the guiding motive of public activity is social interest, versus profit motive in the market sphere of production. Nevertheless, it is too vague to be helpful, at least for purposes of statistical research. Fortunately, not only the nature of considerations which determine the production policy, but also the whole process of decision-making, is different in the two spheres: the market sphere and the administrative sector of the State.

We can say, either that public activity is guided by the budget principle, (i.e., that the quantity produced is not determined according to profit expectations) or that decisions in the public sector are reached through political and administrative procedures. And those, in general, can be recognized by means of a careful analysis of the way the different undertakings are run.

Political and administrative procedures are marked by the dependence of the bodies concerned, on central or local decisions in fixing the amount of expenditures or the sources of revenue, or from central control such as parliamentary control, submission of accounts to administrative authorities, etc.

Now some difficulties still remain on the dividing line between the "pure-administrative" sector on the one side, and the government trading services and public corporations on the other side.

Here too, we must recognise that no general rule can be given, and still a series of criteria is the most we can present to help one's decision. To the

already mentioned criteria of the profitability of the activity and of the expenditure policy, it is possible to add some subsidiary ones, such as those suggested by I. Ohlsson: namely the similarity of the activity to the activity of other bodies or undertakings in the public or in the private sectors ( as in the case of the transport system), the legal point of view, or the classification the undertaker receives in the law, the degree of freedom the buyer of goods and services produced by them enjoys when deciding on the quantity to use, and lastly, the amount of capital (mainly fixed capital) used in the process of production.<sup>1</sup> But it is evident that none of these criteria permits, by itself, a safe decision about the inclusion or exclusion of a particular activity in, or from, the public sector.

Instead, should they not be wisely applied, they may well lead to wrong decisions.

In the last resort we have to recognise that there is no general definition of the public sector, even after having made clear the nature of the problem we have in mind. In practice we have to look at the institutional set-up in the country concerned and draw a dividing line which is not exempt from some degree of arbitrariness.

In actual fact in our study an effort has been made to keep to the delimitation of the Government sector drawn by national accounting conventions, as close as possible. In the fluid cases of the distinction between trading services and public corporations, the same definitions were followed and the same rules were applied as in British national income calculations.<sup>2</sup>

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1. I. Ohlsson, op. cit., pp. 19-20

2. Central Statistical Office, National Income Statistics, Sources and Methods, London, 1956.

As a practical result of this effort, what we concretely included in our concept of Government, in addition to the bulk of services which form part of the budget of the central Government, and which fall mainly in the old traditional administrative services, was:

- (a) The expenditures of the local authorities with the exclusion of trading activities;
- (b) Social insurance;
- (c) The administrative activity and capital formation of the so-called "Organismos de Coordenação Económica" (boards of economic co-ordination) whose functions are much of the nature of those fulfilled by the British Board of Trade;
- (d) The non-trading activities of the autonomous bodies called "Fundos" (funds), which are of recent creation, and have not yet been integrated in the general budget of the Central Government;<sup>1</sup>
- (e) Certain autonomous bodies, like the so-called "Comissariado do Desemprego", whose concern is in developing opportunities of employment for unemployed through public works, etc., and whose activity is of a non-trading character;
- (f) The investment in the trading services of the Government (Post Office, administrations of the harbours, etc.).

All the activities of the so-called "organismos corporativos" were excluded,

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1. The main examples of such "Fundos" are the "Fundo de Fomento de Exportação", which deals with the promotion of exports, the "Fundo de Socorro Social", which gives public assistance and relief, and the "Fundo de Abastecimento", which deals with price stabilization. The main characteristic of these bodies lies in their degree of autonomy in the fulfillment of their particular tasks, and the attribution of particular sources of revenue.

their actions and functions (though being subject to a certain degree of Government control) belonged rather to trade unionism and employers confederations.

2. The Ways of Gauging the Activity of the Public Sector.

It is generally recognised that there is no single index to measure the amount of public activity. As J. M. Culbertson emphasises, "all aspects of Government activity cannot be comprehended adequately by a single measure or a single framework of analysis."<sup>1</sup>

The public sector is a complex entity, and its dimensions and growth must be measured in relation to a particular aspect of government activity specifically related to some question or problem to be answered or to be solved. The appropriate measure of public activity depends on the particular aspect or problem to be analysed.

We can be interested in analysing the activity of the Government as a user of goods and services, as Fabricant seemed to be,<sup>2</sup> or we can be interested in a more comprehensive field of government activity, looking for a measure of the extent in which the allocation of the country's resources is directly affected by government budgetary policy, as in Peacock and Wiseman's study;<sup>3</sup> or even in the relative importance of public economic activity in the generation of the national income or product.

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1. J. M. Culbertson, "The Trend in Government Activity in the United States since 1900", National Tax Journal, Vol. VI, No. 4, pp. 393-4; a review of the book of S. Fabricant with the same title. In the same sense: Gerhard Colm, "Public Revenue and Public Expenditure in National Income", Studies in Income and Wealth, Vol. I, pp. 217-18.
  2. S. Fabricant, *op. cit.*
  3. A. T. Peacock and J. Wiseman, The Growth of Government Expenditures in the United Kingdom, 1890-1955, *op. cit.*

The most suitable measure differs from case to case. On the other hand, there are two main ways of constructing a measure or index of the activity of the public sector: proceeding from the input side, and proceeding from the output side. The way of the inputs, even if it is useful for particular analytical purposes - mainly when the object of the research lies on the use of resources by the Government - is, from a global point of view, the less conclusive and that which presents more technical difficulties. Its shortcomings are immediately apparent from the fact that one factor of the inputs does not give a satisfactory measure of the level of activity and of its fluctuations, unless in conditions of fixed proportion of production. That means that when measuring the level of production or of activity from the side of the inputs it is necessary to analyse the use of the different kinds of inputs and, then, to express them in a common unit of measurement or to weigh and combine them in a manner which gives some sort of overall index.

Notwithstanding these difficulties, some authors tackled the problem of the growth of the public sector from that side.<sup>1</sup> If the aim of the analysis is to study the activity of the government as a user of factors, this can form a useful angle for looking at the problem, despite its deficiencies and the theoretical and practical problems it raises.

Another difficulty connected with the use of the inputs as a measure of the level and growth of State activity, and which holds mainly for countries with a not

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1. For instance, S. Fabricant, *op. cit.*, and Moses Abramovitz and Vera F. Eliasberg in the study, The Growth of Public Employment in Great Britain, already quoted.



very well developed statistical system, is of a more empirical character. It results from the inexistence of data on the stock of public and private capital, the sales of the private to the public sector, and the distribution of the labour force between the two sectors in a year-by-year basis over long periods of time. This prevents the use of the input method for analysing the relative growth of public activity in countries like Portugal.

The other way of looking at the level of activity of a sector is through its output, gross or net, that is, the total output of a sector, or to the value added by that sector. Even here we can use several measures of activity.

In what concerns the public sector three main measures have been used to express its level of activity in relation to the whole output of the country:

- (a) The relation between total public expenditure (including transfers) and the national expenditure;
- (b) The relation between the value of the goods and services (gross of the contributions received from other sectors) produced by the public sector, and the national product;
- (c) The relation between the value added by the public sector and the national product.<sup>1</sup>

We need not enter into the conceptual problems related to the aggregate of the national product (gross or net, and at factor cost or at market prices), to be used for each particular purpose, nor into the problems of inclusion or exclusion of particular items of public expenditure as a measure of the activity of the public sector. However, we should note that each of these relations is more suitable than

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1. In each of these cases we can still vary almost indefinitely the measures obtained according to the concept of government activity taken and the solution given to the problems of selection, valuation, and periodising in national income calculations.

the others for certain purposes.

So, the ratio formed by the relation between the total value of the goods and services produced by the government and national income, is the best of the three for measuring the use of resources by the government or the direct allocation of resources made by the government through its productive activity, ( i.e. as opposed to transfer activity). On the other hand, the ratio of total government spending (including transfers), to national expenditure, is the most suitable to gauge the global influence of government activity on the aggregate to spending of the country. Finally, the value added by the government gives the most accurate measure of the relative importance of the public sector as a producer and, at the same time, measures the influence of the State in the allocation of the factors in the final production. It is the only aggregate which allows a direct comparison between the contribution of the public and the private sectors to the production and welfare of the country.

Since the problem we are interested in is the degree of control the government exerts on the allocation of the total resources of the economy through its budgetary policy, the value added is not a good measure for our purposes. Neither would public expenditure on goods and services as a percentage of national expenditure, since this aggregate does not include transfers and subsidies, which form an important part of such a control. So, the best of the three measures for our purpose seems to be the relation between total public expenditure (including transfers) and national expenditure.

It is certainly arguable, as I. Ohlsson does, that to obtain a proper ratio, of which the national income or expenditure form the denominator, the factor used

as a numerator must be a "part" of the denominator.<sup>1</sup> However, our purpose is not, really, to obtain a true or proper "part" or "share" of the public sector in the national income but, instead, to find an index of the importance and growth of governmental activity as a means of securing the best use of the community's resources as defined by the preferences or the social goals of the time, or the accepted social welfare function. And, for that, the inclusion of transfers and subsidies seems necessary as an essential part of the resource allocation made by the government.

The government can, of course, influence the allocation of resources of the country by many ways not reflected in our measure, such as administrative regulations, etc. Our aim, however, consists in studying only that part of government activity called "budgetary", and only for that part of the public sector generally labelled "administrative".

We shall take as an index or measure of the activity in which we are interested, the aggregate public expenditure of the central and local governments including expenditures on goods and services, as well as transfers and subsidies. Nevertheless because of a number of reasons, our totals do not coincide with those which appear in the published government accounts. First of all, we exclude from our totals all transactions which represent mere financial operations, such as repayment of debt and other financial transactions. Second, all internal transactions, or transactions between different levels of government or between bodies of the same level of government, as well as accounting duplications, were also excluded. Third, in the case of trading services, such as the Post Office, harbour administrations, and the boards dealing with the supplying of the country and with economic development,

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1. I. Ohlsson, op. cit., pp. 230-5.

trading activities proper were excluded - only capital formation being considered.

In many cases a clear-cut distinction between the different kinds of expenditures was not easy but in all of them definitions analogous to those followed in national accounting conventions were applied.

### 3. Problems of measurement and comparability.

There are two main points closely connected, but of a quite different nature, which claim clarification when dealing with the problem of quantifying the rather diffuse concept of the level of government activity, or of the degree of control the government exerts on the allocation of the resources of the country.

The first one, which is of a more theoretical nature, concerns the meaning that can be attributed to a quotient in which the numerator is some kind of aggregate public expenditure, and the denominator the national income, product or expenditure.

Is there any meaning that can be ascribed to such a quotient? In the affirmative case, what meaning?

The second point is more of expediency or of an empirical nature, and relates to the definition of the terms of the fraction, or the concepts of public expenditure and national income or expenditure to be taken to obtain the most suitable measure of the phenomenon we have in mind.

We can, doubtless, use a ratio between public expenditure and national expenditure, provided we know what we put into that relation, i.e., provided we keep in mind the true nature of the numerator and of the denominator.

The first point to make clear is that such a relation does not represent, in any way, the share of the government in the national income. If there is more than one quotient or ratio which can be called the public sector's share in national

income or product, the one which we use does not claim to have such a right.

We employ it as a structure indicator, but this expression is understood in a broader sense than that given to it by Akerman in his Ekonomisk Teori,<sup>1</sup> and it is not intended to be a "real" or "genuine" structure quotient in the sense given to that term by Ohlsson.<sup>2</sup>

In actual fact, when we use the widely common process of presenting the aggregate chosen to express our concept of public activity as a percentage of the national product or, expenditure, we are only establishing its order of magnitude in relation to the total amount of resources annually available to the nation for consumption and investment. We are not suggesting that it represents the part of those resources which is being used by the State, and that the rest is what remains for private use. We are not trying to measure the relative contributions of the public and private sectors to the nation's economic welfare or the relative productivity of the two sectors.

In making this point, and in stressing the non-homogenous character of the relation chosen as our "structure indicator" we make it superfluous to emphasise the different types of aggregates that public expenditure and national income or expenditure are, and the differences of valuation embodied in the construction of the two aggregates.

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1. Vol. I, p. 269, quoted by I. Ohlsson, op. cit., p. 233.

2. Ohlsson defines genuine quotients as being those whose numerator is such that when subtracted from the denominator, the residual is of the same type of the numerator and represents the remaining part of that total which is the denominator, i.e., in a "genuine" structure quotient the numerator forms part of the denominator. See, op. cit., p. 233.

The other point which requires some discussion is that which relates to the concepts of public expenditure and national product used in our ratio and the appropriateness of this ratio to measure the phenomenon we try to analyse.

From the acceptance of the non-homogeneity of the two terms of the relation it does not follow that the choice of concepts does not matter. The degree of meaningfulness is not the same for every pair of concepts of public expenditure and national product or expenditure, and we must, besides trying to reach a degree of comparability as high as possible between the two terms of the quotient, choose the relation supposed to be the best approximation to our problem.

Since we are not interested in measuring the relative contributions of the public and the private sectors to the total product of the country, nor in their relative shares in the use of its resources, but in the extent of public control or direct influence on the allocation of those resources, it follows that we cannot leave aside the amount of transfers and subsidies which form part of public expenditure. To do that would be to make our measure rather meaningless, since transfers made through the budget are an important element in the process of resource allocation in the mixed economies of our time. So, our aggregate of public expenditure will not include expenditures on goods and services alone, but also transfers and subsidies made by the State to other sectors of the economy.

Having made this point, it seems that the most suitable concept of national output or expenditure to refer to, should include an item similar to that of government transfers for the economy as a whole. But there is no such aggregate in the current national income calculations and we have to choose from the existing aggregates (or from those which can be constructed with the help of the available data) the most suitable for our purpose.

At first sight it seems that the most appropriate aggregate would be the gross national product at market prices, since government expenditures are computed gross of depreciation of the public capital stock and goods and services are paid for at current prices. However, when looking more carefully at the problem, one recognizes that the element of indirect taxation included in the valuation of the national product at market prices introduces in the comparison an important factor of uncertainty. Since the main object of our study is the comparison of governmental activity through a long period of time, the changes from direct to indirect taxation, and vice-versa, would alter our ratio. The best solution would be to take national product at factor cost and public expenditure excluding the indirect tax content. Unfortunately, that exclusion is not possible except for countries which have input-output tables. Further, it is only possible to do this for the most recent years, even if we are prepared to extrapolate the data on the basis of certain assumptions.

On the other hand, the examination of input-output tables shows that the indirect tax content of public consumption varies between 1 per cent and 2 per cent in most countries for which there are input-output tables available,<sup>1</sup> and it is 2% on average, in the O.E.E.C. member countries taken together.<sup>2</sup> It is difficult to estimate how large it is in Portugal. It does not seem, however, that the margin of error introduced when taking public expenditures gross of their indirect

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1. The most outstanding exceptions in Europe are, Netherlands with 4% rate, and France and Germany with around 5%.
  2. On the basis of the input-output table of Western Europe, published by O.E.E.C.

tax content will be appreciable. As our main concern lies in comparisons through time, and during the period for which we have estimates of the national income there were no profound changes in the tax structure, it seems that to take public expenditures gross of the indirect tax content, and national product at factor cost, is still the most sensible solution which we can devise. So, we took as our measure of the direct influence of the government's budgetary policy on the allocation of the resources of the country, the relation between public expenditures on goods and services, plus transfers and subsidies (net of inter-governmental payments and accounting duplications), and national product at factor cost.

#### 4. Deflating Public Expenditure.

When faced with the problem of choosing a deflator for transforming public expenditures in money terms into public expenditures in real terms, either to measure their absolute quantum of growth; or to compare it with the growth of the national product, we are confronted with the whole range of problems presented by the construction and use of index numbers.

First of all, we have to bear in mind the fact that an index number is a mere statistical device to measure in an indirect way the magnitude of a change which is not susceptible, either of accurate measurement in itself, or of direct valuation in practice.<sup>1</sup>

Having to gauge the overall change in a group of distinct and independent variables between two or more points in time, we have no other way, but to use a tool which, by means of a procedure of aggregation allows us to compress multi-dimensional space into linearity. An index number is, then, only a measure of

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1. F. Y. Edgeworth, "The Plurality of Index Numbers", Economic Journal, 1925, quoted by R. G. D. Allen in Statistics for Economists, London, 1959, p. 102.

dispersion, and it is possible to find several alternative measures of dispersion. Since there is no a priori "best" measure of dispersion or ideal index number,<sup>1</sup> and each formula has its particular meaning, we cannot avoid the problem of the fitness of a particular index to the phenomenon we want to measure.

Not speaking of the general problems connected with the construction of index numbers and of the theoretical conditions required for their proper application, and circumscribing our discussion to the particular problem we have to tackle, there are three relevant questions to put:

- (a) What do we intend to measure?
- (b) What does our index number measure?
- (c) What is the relation between what we want to measure, and what our index number does measure?

What we want to measure is the amount of resources handled by public authorities through the budgetary mechanism through time. The important point is, of course, that of determining the relative amount of these resources taking the national output as the other term of the comparison. Since we have no reliable data on the national product except for a small period of time in the most recent years, the main problem related with the use of the deflator is that of measuring the amount of resources not only used, but whose allocation was directly influenced by public authorities by means of the budget.

Public expenditures gross of transfers and subsidies, which we take as representing the amount of these resources, are expressed in money terms, reflecting current prices and factor payments. The annual series of these expenditures tells

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1. Even if there is one with this name.

us little about how that amount has really changed from year to year, for they are vitiated by price changes. To go behind the "monel veil" in order to find the quantity changes - these taken in the economic sense of changes in "real" value - we need to expurgate the overall change of changes in the value of money. To do that, we needed, strictly speaking, an index number with the same coverage of the aggregate measured, a suitable formula, and an adequate system of weights. If the best index for that purpose would be one of the Laspeyres' form or one of the Paasche's form (or some combination of both, such as that proposed by Marshall and Edgeworth) is a problem that cannot be decided without an examination of the dispersion of the p's and q's.

In relation to the second question - what does our index number measure? - we have to begin with a description of the type of index we used as a deflator.

Our index number - the only available for the period previous to 1928, is an index number of retail prices of the Laspeyres' form and with a small coverage.<sup>1</sup> What it intends to measure is the cost of living in Lisbon.

Even for that purpose it seems scarcely adequate, due to its small coverage and to the doubtful correspondence of its system of weights, to some kind of average or typical family budget (even ignoring the possible meaning of such a concept) as representative of the cost of living in the country.

For the purpose of deflating public expenditures, its main weakness lies in the fact that it does not include public services. Thus, it fails to meet, in a

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1. Details on the composition of this index are given in the Appendix on Sources and Methods.

basic point, the theoretical requirement of having the same coverage as the aggregate it intends to measure. Then, the bold assumption has to be made that the value of public services moved in the same manner as the prices of consumer goods in general, and this is very doubtful.

On the other hand, our aggregate of public expenditure includes transfers and subsidies. In relation to transfers to consumers the use of an index of retail prices as a deflator does not seem subject to much criticism (provided the index reflects the "true" movements of consumer's prices). In what concerns subsidies, it can be argued whether the most appropriate index would be a wholesale or a retail price index, but the ultimate decision would depend on the point of the chain of production in which they are introduced, and on their final effect upon consumer's prices. Were it feasible, the best method would probably be to use a wholesale price index for deflating some subsidies and a retail price index for others.

Having answered in general terms the two first questions - "What do we intend to measure?" and "What does our index number measure?" - the third question - "What is the relation between what our index number measures and what we intend to measure with it?" - is also answered. The answer is that the index used is quite inadequate to measure what we intended to measure.

In practical terms what we can say is that the index used was the only one available, and a wholesale price index, even if it had existed, would not have been more suitable for our purpose. The current wholesale price indexes do not include public services and, furthermore, they fail to enter into account with changes in the relative costs of distribution. Thus they would be still farther from revealing the changes in our concept of economic value of the resources handled by

public authorities.

If we apply to public expenditures, as it seems reasonable, the rule that the best deflation of national product is that which is arrived at by the use of a series of sectional price indexes, each one applied to one particular sector with the largest coverage possible inside the sector, and an adequate weighting system, we shall conclude that the best deflator for public expenditures would be one composed of at least two different indexes: one expressing the cost of producing given amounts of public services of a given standard through time, duly weighted by the quantities of services in terms of the relative amounts of expenditures consumed by them; and another for transfers, which would be a kind of index of cost of living, showing the evolution of the cost of living of the average or typical receiver of transfers from the government. Such indexes, which are already compromises of the theoretical requirements of the appropriate index number with considerations of feasibility, would be hard to construct and not less difficult to keep meaningful for a long period of time.

Up to now we have considered the problem of deflating public expenditure taken as a separate and independent aggregate, i.e. of expressing its value in a fixed unit of reference. However, our major concern is in comparing the resources handled by the State with the total resources annually available to the community for consumption and investment, and this raises another difficulty.

In actual fact, we only have data for the national product for a much shorter period of time than for public expenditures; but, the problem of allowing for changes in the money value of the two aggregates considered together has to be faced.

Did their relative quanta change in the same direction as their relative money values?

The practice of comparing the national income or product with its components through time without deflating them previously, is quite common. In theory it involves the assumption that the relation between the money values of the two aggregates move in the same way as the ratio of their real values or, in other words, that their money values stretch equally. In practice, the consideration behind this procedure is that the error committed when we deflate the two aggregates can easily distort the relation in a greater extent than when the money values are taken without deflation. In certain cases, however, as in estimating the rate of investment through time, it can well happen that the prices of capital goods and those of consumer goods move at such a different pace, that to take them in money values can produce a quite erroneous result.

Apart from this possibility, in the case of public expenditures, we have to consider the fact that they include transfers and subsidies, which do not form part of the national income.

What is then the best procedure: to deflate both aggregates - public expenditure and national product - before comparing them, or to compare directly their money values without deflating them?

The fact that public expenditures include a fair amount of transfers, which are not accounted for in national income calculations, does not seem to invalidate the use of the same index or indexes for deflating the national product and public expenditures, for changes in the purchasing power of a given amount of transfers can well be taken into account by the index used for deflating the national product. Such a procedure, indeed, does not seem to introduce a greater error than when we deflate public goods and private goods with the same index or when we deflate capital and consumer goods with an overall index. The problem is more one of

deciding whether the index used is appropriate for deflating the kind of aggregates to which we are applying it, or not. The use of a single index for deflating both aggregates scarcely can be adequate, given the differences in their composition. This, however, does not follow from the fact that public expenditures include transfers and the national product does not.

A priori we have no criterion for deciding what is the best combination of indexes, but there is a strong ground for supposing that if it were possible the most accurate result would be reached by using different index numbers for the different aggregates or components of public expenditure and national product.

In practice we have no other way of knowing the difference which makes use of different deflators, except by trying them and comparing the results of the possible alternatives.

Such a comparison is not possible for Portugal. It was made for Great Britain<sup>1</sup> by establishing the ratio between public expenditure and national product before and after deflating both aggregates and the conclusion was that the difference between the ratios obtained by the two procedures was so small (less than 0.2% for the most of the years) that for the purposes of applied research is almost indifferent to use one or the other.

In our case, as we had no reliable indexes for making a proper deflation of our aggregate, it seemed to us that to establish the ratio of public expenditure to national income without deflating these two aggregates, would involve the least degree of error. This procedure was, therefore, chosen.

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1. By A. T. Peacock and J. Wiseman in The Growth of Government Expenditures in the United Kingdom, 1890-1955, op. cit.

CHAPTER III.

THE PATTERN OF GROWTH OF PUBLIC EXPENDITURE IN PORTUGAL.

It is the object of this chapter to analyse the time-pattern of the growth of public expenditure in Portugal in order to find some of the relevant factors which contributed to that growth. We say "some" of the relevant factors, and not "the" factors, because the study of the influences accounting for the growth of public expenditure cannot be complete before the analysis of the growth of different categories of expenditure is made. And that analysis forms the content of the next chapter. Meanwhile, some of the factors which contributed to the increase in the absolute level of expenditure will be detected in the analysis of the time-pattern of the growth.

The best way of conducting this analysis in aggregative terms would consist in discussing the growth of the expenditures of all levels of government taken together and considering afterwards separately the behaviour of the expenditures of the central and the local governments. Since the available data concerning local authorities do not go further back than 1928, while central government data go as far back as the beginning of the century, it seemed preferable to examine separately the expenditures of the two levels of government, and only after that make some references to the increase in total expenditures for the period for which there are data.

1. The Growth of the Expenditures of the Central Government.

(a) The Absolute Growth of Expenditure.

Table I presents the expenditures of the central government in current and in

TABLE I.

## Expenditure of the Central Government in Portugal

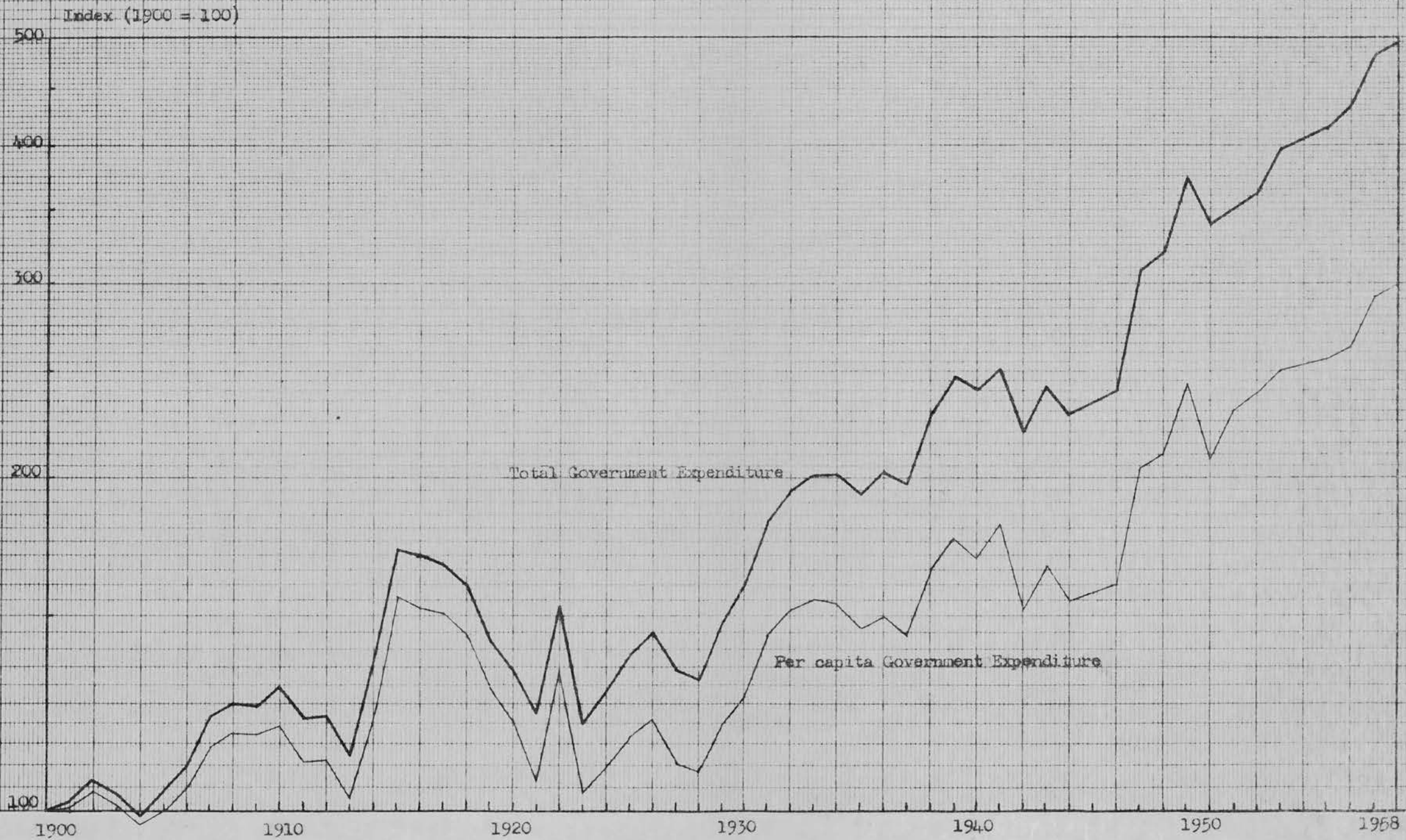
(1900 - 1958)

(1,000 millions of escudos)

Year	Expenditure at current prices	Price Index Deflator	Expenditures at 1914 prices	Index of Growth 1900=100	Year	Expenditure at current prices	Price Index Deflator	Expenditures at 1914 prices	Index of Growth 1900=100	Year	Expenditures at current prices	Price Index Deflator	Expenditures at 1914 prices	Index of Growth 1900=100
1900	45.0	90.1	49.9	100	1919	224.5	313.6	71.6	143	1939	2,361.6	1,916	123.3	247
1901	45.7	90.0	50.8	102	1920	318.6	475.2	67.1	134	1940	2,408.0	2,009	119.9	240
1902	46.0	87.3	52.7	106	1921	448.3	728.1	61.6	123	1941	2,848.6	2,268	125.6	252
1903	46.5	90.0	51.7	104	1922	748.2	983.0	76.1	153	1942	3,026.3	2,758	109.7	220
1904	47.4	96.4	49.2	99	1923	966.7	1,613	59.9	120	1943	3,758.4	3,111	120.8	242
1905	49.4	95.5	51.7	104	1924	1,217.8	1,908	63.8	128	1944	3,650.0	3,208	113.8	228
1906	52.5	95.5	54.9	110	1925	1,454.6	2,115	68.8	138	1945	4,067.7	3,479	116.9	234
1907	57.7	95.5	60.5	121	1926	1,607.9	2,224	72.3	145	1946	4,765.0	3,980	119.7	240
1908	60.2	96.4	62.4	125	1927	1,673.7	2,499	67.0	134	1947	6,306.6	4,103	153.7	308
1909	60.4	97.3	62.1	124	1928	1,595.1	2,427	65.7	132	1948	6,188.2	3,881	159.5	320
1910	60.5	93.6	64.6	129	1929	1,729.1	2,361	73.2	147	1949	7,338.5	3,920	187.2	375
1911	60.3	99.1	60.8	122	1930	1,792.8	2,243	79.9	160	1950	6,454.4	3,819	169.0	339
1912	61.0	99.1	61.6	123	1931	1,811.4	1,990	91.0	182	1951	6,959.0	3,872	179.7	360
1913	57.0	100.9	56.5	113	1932	1,893.5	1,949	97.2	195	1952	7,294.4	3,878	188.1	377
1914	67.8	100.0	67.8	136	1933	1,956.3	1,948	100.4	201	1953	7,765.9	3,913	198.5	398
1915	95.9	111.2	86.2	173	1934	1,975.1	1,968	100.4	201	1954	7,978.3	3,944	202.3	405
1916	116.0	137.1	84.6	170	1935	1,920.6	1,982	96.9	194	1955	8,423.9	4,077	206.6	414
1917	143.3	172.1	83.3	167	1936	2,049.8	2,022	101.4	203	1956	9,218.3	3,256	216.6	434
1918	187.2	234.2	79.9	160	1937	2,065.3	2,102	98.3	197	1957	10,166.7	4,257	238.8	479
					1938	2,310.2	2,037	113.4	227	1958	10,490.0	4,258	246.4	494

GRAPH I.

INDEX OF TOTAL AND PER CAPITA GOVERNMENT EXPENDITURE...  
AT CONSTANT (1914) prices, 1900 - 1958.



real terms since the beginning of the century, as well as the index of growth of these expenditures on the basis of their level in 1900.

From that table, and from graph I, we can see that since the beginning of the century up to 1958, the expenditures in real terms experienced an increase of five times, and that this increase was quite unevenly distributed through time.

First, and in very broad terms, we can say that the increase occurred in two different periods: 1900-10 and 1928-58 - particularly in the years following the Second World War.

At first sight it seems quite impossible to explain this growth in all its aspects on the basis of a single factor, such as the increase in income per head or the effect of wars. There are some factors, however, whose influence on that growth is immediately suggested by an examination of the time-pattern. The first one is that of the price movements.

There is quite a striking inverse correlation between the growth of public expenditure and the price index movements. The first period in which we notice an appreciable increase in the absolute level of public expenditure, that of 1900-10, was one of only slightly rising prices: an increase in expenditures of 29% coincided with an increase of less than 5% in the general level of prices.

The war years, and especially 1915, the year in which Portugal entered the war, had of course relatively high expenditures. However, immediately after the war, expenditures in real terms declined to the pre-war level, or even lower, remaining at that level up to 1928. In that year Dr. Salazar took power as a Minister of Finance. Then we observe an inverse correlation between the movements in the index of prices and those of expenditures in real terms. From the end of

World War I, and up to 1923, the country lived in a period of galloping inflation in which the tax system, mainly based on property tax and import duties assessed almost entirely on a "specific" basis, showed itself completely incapable of matching the decline in the value of money and coping even with the maintenance of a very low standard of public services. The budgetary deficit formed the main concern of all governments of that epoch, and they tried every expedient to find cash for the meagre activity of the State.

In the three years which followed 1923 there was a temporary increase in public expenditures in real terms which coincided with a slowing down in the rate of increase in prices. After the new financial administration restored the stability of prices in 1928 there began a new regular increase in the level of public expenditure (the period from 1927 to 1933 was one of declining prices, followed by a period of relatively stable prices up to the Second World War).

Even the experience of wartime was in accordance with the trend that large increases in the price level prevented the growth of public expenditure in real terms. In actual fact the expenditures of the central government, in real terms, remained almost stationary during the war.

It was just after the war that Portuguese public expenditures experienced their greatest push upwards. That increase deserves careful explanation, but before trying to see what accounted for it, it seems convenient to refer to some aspects of that growth.

The first one is its relation to political factors. It is difficult to avoid feeling that the trends and behaviour of the spending of the central government bore some relation to the political ventures of the country. One is compelled to relate the periods of regular growth of the expenditures in real terms with

administrative stability, and the irregularity and the incapacity of maintaining the level of expenditure with government instability. That does not mean that we believe this relationship necessarily holds at all times, but only that, owing to particular reasons, such a relationship between the two phenomena was experienced broadly in Portugal in the last six decades.

The period up to 1910 was, indeed, one of relative stability in government. It included a short experience of dictatorship under the premiership of João Franco while the monarchy was still in power. During the last two years of the monarchy, after the regicide in 1908, the regime gradually grew weaker with an inexperienced and powerless young king at the head of the State. But it was not until 1910 that the change to the Republican regime occurred.

The years which followed, up to 1926 (the year in which General Gomes da Costa seized power), were of almost permanent government instability with continuous cabinet failures at an average of some two per year. It was also a period in which there were no permanent increases in the absolute level of expenditure. An upward trend only reappeared after 1928, when governmental continuity and price stability were restored.

The explanation for this relation between government continuity and the growth of public expenditures comes, probably from two different factors: one, which was already pointed out, was the alleged incapacity for weak and non-lasting governments to enforce price stability or to adapt the tax structure of the country to a context of rapidly growing prices; the other proceeds from the different approaches to vote-catching or the ways of gathering support from the nation at large. Even during the last years of the monarchic regime, governments which could last in power for some time probably believed that the ultimate test of their administration and,

hence, the support they could get from the electorate, rested upon the "working" of public institutions, i.e., public works and the standards of services. Governments whose support rested on very mobile electorates and unstable parliamentary coalitions believed, probably, that they could remain longer in power if they did not challenge the tax-payer with an always apparently growing tax bill. They preferred, in general, to rely on deficit financing and in treasury expedients which, in the end, worked in the opposite direction to that desired.

The Salazar Administration, having come to power with the explicit plan of fighting inflation, strengthening the position of the escudo, and restoring the balance between revenue and expenditure by curbing the wastage of funds, began by reforming the law governing public expenditure procedures in 1928, and by reforming the tax system in 1929. The Administration relied, not so much on maintaining the level of expenditure, but, instead, on restoring price stability, balanced budgets, and on the material achievements of its programmes of public works (mainly in the fields of road construction, harbour modernization and the building of schools).

The balanced budget was restored, but not as much as a result of the economies enforced by tighter control of expenditures, as is generally believed, but through an increase in tax proceedings.

There was, however, an increase in the level of government expenditure which was not only an increase in the absolute level, but also an increase in its share of national expenditure. This occurred after the Second World War, but it claims for a different and more detailed explanation.

However, before trying to analyse it there are two other aspects to consider in connection with the trends shown by the absolute level of expenditure of the central government. The first refers to the impact of unemployment on that level.

It is impossible, due to the lack of statistical data, to conduct a detailed analysis on that point. Nevertheless, there is one conclusion which appears to be quite safe to draw from a mere analysis of government accounts: unemployment did not exert a permanent effect on the level of expenditure of the central government.

Neither the Portuguese National Institute of Statistics nor the Department corresponding to the British Ministry of Labour - the "Ministério das Corporações" - collect regular data about the state of employment in the country. In the last censuses of population, there were some data on unemployment, but they were quite incapable of giving a true picture of the state of employment: first, because they completely overlooked partially unemployed (those who only work three or four days per week, for instance) which forms the main problem of concealed employment in the country; and second because they exclude those who look for employment for the first time.

With only a broad knowledge of the Portuguese economic history of the last half-century, and from reading the reports which accompanied the accounts of the government in their presentation to Parliament, one ascertains that unemployment formed a major concern of governments, especially in the first half of the 1920's, and even in some years of the First World War (especially 1915 and 1916).

In 1915 and 1916, as well as from 1920 to 1925, expenditures on public works and different forms of helping agriculture - directed to fight unemployment and the economic crisis experienced by the country - accounted for the main part of the increase in expenditures which appears under the heading of "economic services", and which were considerably inflated for these years.

Notwithstanding the general concern with the problem of unemployment and the "economic crisis", these factors were unable to produce a permanent increase in the level of expenditures of the central government. Indeed, after having reached very high levels, those expenditures returned to their previous level, if not to a lower one.

A last major point to consider in relation to the growth of expenditures in real terms is that of the effect of the two world wars on the growth of public expenditure.

As it is clear from Table I and the corresponding graph, no permanent effect was left over by World War I on the level of expenditure. War, mainly through the increase in defence expenditures, either in the Metropolis or in the Colonies, produced a temporary raise of expenditure. However, as soon as the defence effort ceased to require an important amount of public resources, expenditures fell to their previous level, notwithstanding the permanent financial obligations left over by the war, which continued to inflate the budget up to the beginning of the 1920's.

The effect produced by World War II is much more complicated to analyse and we prefer to discuss it in detail in the Conclusions, when trying to reconcile the different factors which determined the growth of public expenditure in Portugal during our period of analysis. It is, however, important to note that the expenditures of the central government - as well as those of the local authorities - did not increase in real terms during wartime. There was a quite substantial increase in expenditures in money terms: they more than doubled from 1938 to 1946; but once more a rapid devaluation of money prevented them from growing in real terms.

The period subsequent to the war knew a permanent increase of expenditures not only in absolute real terms, but also as a percentage of the national product.

An adequate explanation for this growth, however, cannot be provided at this stage of the analysis.

(b) The Growth of Expenditures per head.

The study of the growth of public expenditure per head will lack a good deal of meaning without some knowledge of the movement of national income or product per head.

The growth of population can, indeed, influence the trend of public expenditure in more than one direction. It is to be expected that for most categories of expenditure the absolute amount of outlays is forced to grow, just to maintain a given standard of service. Thus it is for education and, one should expect, law and order, many of the social services, and for some categories of economic services. But, the hypothesis of the maintenance of a given standard of service is not a necessary one and, in relation to some categories, it can be an idle one. Relief payments and expenditures on public assistance in general can very well diminish when population grows if such growth is accompanied by an improvement in the conditions of employment and the general standard of living, especially if it benefits in particular the lower income groups.

Unfortunately, we cannot relate with any accuracy, the trend of expenditures per head, either with the output per capita, or with the state of employment for the whole period of our analysis.

It is difficult to establish any well founded hypothesis on the growth of the Portuguese national income per head, given the lack of information for most of the period.

Another factor related with population growth which can influence not only the amount, but also the composition of public expenditure, is the distribution of the

TABLE II.

Per Capita Expenditure of the Central Government in Portugal (1900 - 1958).

Year	Expenditures at 1914 prices (1,000 mn. escudos)	Resident Population (1,000's.)	Expend. per head at 1914 prices	Index of Growth	Year	Expend. at 1914 prices (1,000 mn. escudos)	Resident Population (1,000's.)	Expend. per head at 1914 prices	Index of Growth	Year	Expend. at 1914 prices (1,000 mn. escudos)	Resident Population (1,000's.)	Expend. per head at 1914 prices	Index of Growth
1900	49.9	5,423	9.20	100	1919	71.6	6,022	11.89	129	1939	123.3	7,595	16.23	176
1901	50.8	5,452	9.32	101	1920	67.1	6,033	11.12	121	1940	119.9	7,722	15.53	169
1902	52.7	5,500	9.57	104	1921	61.6	6,079	9.87	107	1941	125.6	7,758	16.88	183
1903	51.7	5,549	9.32	101	1922	76.1	6,159	12.36	134	1942	109.7	7,830	14.01	152
1904	49.2	5,598	8.79	96	1923	59.9	6,238	9.60	104	1943	120.8	7,902	15.29	166
1905	51.7	5,647	9.16	100	1924	63.8	6,317	10.10	110	1944	113.8	7,974	14.27	155
1906	54.9	5,696	9.64	105	1925	68.8	6,396	10.76	117	1945	116.9	8,046	14.53	158
1907	60.5	5,744	10.53	114	1926	72.3	6,476	11.16	121	1946	119.7	8,118	14.75	160
1908	62.4	5,793	10.77	117	1927	67.0	6,555	10.22	111	1947	153.7	8,190	18.77	204
1909	62.1	5,842	10.63	116	1928	65.7	6,634	9.90	108	1948	159.5	8,262	19.31	210
1910	64.6	5,891	10.97	119	1929	73.2	6,713	10.90	118	1949	187.2	8,333	22.46	244
1911	60.8	5,960	10.20	111	1930	79.9	6,826	11.71	127	1950	169.0	8,441	20.02	218
1912	61.6	5,965	10.33	112	1931	91.0	6,878	13.23	144	1951	179.7	8,477	21.20	230
1913	56.5	5,973	9.46	103	1932	97.2	6,968	13.95	152	1952	188.1	8,549	22.00	239
1914	67.8	5,981	11.34	123	1933	100.4	7,057	14.23	155	1953	198.5	8,621	23.03	250
1915	86.2	5,989	14.39	156	1934	100.4	7,147	14.05	153	1954	202.3	8,693	23.27	253
1916	84.6	5,997	14.11	153	1935	96.9	7,237	13.39	146	1955	206.6	8,765	23.57	256
1917	83.3	6,005	13.87	151	1936	101.4	7,326	13.84	150	1956	216.6	8,937	24.24	263
1918	79.9	6,013	13.29	144	1937	98.3	7,416	13.26	144	1957	238.8	8,909	26.80	291
					1938	113.4	7,506	15.11	164	1958	246.4	8,980	27.44	298

population per age group. In the case of Portugal the fertility rate has been fairly stable with a slight trend to decline in the last decades. The First World War produced a small "dent" in the population pyramid followed by an increase in the school age groups at the end of the twenties and in the thirties. The effect of these changes, even in particular categories of expenditures (mainly education), appear as having been of relatively minor significance compared with the influence of the general change of opinion concerning education which has occurred in the last decades. The impact of the ageing of the population, on pensions for instance, was negligible given the fact that up to World War II only the civil servants had a well-established right to old age pensions. Lately the age of retirement has been successively increased, which probably more than offset the effect of the ageing of population. In any case it is extremely difficult and almost guesswork to attempt to separate the influences of these factors on public expenditures in general.

Comparing the growth of the expenditure of the central government in absolute terms with the growth on a per capita basis, we can notice that from the beginning of the century till the end of the fifties the expenditure per head has grown only three times which is a little more than half the five times increase in the same expenditures in absolute real terms.

Part of the relatively rapid increase in expenditures in absolute terms after the Second World War was the result of the growth of the rate of increase in population. In effect, the slope of the curve of expenditures per head after the war does not differ greatly from that of the period between 1928 and the end of the war.

## 2. The Growth of Expenditure of Local Governments.

Taking 1928 as a basis, and considering only the rates of growth of the expenditures of the central and local governments in real terms, we find that the average annual rate of growth of the two levels of decision-taking in the public sector during the last thirty years was quite similar. While the expenditures of the central government grew  $3\frac{3}{4}$  times during the three decades beginning in 1928, the expenditures of the local governments experienced a  $3\frac{1}{4}$  fold increase.

The pattern of growth of the expenditures of the two levels of government, however, was rather different.

As can be seen from Table III and Graph II, there have been three different relative positions of the indexes of growth of the expenditures of the central and the local governments compared with the 1928 level. From 1928 to 1932, the index expressing the growth of the expenditures of the local authorities on the basis of 1928 remains under the index of growth of the expenditures of the central government; from 1933 up to 1949 the relative position of the two indexes is opposite; but in 1950 the index corresponding to the expenditures of the central government overtook that of the expenditures of the local governments.

A feature to notice in the picture is that of the decline in the absolute level of local expenditure in real terms after 1941 and of its slow recovery up to 1946; this was a result of the inflation experienced during the war.

Trying to explain the behaviour of the index of growth of local expenditures we would say that from 1928 up to 1932 local expenditures failed to keep pace with the growth of expenditures of the central government as a result of the late reform of the local taxes powers. The last reform of the central tax system, indeed, was introduced in 1929, whereas that of the Administrative Code, which defines the tax

TABLE III.

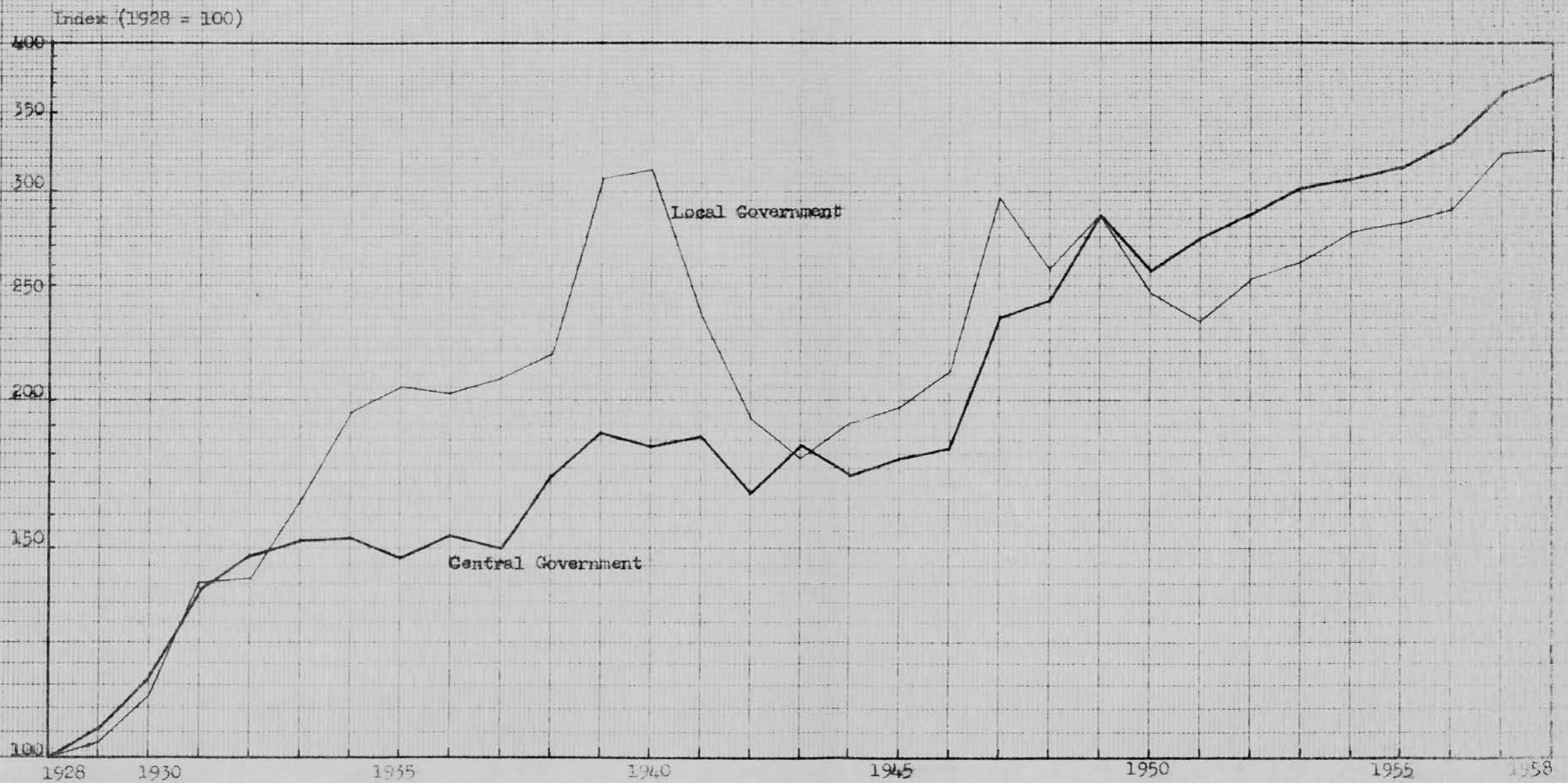
## Expenditures of the Local Governments in Portugal (1928-1958)

(millions of escudos)

Year	Expenditure at current prices	Price Index Deflator 1914=100	Expenditure at 1914 prices	Index of Growth	Year	Expenditure at current prices	Price Index Deflator 1914=100	Expenditure at 1914 prices	Index of Growth
1928	283.0	2.427	11.66	100	1943	650.7	3.118	20.87	179
1929	284.3	2.361	12.04	103	1944	716.1	3.208	22.32	191
1930	305.7	2.243	13.63	117	1945	798.8	3.479	22.96	197
1931	325.0	1.990	16.33	140	1946	978.3	3.980	24.58	211
1932	320.8	1.949	16.46	141	1947	1,417.2	4.103	34.54	296
1933	373.7	1.948	19.18	164	1948	1,162.3	3.881	29.95	257
1934	447.9	1.968	22.76	195	1949	1,307.3	3.920	33.35	286
1935	473.8	1.982	23.91	205	1950	1,097.4	3.819	28.74	246
1936	478.9	2.022	23.68	203	1951	1,055.0	3.872	27.25	234
1937	512.0	2.102	24.36	209	1952	1,143.0	3.878	29.45	253
1938	519.4	2.037	25.50	219	1953	1,196.8	3.913	30.59	262
1939	686.7	1.916	35.84	307	1954	1,275.9	3.944	32.35	277
1940	733.7	2.009	36.52	313	1955	1,333.5	4.077	32.71	281
1941	627.9	2.268	27.69	237	1956	1,438.6	4.256	33.80	290
1942	622.8	2.758	22.58	194	1957	1,601.6	4.257	37.62	323
					1958	1,610.0	4.260	37.79	324

GRAPH II.

INDEXES OF CENTRAL AND LOCAL GOVERNMENT EXPENDITURE  
AT CONSTANT (1914) PRICES 1928 - 1958



powers of the local governments only came into force in 1933. Since then, and up to the middle of the war, a policy of local development not yet impaired by the new ideas of centralization of the process of decision-taking, manifested itself in a faster rate of growth of expenditures at the local rather than at the central level. Afterwards inflation curbed local expenditures in real terms, producing a big slump up to the end of the conflict. After the war there was a tendency for local expenditures to revive, but with the trend for centralization, developed during and after the war, the rate of growth of the expenditures of the central government soon outstripped that of the expenditures of local authorities.

In terms of the shares of the two levels of government in total public expenditures, as is shown in Table IV, two distinct periods of opposite trends can be detected: one of almost continuous growth on the part of the local governments in total expenditures, which goes up to 1940, bringing their share from around one seventh to more than one fifth; and the other from 1940 onwards which, after some fluctuations, shows a marked trend for the decline in that share. After 1951, however, local expenditures in relative terms more or less stabilized around one seventh of the total.

Tables III and IV tell us how the expenditures of local authorities behave in comparison with those of the central government, but they are not conclusive on the important point of the trends towards centralization or decentralization in the process of decision taking. They suggest some degree of centralization rather than the opposite, since the part of local authorities in total public expenditures was declining, but we cannot say to what extent such decentralization took place without examining the proportion of receipts that local governments obtain out of taxation and the importance of grants in aid to their revenue.

TABLE IV.

Expenditures of the Central and Local Governments and their Relation to Total Public Expenditure in Portugal.

(millions of escudos)

Year	Expenditure of the Central Government		Expenditure of the Local Government		Total	Year	Expenditure of the Central Government		Expenditure of the Local Government		Total
	Amount	%	Amount	%			Amount	%	Amount	%	
1928	1,595.1	84.9	283.0	15.1	1,878.1	1947	6,306.6	81.7	1,417.2	18.3	7,723.8
1929	1,729.1	85.9	284.3	14.1	2,013.4	1948	6,188.2	84.2	1,162.3	15.8	7,350.5
1930	1,792.8	85.4	305.7	14.6	2,098.5	1949	7,338.5	84.9	1,307.3	15.1	8,675.8
1931	1,811.4	84.8	325.0	15.2	2,136.4	1950	6,454.4	85.5	1,097.4	14.5	7,551.8
1932	1,893.5	85.5	320.8	14.5	2,214.3	1951	6,959.0	86.8	1,055.0	13.2	8,014.0
1933	1,956.3	84.0	373.7	16.0	2,330.0	1952	7,294.4	86.5	1,173.0	13.5	8,437.4
1934	1,975.1	81.5	447.9	18.5	2,723.0	1953	7,765.9	86.6	1,196.8	13.4	8,962.7
1935	1,920.6	80.2	473.8	19.8	2,394.4	1954	7,978.3	86.2	1,275.9	13.8	9,254.2
1936	2,049.8	81.1	478.9	18.9	2,528.7	1955	8,423.9	86.3	1,333.5	13.7	9,757.4
1937	2,065.3	80.1	512.0	19.9	2,577.3	1956	9,218.3	86.5	1,438.6	13.5	10,656.9
1938	2,310.2	81.6	519.4	18.4	2,829.6	1957	10,166.7	86.4	1,601.6	13.6	11,768.3
1939	2,361.6	77.5	686.7	22.5	3,048.3	1958	10,490.0	86.7	1,610.0	13.3	12,100.0
1940	2,408.0	76.6	733.7	23.4	3,141.7						
1941	2,848.6	81.9	627.9	18.1	3,476.5						
1942	3,026.3	82.9	622.8	17.1	3,649.1						
1943	3,758.4	85.2	650.7	14.8	4,409.1						
1944	3,650.0	83.6	716.1	16.4	4,366.1						
1945	4,067.7	83.6	798.8	16.4	4,866.5						
1946	4,765.0	83.0	978.3	17.0	5,743.3						

Table V presents the amount of grants in aid received by local authorities from the central government as a percentage of local expenditure.

We have no data on the amount of grants in aid received by local authorities except for 1938 and the years since 1947. It is thus very risky to compare the importance of this source of income before and after the war; furthermore, the figures we have do not establish a clear trend.

In all years after the war, grants in aid formed a greater proportion of local expenditures than in 1938. We cannot say, however, that 1938 was a normal year in that respect, since the grants in aid vary quite substantially from year to year. It is suggested by the figures, however, that the importance of grants in aid in the expenditures of the local governments has increased somewhat since 1938, though that increase was in no sense pronounced.

TABLE V.

GRANTS IN AID AS A PROPORTION OF LOCAL EXPENDITURES

Year	Total Expenditure	Grants in Aid	Percentage
1938	519.4	27.1	5.2
1947	1417.2	78.3	5.5
1948	1162.3	111.8	9.6
1949	1307.3	74.4	5.7
1950	1097.4	59.5	5.4
1951	1055.0	61.4	5.8
1952	1143.0	71.2	6.2
1953	1196.8	83.9	7.0
1954	1275.9	98.1	7.7
1955	1333.5	111.4	8.4
1956	1438.6	91.1	6.3
1957	1601.6	112.3	7.0

A point which would help to analyse the trend in the relative importance of the two levels of government in the process of decision-making is that related to the nature of the grants in aid. What proportion of the grants of the central government to local authorities are tied? There is no available data, and we have to look at the normal administrative procedures surrounding these grants. As a normal rule - we would say that almost in their entirety - grants in aid to local authorities are attributed to given projects, and projects which in general require at least the formal approval of a central body (normally the Ministry of Works through its various departments). Thus, they are almost entirely tied, at least in a formal sense, though apart from technical supervision, local authorities enjoy almost a complete degree of freedom in choosing their projects. The rule is for the central government to contribute to a wide range of local projects up to 50% of their total cost.

The only element in which we can judge the relative degree of freedom of the local governments in the use of their grants in aid before and after the war is the proportion of these grants which goes to capital and current expenditures respectively. In what concerns current expenditures, local governments enjoy practically complete freedom of decision, only subject to some legal requirements. In the use of grants in aid for capital purposes there exists the fact that the projects for which they are attributed are carefully examined by the central government, at least in their technical aspects.

The distribution of grants in aid to local authorities between current and capital accounts have changed considerably since 1938, as can be seen from the following table.

TABLE VI.

GRANTS IN AID TO LOCAL AUTHORITIES USED FOR CURRENT AND CAPITAL PURPOSES

Year	Used for Current Purposes		Used for Capital Purposes	
	Amount	Percentage	Amount	Percentage
1938	12.6	46.5	14.5	53.5
1947	12.4	15.7	66.0	84.3
1948	11.5	10.3	100.4	89.7
1949	11.5	15.4	63.0	84.6
1950	11.4	19.1	48.1	80.9
1951	11.4	18.6	50.0	81.4
1952	11.5	16.1	59.7	83.9
1953	11.4	13.6	72.4	86.4
1954	11.4	11.6	86.7	88.4
1955	14.6	13.1	96.8	86.9
1956	14.4	15.8	76.7	84.2
1967	14.5	12.9	97.8	87.1

In conclusion, it can be said that there is some evidence that there was a tendency for a strengthening of the position of the central government in the process of decision-taking after the Second World War, but of quite moderate proportions. This is shown by a decrease in the share of local governments in total public expenditure coupled with an increase in the importance of grants in aid and an increase in the proportion of those grants which are tied.

The problem remains, however, whether this transfer of power of decision-making to the central level was the result of the war itself, by the operation of

the scale effect,<sup>1</sup> or was due to some other cause.

The fact that it was just after 1940, when the consequences of the war begun to be felt through the impact of inflation on public expenditures, that local authorities failed to keep their previous share in total public expenditure, and that after 1950 this share was more or less stabilized, at a lower level, suggests the operation of that effect. In addition to being of very moderate proportions, however, a closer analysis of the situation shows that such changes in the relative importance of the two levels of government as a source of spending decisions, differed from what happened in other countries (namely in Great Britain and the United States) and bear a rather diffuse connection with the war. It was not the need for centralisation of decisions on public expenditures and in mobilizing the tax capacity for the purposes of war which produced the effect of a transfer of power and responsibilities from the lower to the upper levels of government. It was, instead, a slow and regular trend towards more even national standards of services and towards a greater acceptance of the need for national planning in fields like roads, urbanisation, health facilities, etc., which produced this change.

It was due to the changes of mentality which followed the war, and to the problems which appeared in post-war time, rather than to needs created by the war itself or to habits formed during the war period.

It was the new services created at the central level, such as the national insurance schemes, the boards of economic co-ordination, etc., which mainly contributed to the increased relative importance of the central government.

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1. The concept of the "scale effect" was introduced by A. T. Peacock and J. Wiseman in The Growth of Public Expenditures in the United Kingdom, 1890-1955, quoted above, and consists of a decrease in the importance of the lower levels of governments as independent centres of decision-taking inside the public sector. Their decreased role as units of expenditure policy is manifested, either by a decline in their share in total public expenditure, or in their growing dependence on grants in aid received from the higher levels of government.

A final point related to the growth of the expenditures of the different levels of decision-taking, is that which concerns the relative importance of the various kinds of local authorities in total local expenditures and its variations through time.

Table VII presents the distribution of local expenditures among the three types of local authorities: Provincial councils, District councils, and Municipalities - since 1928. Municipalities are the most important of them, their expenditures accounting for around 90% of total local expenditures. The District councils are quite important too, either by their functions, which include roads, police, health, urbanisation, etc., or by their amount of expenditures in the areas covered by them; but they form a type of administrative authority which exists only in the Adjacent Islands (Madeira and Azores), where a greater degree of decentralization is required. The Provincial councils,<sup>1</sup> which covered the whole continental area of the country, had quite restricted functions: mainly those of co-ordination of touristic activities and public assistance. Their importance in terms of expenditure was relatively small and since 1928 it has been reduced even further, especially during the 1940's.

Since the three types of regional and local authorities obtain their revenues from different sources it is difficult, and there is not much sense in looking for a logical explanation of the variations in their respective shares of total local expenditures. There were some fluctuations in their relative proportions over time, but they remained of the same order of magnitude in 1928 and 1957.

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1. They were recently abolished and substituted by District councils.

TABLE VII.

Distribution of the Expenditures of the Local Governments by Type of Authority in Portugal (1928 - 1958).

Year	Municipalities		District Councils		Provincial Councils		Total	Year	Municipalities		District Councils		Provincial Councils		Total
	Amount	%	Amount	%	Amount	%			Amount	%	Amount	%	Amount	%	
1928	251.4	88.8	23.6	8.3	8.0	3.8	283.0	1943	590.4	90.7	48.0	7.4	12.3	1.9	650.7
1929	248.3	87.3	26.3	9.3	9.7	3.4	284.3	1944	644.0	89.9	58.3	8.2	13.8	1.9	716.1
1930	266.8	87.3	27.2	8.9	11.7	3.8	305.7	1945	720.6	90.2	64.0	8.0	14.2	1.8	798.8
1931	287.1	88.3	26.3	8.1	11.6	3.6	325.0	1946	887.2	90.7	76.1	7.8	15.0	1.5	978.3
1932	278.5	86.8	31.5	9.8	10.8	3.4	320.8	1947	1305.1	92.1	95.3	6.7	16.8	1.2	1,417.2
1933	325.2	87.0	37.5	10.0	11.0	3.0	373.7	1948	1052.2	90.5	89.1	7.7	21.0	1.8	1,162.3
1934	402.7	89.9	34.5	7.7	10.7	2.4	447.9	1949	1193.3	91.3	90.7	6.9	23.3	1.8	1,307.3
1935	432.2	91.2	30.0	6.3	11.6	2.5	473.8	1950	978.9	89.2	94.4	8.6	24.1	2.2	1,097.4
1936	441.9	92.3	24.6	5.1	12.4	2.6	478.9	1951	932.3	88.4	99.5	9.4	23.2	2.2	1,055.0
1937	474.5	92.7	26.5	5.2	11.0	2.1	512.0	1952	1010.7	88.4	105.9	9.3	26.4	2.3	1,143.0
1938	480.3	92.5	25.8	5.0	13.3	2.6	519.4	1953	1047.7	87.5	122.3	10.2	26.8	2.2	1,196.8
1939	640.3	93.2	35.3	5.2	11.1	1.6	586.7	1954	1122.3	88.0	125.5	9.8	28.1	2.2	1,275.9
1940	681.6	92.9	39.8	5.4	12.3	1.7	733.7	1955	1180.8	88.5	122.0	9.2	30.7	2.3	1,333.5
1941	569.0	90.6	46.1	7.3	12.8	2.0	627.9	1956	1278.6	88.9	127.3	8.8	32.7	2.3	1,438.6
1942	566.2	90.9	44.2	7.1	12.4	2.0	622.8	1957	1423.6	88.9	145.3	9.1	32.7	2.0	1,601.6
								1958	1426.5	88.6	150.5	9.3	33.0	2.1	1,610.0

CHAPTER IV.

ECONOMIC AND FUNCTIONAL COMPOSITION OF EXPENDITURE

1. General Aspects.

The changes in the composition of the Portuguese public expenditures through time is of interest in this study for two distinct reasons. First of all, by showing the changes in economic and functional structure which accompanied the process of growth it will indicate the relative contribution of each category of expenditure to the overall increase. Secondly, it will help in finding the factors (political upheavals, defence requirements, economic disturbances, changes in social and political philosophy, etc.) which accounted for that growth.

A five-fold increase in the expenditures of the central government in absolute terms, as a three-fold increase in per capita expenditures, obviously did not occur without some important changes in the economic and functional structure of the outlays. The object of this chapter is to scrutinize these changes in expenditures in order to clarify the nature and form of its growth.

With that purpose in mind public expenditures will be broken down into a number of suitable categories (on the basis of the available data) for revealing the nature of the process of growth.

As there was no unique or uniform criterion, the choice of categories was made in a way which would meet the needs of our analysis and enable grouping of the individual items which appear in the accounts of the Treasury as well as those of independent or autonomous bodies whose expenditures were included in the totals.

Concerning the distribution of the expenditures by functions (where the

applications of some kind of scientific criteria seemed still more difficult than in the distribution by economic categories) the main considerations were of expediency. The principal concern was in finding a limited number of categories such as "law and order", "defence", "education and culture", etc., which are commonly used in other similar analyses, and are capable of revealing the main changes in the functions of the government since the beginning of the century, as well as the factors determining them. The resulting break-down was almost as detailed as we wished for the purposes of this study.

The economic composition presented a different problem, and a very simple division into four broad categories had to be made, in view of the difficulty of going into greater detail without losing accuracy in the distribution of individual items among different groups. Thus, only the distinctions between "expenditures on goods and services" and "transfers and subsidies", on the one hand, and expenditures on "current" and "capital" accounts, on the other, were made.

The scope of the analysis and the number of points which could be made clear would certainly be extended if it were possible to proceed in greater detail. But the lack of information, and the existence of general items without sufficient explanation of their economic composition, prevented a more detailed break-down, unless we were prepared to make the allocation of important amounts of expenditure by pure guesswork.

## 2. Functional Categories.

### (a) Expenditure of the Central Government.

An important change occurred since the beginning of the century in the functional composition of the expenditures of the central government, i.e., in the relative importance of the different functions fulfilled by the government. In

order to understand this change it would be very useful to know the relative amount of total national resources absorbed by each function. Unfortunately, the data concerning the Portuguese national product and expenditure cover so short a period of time that no long-term trend can be revealed by an analysis of this type. Therefore, it seemed preferable to concentrate the search on the changes in the relative importance of different functions through time, and to try to relate those changes with the relevant historical events and other factors operating on the distribution of public expenditure.

The functions considered in our grouping of the expenditures of the central government were: general administration, public debt, defence, law and order, social services, economic services, education and culture, relations with overseas (including the expenditures both with foreigners and with the Colonies), and other non specified. A detailed description of the composition of each one of these categories is given in the Appendix on sources and methods.

The first aspect of the problem to be examined is that of the relative growth of different functions.

As we already pointed out, a five-fold increase in expenditures in real terms, and a three-fold increase in expenditures per head did not occur in a regular fashion, neither temporal nor functional. On the contrary, temporary fluctuations in the expenditures on functions such as defence, internal order, and Colonial administration, were associated with an uneven long-term growth of the various functions. So, between the beginning of the century and 1957, there were functions such as economic and social services which increased some twenty times, while the service of public debt declined to about half its amount in real terms.

The following table shows in more detail how many times the expenditures on

each function increased in absolute real terms, and per capita terms since 1900. From this table we can clearly see the differences in the rates of growth of the different functions. As a matter of fact,  $\frac{3}{4}$  of the total growth of the expenditures of the central government were due to the increase which occurred in three categories: economic services, social services, and education and culture.

TABLE VIII.

GROWTH OF EXPENDITURES OF THE DIFFERENT FUNCTIONS OF THE CENTRAL GOVERNMENT

FUNCTIONS	Times Increase: 1900 to 1957	
	Absolute real terms	Per head
General Administration	$2\frac{1}{2}$	$1\frac{1}{2}$
Public Debt	-	-
Defence	$4\frac{1}{3}$	$2\frac{1}{2}$
Law and Order	$5\frac{3}{4}$	$3\frac{1}{2}$
Social Services	$18\frac{1}{2}$	11
Economic Services	$20\frac{1}{2}$	$12\frac{1}{3}$
Education and Culture	$13\frac{1}{2}$	8
Relations with Overseas	$4\frac{1}{2}$	$2\frac{3}{4}$
Other non specified	2	$1\frac{1}{4}$
Total	5	3

While these three categories together grew 17 times in absolute real terms, the other six grew only one and a half times. If from these six categories we excluded defence, the expenditures corresponding to the remaining five scarcely increased at all in real terms, indicating an actual decline in the expenditures per head.

As a first conclusion we can state that, although only public debt service actually declined in real absolute amount, the bulk of the increase in the expenditures of the central government during the last six decades was due almost entirely to the growth of expenditures on economic and social services and education. If we included education and culture in the category of social expenditures (as is frequently done) we would have to assign to the expenditures of economic and social character three-quarters of the total growth of expenditures.

This helps to explain the nature and source of the growth in public expenditures in Portugal. However, the factors determining this growth will begin to emerge more clearly only when we have examined the time-pattern of growth of the different categories. These did not grow on a regular fashion.

On the other hand, each functional category is formed by the aggregation of various items whose movements were sometimes of quite different magnitude and direction, and which, in some cases, will be convenient to examine in detail.

In the case of the expenditures on the relations with overseas, for instance, the increase in the part devoted to foreign relations was more than twice the increase in the expenditures on colonial administration. Similarly, the expenditures on internal order, increased twice as fast as those on justice.

Nor was the time-pattern of growth of the different categories and sub-categories the same. While expenditures on defence expanded very quickly under the pressure of war and international tension, other expenditures sometimes had to be curtailed to give room for military expenditure in a budget of limited resources.

Table IX shows the distribution in money as well as in percentage terms of the expenditures of the central government among various functions.

Two general long-term trends are noticeable: the sharp decline in the relative

TABLE IX.

Distribution of the Expenditure of the Central Government by Functions (1900 - 1957).

FUNCTIONS	1900		1901		1902		1903		1904		1905		1906		1907		1908	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
General Administration	5,282	11.8	5,300	11.6	5,366	11.7	5,451	11.7	5,381	11.4	5,619	11.4	6,146	11.7	5,913	10.2	5,567	9.2
Public Debt	20,673	46.3	21,724	47.5	21,982	47.9	21,853	47.1	22,162	46.7	22,373	45.3	22,398	42.7	23,115	40.0	24,383	40.2
Defence	7,116	15.9	7,059	15.4	7,185	15.6	7,310	15.7	7,515	15.8	8,270	16.7	8,946	17.1	10,664	18.5	11,136	18.4
Law and Order	1,766	4.0	1,797	3.9	1,870	4.1	1,982	4.3	2,080	4.4	2,176	4.4	2,276	4.3	2,399	4.2	2,453	4.0
Social Services	2,723	6.1	2,776	6.1	2,955	6.4	3,167	6.8	3,287	6.9	3,482	7.1	3,526	6.7	3,956	6.9	4,341	7.2
Economic Services	3,671	7.8	3,557	7.8	3,294	7.1	3,258	7.0	3,375	7.1	3,666	7.4	7,172	8.0	5,024	8.7	4,927	8.1
Education and Culture	1,230	2.8	1,265	2.8	1,341	2.9	1,496	3.2	1,566	3.3	1,583	3.2	2,533	4.8	3,279	5.7	3,129	5.2
Relations with Overseas	2,344	5.0	2,089	4.6	1,806	3.9	1,787	3.8	1,929	4.1	2,065	4.2	2,303	4.4	3,183	5.5	4,438	7.3
Other non-Specified	151	0.3	158	0.3	153	0.3	150	0.3	151	0.3	153	0.3	155	0.3	202	0.3	240	0.4
Total	44,956	100.0	45,725	100.0	45,952	100.0	46,454	100.0	47,446	100.0	49,387	100.0	52,455	100.0	57,735	100.0	60,614	100.0

FUNCTIONS	1909		1910		1911		1912		1913		1914		1915		1916		1917	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
General Administration	6,478	10.7	6,246	10.3	6,176	10.2	6,675	11.0	6,308	11.1	6,417	9.5	7,205	7.5	10,151	8.7	17,323	12.1
Public Debt	25,005	41.4	26,822	44.4	26,481	43.9	24,176	39.6	21,643	38.0	19,778	29.2	23,280	24.3	25,662	22.1	22,767	15.9
Defence	9,944	16.5	9,680	16.0	10,490	17.4	11,218	18.4	10,430	18.3	12,596	18.6	20,419	21.3	33,874	29.2	50,446	35.2
Law and Order	2,468	4.1	2,445	4.0	2,414	4.0	2,658	4.4	2,937	5.2	3,061	4.5	3,163	3.3	3,326	2.9	7,303	2.9
Social Services	4,338	7.2	4,243	7.0	4,144	6.9	4,505	7.4	4,402	7.7	4,679	6.9	5,453	5.7	5,314	4.6	5,960	4.2
Economic Services	4,065	6.7	4,162	6.9	4,427	7.4	4,863	8.0	4,714	8.3	8,285	12.2	19,156	20.0	21,566	18.6	17,893	12.5
Education and Culture	3,196	5.3	3,371	5.6	3,400	5.6	3,595	5.9	3,380	5.9	3,321	4.9	3,859	4.0	3,925	3.4	3,944	2.8
Relations with Overseas	4,671	7.7	3,328	5.5	2,629	4.4	3,222	5.3	3,066	5.4	9,540	14.1	13,331	13.9	12,134	10.5	20,753	14.5
Other non-Specified	196	0.3	181	0.3	132	0.2	61	0.1	76	0.1	81	0.1	56	0.1	50	-	34	-
Total	60,351	100.0	60,478	100.0	60,293	100.0	60,973	100.0	56,956	100.0	67,758	100.0	95,922	100.0	116,002	100.0	143,323	100.0

TABLE IX.

Distribution of the Expenditure of the Central Government by Functions (1900-1957).

FUNCTIONS	1918		1919		1920		1921		1922		1923		1924		1925		1926	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
General Administration	21,909	11.7	29,390	13.1	39,290	12.3	49,538	11.1	75,075	10.0	119,021	12.3	175,955	14.4	206,866	14.2	247,707	15.4
Public Debt	20,278	10.8	23,929	10.7	40,139	12.6	75,911	16.9	129,097	17.3	159,328	16.5	177,018	14.6	243,580	16.8	298,199	18.5
Defence	68,047	36.4	71,563	31.9	74,980	23.5	98,988	22.1	142,860	19.1	219,867	22.7	300,810	34.7	342,291	23.5	459,191	28.5
Law and Order	10,244	5.5	19,608	8.7	32,463	10.2	43,487	9.7	50,893	6.8	65,643	6.8	97,812	8.0	118,824	8.2	131,342	8.2
Social Services	7,913	4.2	11,422	5.1	16,965	5.3	25,728	5.7	35,630	4.8	42,262	4.4	54,006	4.4	66,219	4.6	62,746	3.9
Economic Services	25,340	13.5	33,948	15.1	71,427	22.4	95,220	21.2	231,137	30.9	236,857	24.5	215,405	17.7	227,279	15.6	105,582	6.6
Education and Culture	7,149	3.8	13,290	5.9	23,992	7.5	37,485	8.4	59,143	7.9	94,290	9.8	122,064	10.0	132,735	9.1	162,234	10.1
Relations with Overseas	26,266	14.0	21,335	9.5	19,380	6.1	21,856	4.9	24,319	3.3	29,362	3.0	74,663	6.1	116,760	8.0	140,867	8.8
Other non-Specified	7	-	6	-	6	-	46	-	89	-	59	-	36	-	23	-	-	-
<b>Total</b>	<b>187,153</b>	<b>100.0</b>	<b>224,491</b>	<b>100.0</b>	<b>318,642</b>	<b>100.0</b>	<b>448,259</b>	<b>100.0</b>	<b>748,243</b>	<b>100.0</b>	<b>966,689</b>	<b>100.0</b>	<b>1,217,769</b>	<b>100.0</b>	<b>1,454,577</b>	<b>100.0</b>	<b>1,607,868</b>	<b>100.0</b>

FUNCTIONS	1927		1928		1929		1930		1931		1932		1933		1934		1935	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
General Administration	226,131	13.5	157,320	9.9	163,697	9.5	156.1	8.7	134.3	7.4	143.1	7.5	145.7	7.4	142.8	7.2	147.3	7.7
Public Debt	311,765	18.6	318,426	20.0	308,572	17.8	296.2	16.5	291.7	16.1	268.0	14.2	251.8	12.9	261.7	13.3	264.8	13.8
Defence	443,545	26.5	322,985	20.2	364,455	21.1	375.7	21.0	349.1	19.3	409.1	21.6	462.3	23.6	427.1	21.6	398.7	20.7
Law and Order	143,216	8.6	143,072	9.0	133,557	7.7	138.7	7.7	151.9	8.4	139.8	7.4	127.0	6.5	130.5	6.6	138.3	7.2
Social Services	125,884	7.5	201,224	12.6	240,702	13.9	276.7	15.4	283.0	15.6	291.1	15.4	299.1	15.3	308.2	15.6	313.5	16.3
Economic Services	113,651	6.8	214,050	13.4	291,611	16.9	326.1	18.2	383.0	21.1	416.0	22.0	445.7	22.8	478.3	24.2	433.1	22.6
Education and Culture	180,105	10.8	170,966	10.7	173,440	10.0	171.2	9.5	173.4	9.6	176.1	9.3	175.0	8.9	175.1	8.9	172.6	9.0
Relations with Overseas	129,399	7.7	67,045	4.2	53,027	3.1	49.4	2.8	40.5	2.2	46.6	2.4	46.0	2.4	46.9	2.4	47.3	2.5
Other non-Specified	-	-	-	-	-	-	2.7	0.2	4.5	0.3	3.7	0.2	3.7	0.2	4.5	0.2	5.0	0.3
<b>Total</b>	<b>1,673,696</b>	<b>100.0</b>	<b>1,595,088</b>	<b>100.0</b>	<b>1,729,061</b>	<b>100.0</b>	<b>1,792.8</b>	<b>100.0</b>	<b>1,811.4</b>	<b>100.0</b>	<b>1,893.5</b>	<b>100.0</b>	<b>1,956.3</b>	<b>100.0</b>	<b>1,975.1</b>	<b>100.0</b>	<b>1,920.6</b>	<b>100.0</b>

TABLE IX.

Distribution of the Expenditure of the Central Government by Functions (1900-1957).

FUNCTIONS	1936		1937		1938		1939		1940		1941		1942		1943	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
General Administration	160.2	7.8	162.1	7.8	180.9	7.8	201.5	8.5	192.0	8.0	184.6	6.5	179.4	5.9	189.7	5.0
Public Debt	241.9	11.8	234.3	11.3	233.7	10.1	234.2	9.9	228.5	9.5	230.7	8.1	267.9	8.9	299.6	8.0
Defence	410.1	20.0	444.0	21.5	508.9	22.0	509.7	21.6	616.3	25.6	1,055.0	37.0	1,091.7	36.1	1,590.7	42.3
Law and Order	141.6	6.9	143.1	6.9	148.1	6.4	146.9	6.2	147.1	6.1	152.5	5.4	163.0	5.4	178.6	4.8
Social Services	336.9	16.4	322.0	15.6	340.3	14.7	341.7	14.5	354.6	14.7	350.5	12.3	364.4	12.0	423.1	11.3
Economic Services	523.0	25.5	519.8	25.2	637.4	27.6	628.3	26.6	601.6	25.0	622.6	21.9	686.5	22.7	807.7	21.5
Education and Culture	187.7	9.2	182.8	8.9	193.0	8.4	216.7	9.2	216.4	9.0	208.8	7.3	218.1	7.2	219.4	5.8
Relations with Overseas	44.7	2.2	53.7	2.6	46.5	2.0	42.2	1.8	38.4	1.6	38.0	1.3	44.5	1.5	42.8	1.1
Other non-Specified	3.7	0.2	3.5	0.2	21.4	0.9	40.4	1.7	13.1	0.5	5.9	0.2	11.0	0.3	6.8	0.2
<b>Total</b>	<b>2,049.8</b>	<b>100.0</b>	<b>2,065.3</b>	<b>100.0</b>	<b>2,310.2</b>	<b>100.0</b>	<b>2,361.6</b>	<b>100.0</b>	<b>2,408.0</b>	<b>100.0</b>	<b>2,848.6</b>	<b>100.0</b>	<b>3,026.3</b>	<b>100.0</b>	<b>3,758.4</b>	<b>100.0</b>

FUNCTIONS	1944		1945		1946		1947		1948		1949		1950		1951	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
General Administration	229.2	6.3	265.6	6.5	321.0	6.7	352.9	5.6	390.9	6.3	419.6	5.7	384.1	6.0	383.0	5.5
Public Debt	289.6	7.9	279.4	6.9	309.8	6.5	310.9	4.9	295.4	4.8	298.2	4.1	304.8	4.7	317.3	4.6
Defence	1,199.1	32.9	1,153.8	28.4	1,137.8	23.9	1,145.7	18.1	1,141.8	18.4	1,009.4	13.8	966.6	15.0	964.1	13.9
Law and Order	205.4	5.6	247.0	6.1	286.8	6.0	350.1	5.5	355.8	5.7	378.3	5.2	384.7	6.0	396.8	5.7
Social Services	494.6	13.6	590.5	14.5	738.4	15.5	1,173.5	18.6	1,341.0	21.7	1,494.6	20.4	1,613.0	25.0	1,614.0	23.2
Economic Services	914.5	25.1	1,127.3	27.7	1,447.2	30.4	2,369.1	37.6	2,058.3	33.3	3,053.2	41.6	2,087.8	32.3	2,502.6	36.0
Education and Culture	265.8	7.3	298.3	7.3	338.9	7.1	416.6	6.6	448.8	7.3	474.8	6.5	483.8	7.5	491.8	7.1
Relations with Overseas	43.2	1.2	81.3	2.0	167.2	3.5	171.4	2.7	146.9	2.4	201.5	2.7	219.9	3.4	274.4	3.9
Other non-Specified	8.6	0.2	24.5	0.6	17.9	0.4	16.4	0.3	9.3	0.2	8.9	0.1	9.7	0.1	15.0	0.2
<b>Total</b>	<b>3,650.0</b>	<b>100.0</b>	<b>4,067.7</b>	<b>100.0</b>	<b>4,765.0</b>	<b>100.0</b>	<b>6,306.6</b>	<b>100.0</b>	<b>6,188.2</b>	<b>100.0</b>	<b>7,338.5</b>	<b>100.0</b>	<b>6,454.4</b>	<b>100.0</b>	<b>6,959.0</b>	<b>100.0</b>

TABLE IX.

Distribution of the Expenditure of the Central Government by Functions (1900-1957).

FUNCTIONS	1952		1953		1954		1955		1956		1957	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
General Administration	394.3	5.4	395.2	5.1	441.9	5.5	511.7	6.1	572.1	6.2	599.2	5.9
Public Debt	332.2	4.6	345.3	4.4	351.5	4.4	374.6	4.4	391.9	4.3	404.6	4.0
Defence	1,093.3	15.0	1,345.8	17.3	1,530.4	19.2	1,554.8	18.5	1,538.6	16.7	1,459.6	14.4
Law and Order	417.4	5.7	426.1	5.5	438.5	5.5	461.8	5.5	463.4	5.0	480.1	4.7
Social Services	1,744.1	23.9	1,800.9	23.2	1,837.9	23.0	2,028.0	24.1	2,106.8	22.9	2,387.0	23.5
Economic Services	2,544.7	34.9	2,605.2	33.5	2,401.2	30.1	2,438.8	29.0	2,950.8	32.0	3,540.4	34.8
Education and Culture	529.2	7.3	590.9	7.6	646.3	8.1	687.0	8.2	756.3	8.2	782.5	7.7
Relations with Overseas	233.6	3.1	242.6	3.1	316.1	4.0	354.2	4.2	425.5	4.6	499.5	4.9
Other non-Specified	15.6	0.2	13.9	0.2	14.5	0.2	13.0	0.1	12.9	0.1	13.8	0.1
Total	7,294.4	100.0	7,765.9	100.0	7,978.3	100.0	8,423.9	100.0	9,218.3	100.0	10,166.7	100.0

importance of the service of public debt (from 46.3% to 4%) and the big increase in the expenditures of economic and social character. These two trends are not concealed either by temporary fluctuations or by minor changes in other functional categories.

The service of public debt declined partly as a consequence of two major inflations (resulting from the two world wars), and partly as the result of a deliberate policy of repayment and conversion.

In contrast with the service of public debt, the expenditures on economic and social services, together with those on education, show a multi-fold increase in both absolute, and per capita terms, and a considerable increase in their relative importance. Economic services absorbed seven to eight per cent of total expenditures of the central government before the First World War, rising to about one-third after the Second World War. Something similar happened with the expenditures on social services.

The growth of expenditure on education was also important in absolute, as well as in relative terms, but its temporal pattern was quite different from that of expenditures on economic and social services.

The expenditure on education, indeed, followed an almost regular pattern of growth from the beginning of the century, and established its final relative position in total expenditure by the early 1930's. This is in contrast with the pattern of growth of both social and economic expenditures. The former reached 15% of total expenditures only during the 1930's and 20% by the end of the forties, and economic expenditures did not double their relative importance at the beginning of the century until after the First World War.

The various categories also moved in different directions through time, which

makes it still more difficult to explain the whole growth of expenditures on the basis of only one factor or cause. Thus, the examination of the temporal pattern of growth of different categories and the search for the relevant historical events connected with it gains importance.

After having seen in very general terms the influence which inflation and price stability had upon total public expenditures in real terms, and the impact of political instability on the choice between increased taxes and unchanged or declining levels of public services, we can now see how the allocation among the various types of services varied in response to the economic, social, and political conditions of the country.

The decline in public debt and, hence, in the importance of its services was the combined result of two factors: the cumulative effect of two inflations, and a deliberate policy of reducing the burden of the debt to moderate proportions. The latter was the result of a political reaction based on a general distaste of what was historically considered the cancer of the Portuguese Treasury. The extent to which this reaction was an historical and psychological factor affecting financial policy, is shown by the caution in reverting to public borrowing during the First Development Plan. This caution has since been recognized as excessive and without a well-founded economic basis.

In regard to education, too, it is necessary to explain the relative growth of expenditures in terms of the various choices a country makes at different times or in different stages of its economic and social development, rather than merely in terms of change in composition of the population pyramid.

At the beginning of the century, demand for education was rather low for the prevailing standards in Western Europe; but the psychological climate had just begun to change. The governments of that time felt compelled to extend the facilities

for primary education, particularly schools. Primary education was given a high level of priority until a more or less complete coverage of the country was achieved prior to the Second World War. This resulted in the doubling of the relative importance of the expenditures on education in one decade and, after a temporary decline during World War I, in a three-fold increase up to the middle of the twenties. Thereafter, expenditures on education continued to increase in absolute, but not in relative terms. Spending on education was outstripped by increases in other categories, either because illiteracy resulting from a lack of schools had become less acute, or because other wants appeared which claimed a higher degree of urgency.

As a sociological explanation it could be suggested that the country became socially and economically conscious only after having become conscious of its basic educational problem: that of education at the elementary level.<sup>1</sup>

Another explanation which might be given, and which has been advanced as a political argument, is that the Salazar's Administration has relied more on the showing effects of the material achievements in terms of construction of roads, buildings, harbours and dams, than in the development of the secondary and university levels of education.<sup>2</sup>

In fairness it must be said that until the middle of the fifties, no serious lack of teaching facilities was felt, either at the secondary or higher levels.

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1. In fact, the need for widespread secondary education and for greater proportion of high-skilled labour only more recently began to be realized in connection with the requirements of the economic development of the country.
  2. This explanation only holds, however, for the relative growth of the investment component/<sup>of</sup> economic services, and scarcely helps to explain the growth in other categories, particularly social services.

It was after the Second World War that a strong demand for secondary education suddenly appeared and not until the middle of the fifties that the capacity of the secondary schools for meeting that demand began to fall short of requirements. In regard to technical education, the problem has been more one of creating new schools in small urban centres in order to facilitate the access to this type of education, than of finding capacity for the demand in the existing schools. But even here, the demand for skilled labour of the kind those schools could supply does not suggest that steps should have been taken much earlier to avoid shortages in the semi-skilled grades of the industrial labour force. Quite apart from the problem of capacity, however, one could argue that insufficient means and the restricted number of scholarships prevented many of the best brains of the country from receiving adequate education.

Turning to the behaviour of economic expenditures, we can see that they were fairly stable in relative terms up to the First World War. Following a certain increase during wartime and the years just after the war, they tended to absorb a relatively high proportion of total expenditures during the first half of the 1920's. This was due to the efforts of the government to fight the economic crisis by giving some relief to unemployed through public works and by subsidising agriculture and other activities.

Economic expenditures contributed then, by their rapid increase, to influence the growth of total expenditures in the period 1920-23. Later, however, they declined, showing themselves incapable of permanently influencing the general level of expenditure. This illustrates the previously mentioned incapacity of unemployment to influence permanently the level of public expenditure.

From 1923-27 the expenditures on economic services were declining. It was the ne

Administration, with its concern for public works and for providing an economic infrastructure, as a pre-condition for the subsequent development of the country, which brought economic expenditures again to a level oscillating between one-fifth and one-quarter of total expenditure. They remained at this level until the end of the Second World War, at which time a new pressure was felt. This pressure had started before the war due to a change in the institutional framework of the country, which formally took place in 1933, but had been prevented by the war from manifesting itself earlier. Only after the war, and in the climate of the post-war world, was the full effect of these changes felt.

In 1933, indeed, the so-called "Corporative State" was instituted as the constitutional form of the Portuguese State. As a part of this organisational scheme, some 22 boards of economic co-ordination were created with special tax powers, and their growing expenditures were added to those of the services appearing in the traditional framework of the budget. In addition, a number of bodies created for dealing with unemployment, price stability, export promotion, and other "new" objectives were gradually added to this framework. Their expenditures, together with those of the bodies of economic co-ordination, accounted in 1957 for half the expenditures of an economic character.

These "budget-aside" developments in the economic and social fields are of primary importance in explaining the growth of the Portuguese public expenditures after the Second World War. They will be dealt with later in more detail.

Throughout most of the period, expenditures on social services followed a rather different pattern of development than those on economic services. Up to the First World War, indeed, they remained relatively stable - around six to seven per cent of total expenditures. But during the war, and till 1928, instead of being shifted to

higher levels, they remained at a lower level (four to five per cent). It was some time later that they tended to become established at a higher relative position (fifteen to sixteen per cent of the total) which was maintained until the end of the forties.

After the Second World War a new upward trend began, which raised them to something less than a quarter of total expenditures of the central government. This increase was mainly the result of the establishment of a scheme of social insurance just before the war, and of its progressive enlargement after the war. One of the main characteristics of the Portuguese system of social insurance is, indeed, its progressive coverage of the various branches of industry through negotiation of collective agreements between entrepreneurs and trade-unions within the framework of the corporative system. This progressive coverage was the main factor accounting for the regular increase in the expenditures of a social character.

The behaviour of the other categories of expenditure was less relevant for the long-term growth of the expenditures of the central government. Defence expenditures, of course, profoundly influenced that growth in particular periods, and they grew more than four times in real terms in our period. But the relative position of defence expenditure in the beginning and the end of that period was more or less the same; which means that they follow, but they did not take the lead in the general trend of growth.

During the periods of war, defence expenditures absorbed, on average, one third of the resources of the State and during most of the remaining period, they accounted for between one-fifth and one-quarter. Their relative decline after the Second World War (except during the years of 1949-52) was not due to a real contraction of defence expenditures, but rather to their stabilization while other categories continued to grow.

Three categories remain to be considered: general administration, law and order, and relations with overseas. The first declined in relative position falling from about 12% of total expenditures at the beginning of the century to about 6% by the end of the period. The other two more or less kept pace with the general growth.

But, even here, the temporal pattern of growth must be analysed. In effect, neither the decline in the relative position of the expenditures on general administration nor the changes in the other two categories followed the line of average or overall growth in a regular fashion. From 10% to 12% of total expenditures up to the First World War, they reached, during the period of 1923-27 an abnormally high level. Later, they manifested an irregular but definite decline following the period which preceded the Second World War. More recently they have been more or less stable.

The high relative levels of expenditures on general administration in the years 1923-27, which also coincided with a relatively high level of expenditures on education (the other category in which the main component of expenditures is formed by the payments to personnel) can only be explained by the low level of public services in that period. During these years, indeed, the country found itself in a most acute financial crisis. A detailed examination of this period shows the payments to the civil and military servants to be one of the main government concerns. With galloping inflation and the loss of internal and external confidence in the solvency of the State, and with the Treasury exhausted, wages and salaries fell behind prices.

The so-called "extraordinary" expenditures, which in the beginning of the century formed three to five per cent of total expenditures, and before the war never exceeded

10%, were in 1923-27 running above half total expenditures. A large part of this constituted supplements to wages and salaries voted in the course of the fiscal year to compensate the civil and military servants for the devaluation of money. In those years, wages and salaries reached an extremely high proportion of total expenditures, suggesting that the equipment of the public sector was being neglected. And for two decades or so, in fact, roads, public buildings, monuments and national palaces and the equipment of the services had been depreciating without being offset by a corresponding rate of construction and repair. The result was that when the Salazar Administration took power, the main emphasis of public expenditures was on public works - especially roads, harbours, schools and communications - and later on dams, and the distribution of power.

The movements of expenditures on law and order and relations with overseas, to be properly understood, have to be decomposed in their main components, that is to say, justice, and maintenance of internal order in the former, and colonial administration and relations with foreign countries in the latter. These sub-categories were, indeed, subject to quite different influences in regard to their growth and fluctuations.

Expenditures on justice - courts, public prosecutors, prisons, reformatories, etc., - formed a typical case of regular growth with a tendency to (particularly in periods of rapid increase in total expenditure) lag behind the general trend of growth. Fluctuations in their proportion of total expenditures were provoked, in general, by fluctuations in total public expenditure, rather than by sudden changes in this category of expenditures.

The expenditures made on the maintenance of internal order show a different trend. These expenditures, which were running at the same level as those on justice in the first decade of the century, were three to six times greater after the war and

up to 1927-28. This is attributable to the unstable political situation and the period of unrest through which the country passed.

The expenditures with international relations, which formed one of the sub-categories of the expenditures with the relations with overseas, followed a pattern of growth quite different from those on colonial administration. Up to the end of the First World War international relations absorbed, in general, less than 1% of the total expenditures of the central government, which until the war amounted to one-fifth to one-quarter of the expenditures with the colonies. But during the war, and as a result of the conflict, the expenditures with the colonies reached very high levels - more than 16% in 1917-18. After the war they declined sharply in absolute and relative terms, but the period of 1924-27 was one of high colonial expenditures due to the deficits of the colonies covered by the Metropolitan government. After 1928 this outflow of funds was stopped by the reform introduced by the new Administration, according to which the colonies should pay for themselves. As a result, the expenditures on colonial administration of the central government went down from more than 7% of total expenditures during the period of 1924-27, to less than 1% in the following years. In this way, the expenditures on colonial administration fell below the level of those on international relations, being in certain years less than one-third of the latter.

The trend was reversed after the Second World War, when a most serious concern for economic development in the colonies was felt. However, because a large part of the funds devoted to development was spent outside the budget, these figures do not give an accurate picture of the extent in which the policy of development has been carried. Indeed, the proportion of the expenditures of the central government devoted to the administration of the colonies at the end of the 1950's was more or less the same as it was in the beginning of the century.

(b) Expenditure of Local Governments.

The period for which a breakdown of expenditures into functional categories is possible for local authorities is so short (1946-1957) that scarcely any clear trend in the relative growth of the different categories is detectable.

Table X, which shows this breakdown, gives an indication of the relative importance of each function, though it tells very little about trends. However, some two or three tendencies appear in the table. Considering the expenditures of the local governments taken together, there is a fairly clear tendency for expenditures on education to increase in relative terms after 1949. These expenditures, indeed, rose from 5.4% of total expenditures of the local authorities in 1949, to 9.6% in 1957, through a process of almost regular growth. In absolute real terms they were in 1957 more than twice their level in 1949.

The service of the local debt, too, tended to decline in its relative position after 1951.

Expenditures on general administration, after declining for three years after 1946, jump to a higher relative value in 1949 (due to particularly high expenditures on building construction), to decline thereafter almost regularly until the end of the period.

These are the only clear trends in the relative positions of the different functional categories. Law and order tended to follow the general trend of growth (absorbing between 4 and 5% of total expenditures) and social and economic services show a wide range of values without forming any particular trend.

Table X also presents the distribution by functions of the expenditures of the different types of local authorities: municipalities, district councils (only for the Adjacent Islands) and provincial councils. The comparison of the

TABLE X.

## Distribution of the Expenditures of the Local Governments by Functions in Portugal - (1946-1957)

Percentage.

	1946				1947				1948			
	Municipalities	District Councils	Provincial Councils	Total	Municipalities	District Councils	Provincial Councils	Total	Municipalities	District Councils	Provincial Councils	Total
General Administration	25.6	11.7	22.7	24.1	22.8	10.3	16.8	21.6	18.7	12.6	17.3	18.1
Local Debt	4.0	1.5	0.7	3.6	4.1	1.8	0.5	3.9	2.9	1.6	0.5	2.7
Law and Order	4.7	2.0	0.7	4.3	4.7	1.5	0.5	4.4	4.2	1.4	0.5	3.9
Social Services	24.2	23.1	52.5	24.8	23.4	21.9	61.7	24.1	20.9	18.8	61.9	21.6
Economic Services	36.4	36.7	10.4	35.7	40.7	40.0	7.7	39.8	48.3	40.7	7.4	46.8
Education and Culture	5.1	25.0	13.0	7.3	4.2	24.4	12.8	6.2	5.0	24.8	12.4	6.9
Other non-Specified	-	-	-	0.1	-	-	-	-	-	-	-	-
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

	1949				1950				1951			
	Municipalities	District Councils	Provincial Councils	Total	Municipalities	District Councils	Provincial Councils	Total	Municipalities	District Councils	Provincial Councils	Total
General Administration	34.3	13.4	17.0	32.3	27.1	14.0	17.7	25.5	26.0	12.7	17.8	24.3
Local Debt	1.7	1.7	0.4	1.7	2.4	2.1	0.4	2.3	4.6	2.1	0.5	4.2
Law and Order	4.4	2.3	0.4	4.2	6.1	1.5	0.9	5.5	4.7	1.7	0.9	4.2
Social Services	19.5	16.1	62.9	20.1	24.2	19.6	63.4	24.8	27.6	21.2	62.6	27.8
Economic Services	36.7	39.8	5.8	36.3	35.6	37.2	5.6	35.0	32.3	34.9	5.5	31.9
Education and Culture	3.4	26.7	13.4	5.4	4.5	25.5	12.1	6.9	4.7	27.4	12.8	7.5
Other non-Specified	-	-	-	-	-	-	-	-	-	-	-	-
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(Continued;)

values with those of the total clearly shows that the movements of total local expenditures are determined by those of the municipalities. Not only are the relative proportions of total local expenditures devoted to each function fairly close to those of the municipal administration, but also the movements of the total are definitely in the same direction as those of the expenditures of the municipalities.

An examination of the distribution of the expenditures of the district and provincial councils by functions shows that the relative importance of each function often differs considerably from that of the same function in total local expenditures. The same is true of movements and trends. The service of the debt and the expenditures on law and order, in particular, absorb a smaller proportion of expenditures than in total local expenditures. The opposite is the case with the expenditures on social services and education, as a result of the different commitments ascribed by law to the three levels of government.

### 3. Economic Categories.

#### (a) Expenditure of the Central Government.

The changes in the economic structure of the expenditures of the central government were not less pronounced than those observed in their functional composition. The relative importance of expenditures on goods and services and of transfers, in particular, changed considerably in the course of the last six decades.

The expenditures on goods and services, which in the beginning of the century amounted to less than half the total expenditures of the central government, were running at more than  $\frac{2}{3}$  after the Second World War, and reached  $\frac{3}{4}$  in some years.

At the same time the expenditures on capital account which did not exceed, on average, one-twentieth of the total in the first two decades, accounted for  $\frac{1}{3}$  at the



end of the period.

The amount of work required in distributing the central government expenditures by economic categories for each of the 57 years covered by our analysis prevented the formulation of a complete picture of the annual change in the economic composition of these expenditures. However, the general trends and their timing can be perceived in Tables XI and XII where such a distribution was made for selected periods.

Expressed in real terms, transfers and subsidies scarcely doubled in the course of our period, while total expenditures experienced a five-fold increase, notwithstanding the implementation of a system of social security in the meantime. On the other hand, expenditures on goods and services in real terms increased seven times.

The other important long-term change was that which occurred in the relative and absolute amount of expenditures on capital account. Capital expenditures, consisting of expenditures on gross fixed capital formation in the public sector plus capital transfers to the private sector, formed less than one-twentieth of the expenditures of the central government in the beginning of the century. By the end of our period they were running at about one-fifth of the total.

The expenditures on capital formation within the public sector (i.e., expenditures on capital account, less capital transfers) expressed as a percentage of the expenditures on goods and services, absorbed  $\frac{1}{8}$  of these expenditures in 1900 and  $\frac{1}{4}$  in 1957.

Taking this value as representing roughly the rate of capital formation in the public sector,<sup>1</sup> we conclude that it was not, by the end of our period, less than

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1. There are many objections to such a simplified assimilation, but it seemed that for our present purpose it could be fairly well accepted here.

TABLE XI.  
Distribution of the Expenditure of the Central Government by Economic Categories in Portugal (Selected Years : 1899/1900 - 1957).

(Millions of escudos)

Years	Expenditures on Goods and Services						Transfers and Subsidies						Total Expenditure
	Current Account		Capital Account		Total		Current Account		Capital Account		Total		
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	
1899-1900	18.630	42.5	1.608	3.7	20.238	46.2	23.195	52.9	400	0.9	23.595	53.8	43.833
1900-1901	18.946	41.4	1.568	3.4	20.514	44.8	24.874	54.3	400	0.9	25.274	55.2	45.788
1901-1902	19.142	41.9	1.475	3.2	20.617	45.1	24.851	54.4	200	0.4	25.051	54.9	45.668
Average	18.906	41.9	1.550	3.4	20.456	45.4	24.307	53.9	333	0.7	24.640	54.6	45.096
1910-1911	23.042	72.2	2.143	3.9	25.185	46.2	28.811	52.8	567	1.0	29.378	53.8	54.563
1911-1912	26.606	44.3	1.920	3.2	28.526	47.5	30.761	51.2	763	1.3	31.524	52.5	60.050
1912-1913	27.916	45.1	2.323	3.8	30.239	48.9	31.571	51.0	80	0.1	31.651	51.1	61.890
Average	25.854	43.9	2.129	3.6	27.983	47.6	30.381	51.6	470	0.8	30.851	52.4	58.834
1920-1921	238.232	59.6	74.820	18.7	313.052	78.3	78.585	19.7	7.983	2.0	86.568	21.7	399.620
1921-1922	303.581	61.1	35.682	7.2	339.263	68.3	155.963	31.4	1.672	0.3	157.635	31.7	496.898
1922-1923	715.048	75.0	16.628	1.8	731.676	76.8	215.016	22.6	6.264	0.7	221.280	23.2	952.956
Average	418.953	68.0	42.377	6.9	461.330	74.8	149.855	24.3	5.306	0.9	155.161	25.2	616.491
1936	1,300.1	63.4	284.0	13.9	1,584.1	77.3	383.8	18.7	81.9	4.0	465.7	22.7	2,049.8
1937	1,344.6	65.1	258.8	12.5	1,603.4	77.6	367.8	17.8	94.1	4.6	461.9	22.4	2,065.3
1938	1,509.2	65.3	323.0	14.0	1,832.2	79.3	368.2	15.9	109.8	4.8	478.0	20.7	2,310.2
Average	1,384.6	64.6	288.6	13.5	1,673.2	78.1	373.3	17.4	95.3	4.5	468.6	21.9	2,141.8
1946	2,882.3	60.5	774.7	16.3	3,657.0	76.7	748.6	15.7	359.4	7.5	1,108.0	23.3	4,765.0
1947	3,212.7	50.9	1,523.4	24.2	4,736.1	75.1	1,246.8	19.8	323.7	5.1	1,570.5	24.9	6,306.6
1948	3,355.5	54.2	1,095.0	17.7	4,450.5	71.9	1,365.4	22.1	372.3	6.0	1,737.7	28.1	6,188.2
1949	3,499.0	47.7	1,481.6	20.2	4,980.6	67.9	1,916.3	26.1	441.6	6.0	2,357.9	32.1	7,338.5
1950	3,547.6	55.0	860.4	13.3	4,408.0	68.3	1,642.6	25.4	403.8	6.3	2,046.4	31.7	6,454.4
1951	3,555.8	51.1	1,003.2	14.4	4,559.0	65.5	1,995.3	28.7	404.7	5.8	2,400.0	34.5	6,959.0
1952	3,807.6	52.2	970.1	13.3	4,777.7	65.5	2,178.9	29.9	337.8	4.6	2,516.7	34.5	7,294.4
1953	4,196.9	54.0	1,077.5	13.9	5,274.4	67.9	1,996.1	25.7	495.4	6.4	2,491.5	32.1	7,765.9
1954	4,599.8	57.7	979.5	12.3	5,579.3	69.9	2,037.9	25.5	361.1	4.5	2,399.0	30.1	7,978.3
1955	4,824.6	57.3	1,075.1	12.8	5,899.7	70.0	2,094.7	24.9	429.5	5.1	2,524.2	30.0	8,423.9
1956	4,946.3	53.7	1,386.3	15.0	6,332.6	68.7	2,454.3	26.7	426.4	4.6	2,885.7	31.3	9,218.3
1957	5,097.6	50.0	1,588.7	15.6	6,686.3	65.8	2,931.6	28.8	548.8	5.4	3,480.4	34.2	10,166.7

TABLE XII.

Distribution of the Expenditure of the Central Government between Current and Capital Accounts in Portugal (Selected periods from 1899-1900 to 1922-23 and 1931-1957).

Millions of Escudos

Years	Current Expenditure		Capital Expenditure		Total	Years	Current Expenditure		Capital Expenditure		Total
	Amount	%	Amount	%			Amount	%	Amount	%	
1899-1900	41.825	95.4	2.008	4.6	43.833	1931	1,538.9	85.0	272.5	15.0	1,811.4
1900-1901	43.820	95.7	1.968	4.3	45.788	1932	1,583.7	83.6	309.8	16.4	1,893.5
1901-1902	43.993	96.3	1.675	3.7	45.668	1933	1,629.4	83.3	326.9	16.7	1,956.3
Average	43.213	95.8	1.883	4.2	45.096	1934	1,633.7	82.7	341.4	17.3	1,975.1
1910-1911	51.853	95.0	2.710	5.0	54.563	1935	1,626.7	82.7	339.6	17.3	1,966.3
1911-1912	57.367	95.5	2.683	4.5	60.050	1936	1,683.9	82.1	365.9	17.9	2,049.8
1912-1913	59.487	96.1	2.403	3.9	61.890	1937	1,712.4	82.9	352.9	17.1	2,065.3
Average	56.235	95.6	2.599	4.4	58.834	1938	1,877.4	81.3	432.8	18.7	2,310.2
1920-1921	316.817	79.3	82.803	20.7	399.620	1939	1,876.9	79.5	484.7	20.5	2,361.6
1921-1922	459.544	92.5	37.354	7.5	496.898	1940	1,936.0	80.4	472.0	19.6	2,408.0
1922-1923	930.064	97.6	22.892	2.4	952.956	1941	2,412.1	84.7	436.5	15.3	2,848.6
Average	568.808	92.3	47.683	7.7	616.491	1942	2,541.9	84.0	484.4	16.0	3,026.3
						1943	3,201.4	85.2	557.0	14.8	3,758.4
						1944	3,016.6	82.6	633.4	17.4	3,650.0
						1945	3,272.2	80.4	795.5	19.6	4,067.7
						1946	3,630.9	76.2	1,134.1	23.8	4,765.0
						1947	4,459.5	70.7	1,847.1	29.3	6,306.6
						1948	4,720.9	76.3	1,467.3	23.7	6,188.2
						1949	5,415.3	73.8	1,923.2	26.2	7,338.5
						1950	5,190.2	80.4	1,264.2	19.6	6,454.4
						1951	5,551.1	79.8	1,407.9	20.2	6,959.0
						1952	5,986.5	82.1	1,307.9	17.9	7,294.4
						1953	6,193.0	79.7	1,572.9	20.3	7,765.9
						1954	6,637.7	83.2	1,340.6	16.8	7,978.3
						1955	6,919.3	82.1	1,504.6	17.9	8,423.9
						1956	7,405.6	80.3	1,812.7	19.7	9,218.3
						1957	8,029.2	79.0	2,137.5	21.0	10,166.7

the rate of capital formation in the Portuguese economy as a whole, i.e. 14% to 15% of G.N.P. Though we have no data on the rate of capital formation of the country in the beginning of the century, it would appear that it could hardly be smaller than that in the public sector: i.e. gross capital formation less than 5%. This increase in the rate of capital formation through the public sector is in accordance with the general trend and, hence, the record of Portugal is not exceptional in this respect.

The picture given above of the secular trends in the economic composition of the expenditures of the central government, having been obtained merely by comparing the situations at the beginning and at the end of the period, conceals the development of these trends that can be brought to light through an examination of Tables XI and XII. Indeed, the conclusions drawn from such a comparison are, to a certain extent, misleading since the secular trend in the relative importance of the expenditures on goods and services and transfers was the result of two different and opposite movements whose combination produced the change outlined above.

In general terms, transfers occupied a very important position up to the First World War, given the paramount position of the service of public debt in total public expenditures during the first decade of this century. Later their importance declined steadily up to the Second World War. Just after the war transfers showed a new trend to increase their relative position in total expenditures due to the growing amount of public funds going to pension schemes and public health services.

In the distribution of the expenditures of the central government between current and capital accounts, there were no such opposing trends. Capital expenditures - on goods and services, as well as transfers - were relatively small prior to the First World War. In the twenties they reached considerable importance in particular years

as a result of measures to combat unemployment. During the thirties they became an important component of public expenditure, due to the emphasis on reconstruction and providing the country's overhead capital. Lately their importance has still further increased. The First Development Plan (1952-1958) demanded an increased emphasis on capital formation. This did not result, however, in a higher rate of direct investment in the public sector. The government acted mainly through its financial institutions and credit facilities, leaving no trace in our figures.

(b) Expenditure of the Local Governments.

As with the distribution of the expenditures of the local governments by functional categories, the only period for which a breakdown of expenditures by economic categories is possible, is that of 1946-57. Here, too, it is very difficult to detect any clear trend.

Table XIII presents the economic composition of the expenditures of the local governments together, as well as that of each type of local authority, individually.

Although current expenditures on goods and services present a fairly regular pattern of growth, expenditures on capital account show some sharp fluctuations which make it difficult to discern any trend in the relative growth of the two categories.

However, Table XIII does make it clear that the weight of transfers and subsidies in the expenditures of the local governments was smaller than in the central government. This was to some extent due to the fact that social security - the main device of income redistribution of the budget - is dealt with at the central level.

The main items of transfers in the budgets of the local governments are relief to the poor and health assistance to those who are not covered by the national

TABLE XIII.

## Distribution of the Expenditure of the Local Governments by Economic Categories in Portugal

(1946 - 1957)

Percentage.

Year	Municipalities						District Councils						Provincial Councils						Local Governments Taken Together					
	Expend. on Goods & services			Transfers			Expend. on Goods & services			Transfers			Expend. on Goods & services			Transfers			Expend. on Goods & services			Transfers		
	Current	Capital	Total	Current	Capital	Total	Current	Capital	Total	Current	Capital	Total	Current	Cap.	Total	Current	Cap.	Total	Current	Cap.	Total	Current	Cap.	Total
1946	56.5	38.3	94.8	3.9	1.3	5.2	71.5	22.1	93.6	6.4	-	6.4	84.1	7.5	88.5	11.5	-	11.5	58.8	35.7	94.5	4.3	1.2	5.5
1947	45.8	79.0	94.8	3.6	1.6	5.2	59.3	35.0	94.2	5.8	-	5.8	78.5	11.3	89.7	10.3	-	10.3	47.8	46.9	94.7	4.0	1.4	5.3
1948	38.5	57.6	96.1	3.2	0.7	3.9	51.3	43.0	94.3	5.7	-	5.7	78.7	10.4	89.1	10.9	-	10.9	40.5	55.3	95.8	3.6	0.6	4.2
1949	35.8	60.2	96.0	3.2	0.9	4.0	57.8	36.7	94.5	5.5	-	5.5	74.6	16.5	91.1	8.9	-	8.9	38.3	57.5	95.8	3.5	0.8	4.3
1950	47.6	46.1	93.7	5.1	1.3	6.3	60.9	33.6	94.4	5.6	-	5.6	74.1	16.0	90.1	9.9	-	9.9	49.7	44.0	93.6	5.3	1.1	6.4
1951	51.3	42.9	94.2	4.1	1.7	5.8	59.0	34.7	93.7	6.3	-	6.3	79.0	10.3	89.3	10.7	-	10.7	53.0	71.1	94.0	4.5	1.5	6.0
1952	49.0	45.2	94.3	4.4	1.3	5.7	57.4	37.0	94.4	5.6	-	5.6	73.8	26.7	90.5	9.5	-	9.5	50.7	43.5	94.2	4.7	1.1	5.8
1953	50.0	44.8	94.8	3.5	1.7	5.2	54.1	41.4	95.5	4.5	-	4.5	77.0	14.0	91.1	8.9	-	8.9	51.3	43.5	94.8	3.8	1.4	5.2
1954	47.6	46.9	94.5	3.7	1.8	5.5	55.7	39.7	95.4	4.6	-	4.6	73.4	17.7	91.1	8.9	-	8.9	49.2	45.3	94.5	3.9	1.5	5.5
1955	49.7	45.3	95.0	3.3	1.7	5.0	57.7	36.7	94.3	5.7	-	5.7	70.0	21.6	91.6	8.4	-	8.4	51.2	43.7	94.9	3.7	1.5	5.2
1956	47.9	46.8	94.7	3.6	1.7	5.3	62.1	32.6	94.7	5.3	-	5.3	70.3	21.8	92.1	7.9	-	7.9	49.9	44.7	94.6	3.9	1.5	5.4
1957	45.6	49.6	95.2	3.1	1.7	4.8	58.4	36.8	95.2	4.8	-	4.8	72.5	19.6	92.1	7.9	-	7.9	47.6	47.5	95.1	3.4	1.5	4.9

insurance schemes (which includes the bulk of the agricultural population) and who cannot afford private treatment.

In the category of capital expenditures on goods and services, roads and urbanization absorb most of the funds available for capital formation in local budgets.

On the average, expenditures on goods and services account for some 95% of total expenditures of the local governments. This same proportion holds for municipalities and district councils, which dominate in the total. In the budgets of the provincial councils, transfers account for eight to eleven per cent. This higher proportion of transfer payments in the expenditures of the province is due to the importance of public assistance, namely through subsidies to hospitals, at the provincial level.

The relative amount of capital formation was higher in the lower levels of local government, varying between 45% and 50% for the municipalities, between 35% and 40% for the districts, and between 10% and 20% for the provinces, during most of the years.

All these differences in the economic composition of expenditures between the various levels of government are mainly the result of the different functions to which they are committed.

CHAPTER V.

PUBLIC EXPENDITURE AND THE NATIONAL PRODUCT.

1. The Fundamental Question.

The basic question in studying the long-term changes in size and composition of public expenditures of a country is, obviously, that of how this spending relates to the community's output.

Such a relation is helpful in revealing the nation's choice regarding the allocation of resources between private and public goods, i.e., in showing the substitution effect of private for public goods, or vice-versa, as national income changes.

Did public expenditures grow faster or slower than national expenditure? In what periods did they grow at a higher rate than the national product, and in what periods did they show a relative decrease?

Such are the fundamental questions for any interpretation of the process of growth of the public sector and of its pattern of development through time. A study of the nature of this one should, therefore, start by looking at these questions.

However, these are also the questions for which a positive and empirical answer seems the most difficult, due to the lack of reliable data on the magnitude of the Portuguese national product respecting almost four of the six decades.

2. Some Hypotheses Regarding the Share of Public Expenditure in the National Product.

In these circumstances three main possibilities seem to be open, at least from

a theoretical point of view.

The first, and undoubtedly the best way of tackling the problem - could it be worked out - was that of proceeding with all the available data on production, earnings, employed labour force, etc., and on the basis of some workable hypothesis, try to extend the national income series as far back in time as possible. The levels of the national income could then be compared with the amount of public expenditures of the corresponding years. But the volume of data which would have to be collected for that purpose, and the inadequate coverage of the available statistical elements, added to the difficulties of gauging such factors as the degree of tax evasion, concealed unemployment, the average productivity of the worker, unmarketed agricultural production, and the product of many industries and trades not recorded in any kind of statistics, would make the results so dubious that it hardly seems worth-while to undertake such a task. At least, no student of the Portuguese economy has dared to face it till now.

A second theoretical possibility would consist in proceeding on the basis of some sound hypothesis or model of economic growth to establish the pattern of behaviour of Portuguese production in the past decades. But, to be acceptable, this procedure would require some form or other of statistical checking of the results.

Drawing a parallel with the growth of other economies would be a useful procedure, but it could not be accepted at its face value without a thorough critique of its plausibility.

Some authors (if only for the sake of having a theoretical framework of analysis) have been brought to consider the backward or underdeveloped economies as quasi-equilibrium systems in which the equilibrium state possesses some degree of stability

in what concerns income per head.<sup>1</sup> The models so constructed depend on the assumption that before a "critical minimum effort" is made (which breaks the vicious circle of the income-population growth) if the equilibrium state is temporarily disturbed by some external shock or influence, new forces set in motion which tend to depress per capita income up to the equilibrium level. Hence, before the take-off or the period of transition from backwardness to a phase of self-sustained growth takes place, the increase in population tends to match the increase in income.

Though such a scheme forms a mere tool of analysis, and does not pretend to stand as a statement on the behaviour of any underdeveloped economy at a particular period of time previous to the take-off, this hypothesis seems to be confirmed by the experience of most underdeveloped economies.<sup>2</sup> Nevertheless, to pretend that a given economy, such as the Portuguese, should follow this pattern in a certain period of time is quite a different matter.

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1. See, for instance: Harvey Leibenstein, A Theory of Economic Demographic Development, Princeton, Princeton University Press, 1954; and Economic Backwardness and Economic Growth, New York, John Wiley and Sons, Inc., 1957; Richard R. Nelson, "A Theory of the <sup>Low</sup> Level Equilibrium Trap in Underdeveloped Economies", American Economic Review, December, 1956; and Robert Solow, "A Contribution to the Theory of Economic Growth", Quarterly Journal of Economics, February 1956.
  2. Simon Kuznets notes that in the countries which in 1952-54 had per capita incomes of \$100 or less, and which represented about half the world population, growth in income per head over past decades must have been very small. In effect, extrapolating backwards the actual rates of increase, he finds that very soon we arrive at such low levels in earlier times that even mere subsistence could not be possible. There is some direct evidence (e.g. India and Egypt) that in some countries there was scarcely any rise in real per capita income over the last decades. See: Six Lectures on Economic Growth, The Free Press of Glencoe, Illinois, 1959, p. 25.

Considering the fact that after the effort made during the second half of the 19th century to provide the country with a basic framework of railways and roads, the shock produced by the change of regime in 1910, followed by World War I, and by a prolonged period of political instability close to anarchy, and galloping inflation, did not supply the conditions for a subsequent take-off (and there is evidence that throughout that period the basic equipment of the country, far from being enlarged, was deteriorating), it would not be at all surprising if per capita income remained stagnant. Not only the general (economic, social and political) conditions of the country were unfavourable to the operation of the private sector, but the poor (by every standard) level of private initiative suggests that no influence generated in this sector compensated for the feeble performance of State activity.

But to jump from the general picture left by the economic history of the time to the acceptance of a certain rate of growth of production (equalling, for instance, that of population growth), is manifestly unscientific, if not outright presumptuous.

To assume that the rate of growth of the Portuguese economy before the take-off (anywhere we can plausibly situate it) did not exceed for a long time the rate of growth of population, seems very far from the truth. Quite apart from the periods in which the income from the trade in spices from India and the gold of Brazil poured in from the outside, there is some evidence that the period of railways construction was one of relatively vigorous activity.

Admitting that the estimates of the Portuguese national income made by Michael Mulhal for different years are comparable to one another (leaving aside the question of what they really represent), the production of the Portuguese Metropolis more than doubled in the 26 years from 1870 to 1896. This represents a composite annual rate

of growth exceeding 3%, while the rate of population growth was around 1% per annum. But there is no evidence, nor even confidence, that this rate of growth was maintained during the first quarter of the present century.

In the three decades which go from 1906 up to the Spanish Civil War, the national income of Spain at constant 1929 prices increased from 15.8 milliards of pesetas to 25.3 milliards: an increase of only 38%.<sup>1</sup>

It is very doubtful that the Portuguese economy up to the end of the twenties was able to exceed this rate of growth. The scant and partial evidence we can gather from the introductory reports on the Treasury accounts, and from the literature on the economic history of the time, throws doubt on the likelihood of a faster rate of growth in Portugal than in Spain during this period.

Even assuming that the output of the country had not grown at all since the end of the first decade up to the end of the 1920's, there was still the possibility that public expenditures as a share of the national product remained constant. Indeed, public expenditures in real terms were, in the first half of the twenties, at the level they reached in the end of the first decade of this century.

The third possibility of establishing some comparison between the growth of the public sector and that of the economy since the beginning of the century would consist in taking the estimates of the national income or product that have been made by some authors (either at their face value or after some correction). There were, indeed, various private estimates of the Portuguese national income and wealth by

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1. Cf. Consejo de Economía Nacional, Anuario Estadístico, 1945-46, Madrid, 1947 p. 1072; for a discussion of the sources and methods used in these estimates see: Moneda y Crédito, June, 1946.

foreign as well as Portuguese authors during the end of the last century and the beginning of the present.<sup>1</sup> The difficulty is that we know very little about the methods and sources they used in obtaining their results. It is, therefore, difficult to judge the value of these early estimates.

In all but one case they neglected to specify the area considered (referring only to the Continent or to the Continent and the Adjacent Islands). They often used in the same estimates, values concerning different (sometimes distant) years without actualising them; when allowing for price changes they used coefficients (not indexes) that they do not explain. Some values were obtained by generalising a particular case without showing whether it was a representative one; others were arbitrarily established, either by comparison with other countries, or by some other ways. Finally, when fiscal statistics were used as a basis for calculations, the phenomenon of tax evasion was forgotten or was given a value which is presented without any explanation on the procedure used to obtain it. In addition to all those points, values which could lately be determined with some accuracy, differ markedly from those used in the calculations, and between estimates of different authors show discrepancies for which no plausible explanation can be found.

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1. Michael Mulhal, Bento Carqueja, José Vandelós and Barros Queiroz, made several estimates of the national income of Portugal between 1870 and 1917. See: Michael Mulhal, The Progress of the World Since the Beginning of the Nineteenth Century, London, 1880; Balance-Sheet of the World for Ten Years, 1870-1880, London, 1881; Industries and Wealth of Nations, London, 1896; and the four editions of Mulhal's Dictionary of Statistics, London, 1884, 1886, 1892 and 1899; Bento Carqueja, O Imposto e a Riqueza Publica em Portugal, Lisboa, 1898; José Vandelós, "La Riquesse et les Revenues de l'Espagne et du Portugal", Matron, Vol. V, No. 4, 1925; and Tomé José de Barros Queiroz, Impostos, Lisboa, 1917. As a review of these estimates and a critique of their methods and accuracy, see: Amaro Gurreiro, "A Avaliação do Rendimento Nacional", Revista do Centro de Estudos Economicos, No. 7, Lisboa, Instituto Nacional de Estatística, 1948.

In view of these inconsistencies, it would not be advisable to compare the amounts of public expenditures with the values of the national income estimated by these authors. The most we can do is to discuss the plausibility of the results obtained with them.

If we took the estimates made by Michael Mulhal, José Vandelós and Bento Carqueja, which can be attributed to the years of 1896, 1914 and 1917, respectively (leaving aside that of Barros Queiroz, for it seems extremely undervalued and would give values completely unacceptable), we would find the share of central government expenditure in national income equal to 11% at the end of the century; around 14% just before World War I; and of 27% in 1917 (during the war). What can be concluded from these figures?

Even if the values do not look much out of proportion from what we know of other countries, they seem rather high. Indeed, if the proportion of the expenditures of the local governments to total public expenditures in the beginning of the century was not much different from what it was in 1928, those percentages would correspond to shares of 13% and about 15% or 15½% for total public expenditures in 1896 and 1914 respectively.

These shares must be considered rather high by the standards of the time. But they cannot be dismissed as unacceptable or even improbable, for there is some evidence that the level of the Portuguese public expenditures was relatively high by the turn of the century. In actual fact these percentages quite agree with the picture traced by Mulhal of the Portuguese public finance of the time. If his estimates were made in a way which allows comparisons between countries, Portugal was at that time among the countries with the highest proportions of public expenditures to national income. In fact, Mulhal did not calculate this share. He

calculated instead, the tax burden of each country included in his study, and he found in Portugal one of the highest tax burdens among European countries (13 $\frac{1}{2}$ %). Only Italy, with 19%, and Greece with 14%, exceeded this burden. Holland with 12 $\frac{1}{2}$ % and France and Austro-Hungary with 12%, approached it, but the figure for Great Britain, Norway and Denmark was 8 $\frac{1}{2}$ %, and for Belgium, Switzerland, and Sweden 7% to 7 $\frac{1}{2}$ %. In young countries like the United States, Canada and Australia, the percentages were still smaller (about 5%).

Tax burden, of course, is not the same as the share of public expenditures in the national income. But even here the scales deviate in a direction unfavourable to Portugal, increasing the probability of a high rate of expenditures in relation to the national income.

Portugal, indeed, was at that time in an anomalous situation regarding the balance between revenue and expenditures and the accumulated public debt. As Michael Mulhal points out, "between 1825 and 1867 there was so loose a system of finance that expenditure was usually 40% over revenue and thus, the debt rose from 7 to 47 millions sterling. In the subsequent period of 27 years, things have been much worse and deficits piled one on another to the amount of 101 millions, the debt now amounting to 148 millions sterling".<sup>2</sup>

If this was so, the proportion of public expenditures to national income that we found for the beginning of the century was probably not far from reality. There is some probability of exaggeration in so far as Mulhal estimated the "earnings of people" and the way he did this suggests a concept much nearer that of net national

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1. Industries and Wealth of Nations, op. cit.

2. Ibidem.

product than to gross national product which we used for the years for which we have official estimates.

In any case, there is a strong suggestion that public expenditures in Portugal were, at the end of the century, abnormally high for the resources of the country and the standards of the time. The values presented by Mulhal for the tax burden of different countries also indicate that public revenue (and certainly also public expenditure) at the closing of the century did not keep any relation with the levels of economic development. Mulhal presents ample data on industrial development, degree of urbanisation, etc., from which we can draw some idea on the relative levels of development of the various countries. No correlation exists between these levels and the respective tax burdens, as it seems to be generally the case in modern times.

### 3. The Share of Public Expenditures in the National Product in Recent Years.

The years for which there are official calculations of the Portuguese national income are those of 1938 and 1947-58.

Taking public expenditures as previously defined, we find that expenditures of the central and local governments taken together, amounted in 1938 to 20.1% of G.N.P. at factor cost. In the period 1947 to 1949 they were running at about 22% on average. They decreased sharply in 1950 to 18%, but subsequently showed a definite trend to increase regularly year after year, reaching in 1958 the level of the years immediately after the war.

This trend is shown in Table XV.

What do these figures suggest? First of all, it would be interesting to see how the share of public expenditure in the national product of Portugal compares with that of other countries in similar and different levels of economic development.

TABLE XIV.

RATIO BETWEEN PUBLIC EXPENDITURE AND GROSS NATIONAL PRODUCT AT FACTOR COST  
IN PORTUGAL.

Year	G.N.P. at factor cost (billions of escudos)	Public Expenditure (billions of escudos)	Percentage
1938	13.9	2.8	20.1
1947	35.1	7.7	21.9
1948	36.3	7.4	20.4
1949	37.8	8.7	23.0
1950	42.0	7.6	18.1
1951	44.4	8.0	18.1
1952	73.8	8.4	19.2
1953	45.0	9.0	19.9
1954	46.9	9.3	19.8
1955	48.4	9.8	20.2
1956	52.0	10.7	20.6
1957	53.8	11.8	21.9
1958	55.0	12.1	22.0

Some authors have suggested that there is a broad correlation between the level of economic development and the proportion of public expenditures to national income,<sup>1</sup> and some attempts have been made to investigate this correlation.<sup>2</sup>

Our view on this point is that it is extremely difficult and debatable to draw definite conclusions from inter-country comparisons in this field, where the values obtained depend to so large an extent on the definitions given of the public sector. To apply a uniform concept and work with it in a wide range of countries is an exceedingly difficult task. However, within certain margins of error, and leaving room for the influence of other factors, these studies - as well as those made in the United States on the amount of per capita expenditures in different states - show that if there is any factor (income per head, population density, degree of urbanisation and geographical size of the country or State) which presents a definite correlation with the share of public expenditures in the national income, it is the income or output per head.

This does not mean that factors such as the size of the country,<sup>3</sup> the composition

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1. On that point see Chapter I.
  2. Remember the studies of R. Oshima and W. A. Lewis and Alison Martin already quoted, and see the study in the Economic Survey of Europe, 1959 (United Nations, Economic Commission for Europe, Geneva, 1960) on the share of the public sector in Western Europe.
  3. On the influence of the size of the country on the amount of public expenditures per head, see: E. A. G. Robinson, "The Size of the Nation and the Cost of Administration"; and W. Prest, "Note on Size of States and Cost of Administration in Australia", in International Economic Papers; The Economic Consequences of the Size of Nations, edited by Austin Robinson, London, Macmillan and Co., 1960.

of the population by age groups and urbanisation have no influence on the amount of expenditures per head and the structure of these expenditures. It only means that such factors have not sufficient impact on public expenditures for being normally included among the relevant factors determining the growth and structure of these expenditures.

If this is accepted it will be interesting to see how Portugal would fit in a table like that constructed by Oshima.<sup>1</sup> If Portugal were included in it, it would appear on the dividing line between the developed and the underdeveloped countries, either at the bottom of the former or at the top of the latter. This is, probably, not far from its correct position as far as economic development is concerned.

On the sole ground of the income or output per head it appears in a rather high position. But if we take into account its European location and hence, some stronger demonstration effect to be expected from this, the share of the public sector in the Portuguese economy does not seem out of place.

Some exaggeration of the relative position of Portugal can also result from the fact that Oshima uses G.N.P. at market prices in his calculations and not at factor cost, as we preferred to do.<sup>2</sup>

4. Factors which determined the Growth of the Share of Public Expenditure in the National Product.

A second point relates to the time-pattern of growth and the factors determining the increase in the share of public expenditures in the national income from

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1. American Economic Review, June 1957.

2. See reasons in Chapter II.

1938 to the post-war period, and particularly to the problem of whether it was or was not the result of the displacement effect of the war.

Two main factors deserve special attention. First, the war left the share of the public sector in the national income some 2% above the pre-war level. Secondly, the pattern of growth of that share was not a case of establishing a peak during the war years, followed by a levelling off of the relative amount of public expenditure at a higher position than before the war, as occurred in other countries. Instead, total government expenditure remained throughout the war at its absolute level of 1939. It was just after the war, in 1947 and 1949, that the marked increases took place, and this did not establish a permanent new level of the proportion of the community's resources commanded by the authorities through the budget. On the contrary, the relative amount of resources allocated by the budget was sharply curtailed in 1950 and regularly increased thereafter, reaching in 1958 the level of 1947.

The reasons for such behaviour are not difficult to find for one acquainted with Portuguese public finance in the last decade. Firstly, Portugal did not enter the war. Even if war could not fail to produce a strong impact on the Portuguese economy, as elsewhere, the pressures on increased expenditure were not strong. Some new sources of public revenue, such as the tax on war profits, and export duties on some strategic materials (e.g. tungstene), eased the financial position of the government. But other sources of revenue did not follow the increase in the individuals' money incomes because of the rigidity of certain brackets of the tax system. Thus, an important increase in the revenue in money terms did not result in a corresponding increase in real terms. Similarly with expenditures. Some sectors of the spending activity of the State, namely wages and salaries to the civil and military servants, never caught up with inflation.

At the end of the conflict the country found itself in an easy position in the international markets. War profits continued for some time to be an important source of revenue. It was easy to expand the spending activity of the country, particularly in the field of investment, as happened in 1947 and 1949. But just at the end of the forties the government was confronted with the drying up of the main sources of revenue generated by the war: the proceeds of the tax on war profits was rapidly declining and exports of tungstene had been brought to an end.

The first measures aimed at dealing with this situation without breaking the rule of balanced budgets or pressing harder on the tax capacity of the traditional sources of revenue was to introduce very strict rules on public spending, such as those which led to a near halt of new appointments for the civil service as well as other stringent measures.

Notwithstanding these temporary difficulties of the transition period, a reality had to be faced: new services had been introduced and the schemes of social security had just begun to operate on a national basis with the intention of progressive coverage. Thus, year after year, the share of public expenditure in the national income was growing till it reached again its 1947 level in 1958. The process is by no means finished: 1959 was the first year of the Second Development Plan, in which the government sector is to play a more effective role in the effort to speed up the process of growth of the national economy.

Let us now turn to the interpretation of these facts. Shall this pattern of growth be considered the result of a displacement effect of war, or must it be explained otherwise?

The answer depends to a certain extent on the exact meaning or comprehensiveness we are prepared to give to the concept of "displacement effect".

It seems possible to find three different influences accounting for it, all referred to by Professor Peacock and Mr. Wiseman in connection with their explanation of the growth of public expenditure in Great Britain:

- (a) In time of crisis people are willing to accept methods of raising revenue and rates of taxation formerly considered intolerable; and once they were accepted, it is easier to maintain them than to implement new methods of taxation and to raise tax rates in normal times;
- (b) Wars leave lasting financial obligations, such as increased debt service, war pensions, etc., which account for more or less permanently raising the levels of expenditure.
- (c) Wars and other major disturbances, such as the great American depression, produce strong psychological shocks which give place to revisions of ideas and choices as deep as those concerning the "duties" of the State in the fields of social justice, security of individuals, etc.

Which of these factors is considered the decisive one or the sine qua non of the displacement effect?

We can surely state that the first two influences were not appreciably felt in Portugal after the Second World War. The tax burden was not appreciably altered during the war period, and the increased receipts resulting from some sources of revenue were of a temporary character and did not create true new habits of taxation. Only new services were created. Secondly, the rigidity of the tax system prevented the increase in money incomes in the country from being translated into increased real levels of State revenue and expenditure in a period

of inflation. Furthermore, lasting financial obligations of some magnitude were not left by World War I on the Portuguese budget.

Therefore, the first two influences referred to were not operative as permanent factors of growth of the share of public expenditures in national income after the Second World War. The third influence surely was, and to it, must be assigned a good deal of the responsibility for the increase of the Portuguese public expenditures during the fifties, after the temporary decline of 1950.

War did not seem to have created, though it certainly accelerated a process which had begun just before the conflict. Expenditures of economic and social character, which accounted for  $\frac{5}{2}$  or so of the total increase in the expenditures of the central government, were already growing at a high rate when war broke out. The big increase in this field, however, occurred after the war was over.

The climate of the post-war world pressed for more social assistance, greater personal security and more rapid economic advancement. And Portugal could not avoid feeling the internal, as well as the external influence of such pressures.

Any member country of the International Labour Organisation, however underdeveloped, must accept the international standards and minima of responsibility concerning the security of the worker. In the international field, a civilised nation must follow the lead of its more developed and richer neighbours and bear the financial burden of education, health, common defence, promotion of employment opportunities, etc.. On the internal front, the government faced the new claims for higher standards of living, higher rates of economic growth and rapid industrialization of the country, under the demonstration effect of their European neighbours and the universal eagerness for the enjoyment of material goods.

Our view is that the increase in the share of public expenditure in the national income has been pressed by forces connected with the transformations which occurred in the structure of the economy - namely the provision of an adequate economic infrastructure and the creation of institutions capable of insuring a degree of control on the economy and carrying out the policy of the government towards fostering economic development. At the same time there were corresponding changes taking place in the social environment. The war broke resistances and increased the strength of these claims and pressures. Whether these pressures are embraced by the ring fence of the displacement effect or not, depends on the interpretation we are prepared to give to it.

Summing up, it seems that the influence of economic factors, particularly those related to the change in the economic structure of the country and the concomitant changes in the social conditions and climate, on the one hand, and the impact or shock exogenously produced by the war and the changing in environment it provoked or induced, on the other, were the main contributing factors for bringing about the increase in the share of Portuguese public expenditure in the national income after the Second World War.

## CONCLUSIONS.

### 1. The Object and Framework of the Analysis.

When deciding to undertake our work we had one problem in mind: that of examining, mainly on the basis of statistical evidence, the process of growth of the Portuguese public expenditure and its time-pattern, in search of the relevant factors of growth and of the possible influences of such elements as economic development, unemployment, inflation, wars, changes of regime and the political situation.

It seemed, a priori, that economic development, inflation, and widespread unemployment, exercised some influence on public spending. Furthermore, the degree of political stability through the differences it introduced in the process of vote-catching, should have some impact on the decisions of the spending authorities.

So, we began with these objectives in mind, and tried to draw a framework of analysis capable of putting in evidence the most relevant factors of growth, as well as the inhibiting ones, i.e., those which prevented temporary growth from becoming permanent.

In this attempt we found in Peacock-Wiseman's study, The Growth of Public Expenditure in the United Kingdom, a methodology comprehensive enough to deal with all these factors and to give a clue for the interpretation of the time-pattern of growth, allowing, at the same time, an analysis of the structural changes which accompanied the process of growth.

No doubt, our instruments of analysis, e.g., deflator, etc., were much

cruder and the volume of data much more slender. Therefore, the accuracy of the results and the value and the rigour of the conclusions were necessarily smaller. But, in general terms, we found that to follow a similar methodology, was not only helpful, but also presented considerable advantages of comparability.<sup>1</sup>

All along the analysis we tried to see the phenomenon from the point of view of the economist; hence, the explanations given are mainly in economic terms. The tools we endeavoured to use are those we thought an economist should use. We also tried to employ the economist's jargon, at least to the extent that it seemed useful and more precise than the layman's language. Economic factors and arguments were, therefore, called upon to play the most important part in our explanation. And this seemed to us to be a meaningful way of tackling a problem which is fundamentally one of economic character, i.e., concerning a phenomenon involving decisions embodying economic choices and directed to maximize a welfare function, however defined.

The result of our effort of collection, grouping, treatment and analysis of statistical data was to arrive at an attempt to fit our case in an interpretative framework. And, in this attempt, we found in operation some general trends already visible and observed in other countries, combined with some particular aspects or manifestations related to the historical developments of the country. This suggests the simultaneous action or the interplay of some common forces in the process of growth of public expenditures, with particular conditions which require special examination in the light of the political and social background of the country.

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1. Particularly having in mind the fact that the present work intends to be part of a wider study for various countries for which the Peacock-Wiseman analysis established the general pattern.

As it was to be expected from the nature of the political process through which political decisions are taken, the strength of the forces which were found at work in the growth of public expenditures in Portugal, was not the same as that of other countries. At the same time, certain particular factors appeared to be influencing the process of growth. So, we needed to look for an explanation which, though embodying elements of explanations previously given in relation to other countries, would weight the particular influences felt in Portugal and describe the pattern of growth in such a way as to take into consideration those influences.

2. Common and Special Features of the Growth of Public Expenditure in Portugal.

The main factors which determined the growth of Portuguese public expenditure, together with those which established the time-pattern of this growth, were pointed out along this analysis. Now we shall try to summarise the findings, distinguishing those which represent manifestations of some general or common trends, from the developments which seem to be due solely to particular features of the Portuguese economic, social and political scene, and try to present them in a coherent way.

The principal elements of the growth of Portuguese public expenditure more or less common to almost every country for which a similar study has been undertaken are:

- (a) There is a strong suggestion that public expenditures grew faster than G.N.P. since the turn of the century, notwithstanding the relatively high level that the Portuguese expenditures seem to have attained at the end of the last century.
- (b) This growth cannot be explained by the sole increase in "war-related expenditures", however defined; its main stream came from the expenditures of economic and social character.

- (c) With the only exception of the service of public debt, and to some extent of general administration, which lagged in relation to the general trend of growth, all functions kept pace or exceeded the rate of growth of total expenditures, notwithstanding the considerable differences in the rate of growth of the various functions.
- (d) The greatest part of that growth occurred after the Second World War, in a period of relatively high rate of growth of expenditures in real terms.
- (e) The relative importance of local administration in decision-making declined somewhat from 1938 to the period after the war, and its dependence upon the central government as a source of finance, increased.
- (f) In what concerns the structure of expenditure there was an increase in the relative importance of current transfers up to the Second World War, after which the importance of transfers tended to increase. On the other hand, expenditures on capital account increased considerably their relative importance. On the side of the functional composition, economic and social services overtook all other categories in what concerns rates of growth and relative importance.

As special features of Portugal we can indicate:

- (a) The incapacity of Portuguese public expenditure to grow in real terms in periods of galloping inflation as a consequence of the rigidity of the tax system and of its weakness of response to

- rapid increases of monetary revenues.<sup>1</sup>
- (b) The non-existence of the displacement effect after the First World War, due essentially to the inadequacy of the tax system for coping with inflation, and a peculiar pattern of growth of expenditures after the Second World War.
- (c) The close relation between the periods of political stability and those of growth of public expenditures, which suggests some effect of the process of vote-catching on the spending decisions of the governments. Related to this aspect it is interesting to note the absence of any noticeable influence on the level of expenditure resulting from the change of political regime in 1910.

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1. The inelastic character of the Portuguese tax system in relation to rapid money income variations does not form a peculiarity of the Portuguese system; it is rather a more or less common feature of less-developed countries. The same aspect was emphasized in relation to the fiscal structure of Asian countries by the Committee on Industry and Trade of the Economic Commission for Asia and the Far East, of the United Nations in its report Inflation and the Mobilization of Domestic Capital (E/CN. 1/ILT/WP. L/L6), October 22, 1951, where it is suggested that due to the inflexibility of taxes "the governments command over raw resources through taxation may actually decline as inflation proceeds apace, in spite of a higher aggregate productivity". p. 6.

The differences in the structure of the tax system of different levels of government in the United States, for instance, and the more rigid structures of the low levels of government seem to be on the basis of the lag of the states and local revenues in relation to the federal revenues in periods of inflation. On this point see: Seymour E. Harris, The Incidence of Inflation: or who Gets Hurt? Papers presented to the Joint Economic Committee of the Senate, Washington, 1959.

- (d) In what concerns the process of growth of expenditure after the Second World War - the period of most rapid expansion - it is important to point out the role of the administrative or institutional decentralization in that growth. More than half of the increase in the expenditures of the central government since the end of the war came from the growth of expenditures outside the traditional budget, and from bodies enjoying varied degrees of autonomy and decentralization and special delegation of tax power, or, in other terms, resulted from what the Italian Professor Morselli called "parafiscalit " and to what French authors and the Schuman Plan refer as "parafiscalit ", which in Portugal, like in the Italian corporative State, played an important part in the expansion of the public sector;
- (e) And finally, the sharp decrease in the burden of public debt from 47% of total expenditures of the central government in 1900 to 4% in 1958, not only as a consequence of two major inflationary periods, but also as the result of a deliberate policy of repayment and conversion, aimed at keeping national debt at a low level. This policy has particular historical reasons.

Before trying to put our picture in an integrate framework there are two aspects which require some explanation. The first one is that of the particular pattern of growth of the Portuguese public expenditure after World War II in a more or less regular form since 1950 (after some fluctuations following immediately after the war) instead of establishing a "plateau" after a war-time peak.

The second relates to the importance of institutional decentralization as an expediency for expanding the administrative public sector.

Having not entered the war, and having borne a good degree of inflation for coping with which the tax system was not flexible enough, Portugal did not follow the typical pattern of growth of many other countries, characterized by a peak of expenditure in real terms during wartime. On the other hand, some revenues of war years were of a temporary character, and did not come from the traditional and established sources of public revenue. For all that, the increase in expenditure which occurred after the war was not due to the fact that people got accustomed to high tax rates in the period of war, and so changed their ideas on what can be considered an "acceptable" tax burden (as it seems to have happened in Great Britain and other countries). Such an increase resulted, instead, mainly from the acceptance by the government of the ideas internationally held on the "duties" of the State in what concerns social insurance and welfare, and of such goals as rapid economic growth promoted through a specific governmental policy.

In relation to the role of administrative decentralization in the growth of Portuguese public expenditure some reference to the general problem of "parafiscalité" is needed.

"Parafiscalité" can be defined as the delegation by the State of special tax powers to decentralized or autonomous entities to which some particular tasks or functions were attributed (normally those of social insurance, economic co-ordination and organization and representation of professional interests).<sup>1</sup>

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1. Cf: Aliomar Baleeiro, Limitações Constitucionais a o Poder de Tributar, Rio de Janeiro, 1951, p. 169.

The phenomenon is, by no means, a new one and forms part of an old process of the extension of State activities. But it seems to have acquired particular aspects and relevance in many countries after the Second World War, and especially in Italy during the so-called "Stato Corporativo" (corporative State) just before and during the war, as well as in Portugal, where a "Corporative" regime has been the constitutional form of State.

It also acquired certain importance in France, where a good deal of administrative decentralization took place after the war, having been extensively dealt with in the Schuman Plan, where the contributions to social insurance, family allowances and the contributions to many other bodies of a public or semi-public character, such as the Chambers of Commerce, etc., were grouped under the heading of "la parafiscalité". Many of these contributions were later, either transferred to the general budget of the State or confirmed by parliamentary vote.<sup>1</sup> The same did not happen in Portugal nor in Italy during the corporative regime because of the fact that administrative decentralization is a distinct feature of the corporative State.

The doctrine of the so-called "parafiscal" contributions was developed in some detail by the Italian Professor Emanuele Morselli<sup>2</sup> who pretended that they presented new theoretic-scientific aspects not considered by the traditional theory of public

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1. See: J. Laferrière et M. Waline, *Traité Elementaire de Sciences et de Legislation Financières*, Paris, 1952 - the Chapter on "Parafiscalité".
  2. In particular in Le Finanze degli Enti Pubblici non Territoriali, Padua, 1943.

finance.<sup>1</sup>

We cannot see any scientific substance in that theoretical distinction, and we wholly agree with J. Merigot that the three main characteristics of the parafiscal receipts (a) exclusion from the traditional budget of the State; (b) application restricted to pre-specified ends; (c) autonomy or decentralization of the bodies to which the special tax powers are attributed - are mere administrative aspects. But we cannot fail to recognise the importance of this process of decentralization to circumvent the resistances to an increased tax-burden.

The aspect which Professor Morselli considers typical of these receipts - the fact that they are used for specific and pre-determined economic, social and moral objectives, and that they are contributed by those members of society which particularly benefit from their services - though it forms no new aspect in public finance, had considerable relevance for the process of increasing the tax burden in these countries.

In some cases, as in the case of unemployment contributions in Portugal, which are paid by employed persons, many of whom are not potential beneficiaries of unemployment benefits, the only object of segregating a particular segment of expenditure from the general tax system is to make the contribution socially more acceptable. In this particular case of unemployment contributions, as in many other cases, the special tax or contribution is related to its purpose purely to weaken resistances to its imposition.

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1. On this point see the controversy between Professors Morselli and Laufenburger in Vol. No. 43 (1951) of the Revue de Science et de Législation Financière (now Revue de Science Financière) and the article of Jean Merigot, "Éléments d'une Théorie de la Parafiscalité" in Vol. No. 42 (1949) of the same revue. Long before Professor Morselli had developed his point, many Italian authors, like Nitti, Jannacone, Rufini, F. Flora, Vincenzo Tangorra and A. Graziani, among others, had studied the attribution by the State of tax powers to bodies like Chambers of Commerce, but included their receipts among the so-called "imposte speciali".

This process played a quite important role in the expansion of the public sector in Portugal after the Second World War.

3. Integrating the Factors of Growth of Public Expenditure.

Now is the moment for considering together, in an orderly way, all the relevant factors and features of the growth of the public sector in Portugal, and to try to sort out an integrated explanation of the whole process.

Undoubtedly, the Portuguese case is only one instance of a much more general phenomenon of growth, though a case which, like any other, presents its particular aspects.

Do we need to forge for it a particular, though logical explanation, or does it fit into some of the explanations already advanced for the growth of the public sector? Is there any general explanation for this phenomenon?

We must frankly say that no explanation seems to us general, and at the same time complete enough, to comprehend all the real cases and consider all the relevant factors of growth. Certain authors describe better than others what occurred in certain countries, and some comprehend better than others the relevant factors or forces operating in the process of <sup>growth of</sup> public expenditures in other countries.

In an attempt to dichotomize them we shall say that a group of authors emphasize the importance of the factors which are endogenous to the process of economic development and try to present the growth of the public sector as an aspect or manifestation of the changing structure of an economy when it grows; the others tend to give more attention to shocks or disturbances induced from outside the economic process.

We wonder if both types of factors did not play their own part in the growth of the public sector which occurred more or less everywhere in the course of this century.

Our study of the growth of public expenditure in Portugal and similar studies made for other countries, suggest that the Western economies passed through two phases of development. The first is that which followed (even if historically, and due to a series of social resistances, did not coincide with) the process of urbanization brought about by the industrialization. The second is that which resulted from the structural changes associated with a shift from conditions of perfect competition with a multiplicity of small units to a world in which imperfect competition predominates.

The first one corresponded to the growth and consolidation of the so-called allocation branch of public finance in Professor Musgrave's terminology.<sup>1</sup>

In that phase we notice three main factors pressing for the growth of public activity:

- (a) The diseconomies generated by the process of industrialization and urban concentration;
- (b) The enlargement of the range of services whose social utility exceeds their individual or private utility;
- (c) On the side of the revenues, the greater "taxable capacity" shown by urban areas as zones of monetary economy, by contrast with the rural zones, where the monetary sector is much more contracted.<sup>2</sup>

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1. See: Richard A. Musgrave, Theory of Public Finance, New York, 1959.

2. This effect of urbanisation on the growth of public expenditure has, up to now, received very little, if any, attention, but the experience of the actual underdeveloped countries shows that it plays an important part in the growth of public revenue and expenditure in these countries.

In the second phase we can still distinguish two distinct moving forces causing the growth of public expenditure: that which produced the growth of the stabilization branch of public finance (and which corresponded to the failure of the market mechanism to reach such goals as a level of employment close to full employment), and that which consisted more of a fundamental change in social goals, particularly regarding the distribution of income, which produced the Welfare State and led to the development of the distribution branch of public finance.

In the most advanced countries, these two phases of growth corresponded to a certain extent, to the transition of the economy from the rural stage to the industrial one, and to the attainment of conditions of "mature economies", or the passage from the stage of industrial economies to that of "service economies",<sup>1</sup> respectively.

Historically there was some lag between the appearance of the diseconomies generated by industrialization and urbanisation and public action required to meet the needs thereby created, but clearly there was a logical link between them in the process of growth of expenditure.

In less-developed countries the stage of economic development which would produce the second phase of growth of public expenditure was not reached, but a demonstration effect to introduce some elements of it, has been at work in most of them. The result is that in these countries the process has been blurred by a mixture of elements of the two phases, coupled with a new element: the pursuing by

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1. Or, if one prefers, and using the Rostovian terminology, to the stage of "high mass consumption". See: W. W. Rostow, The Stages of Economic Growth - A non-Communist Manifesto, Cambridge, Cambridge University Press, 1960.

the governments of policies specifically directed to foster economic growth. The two phases were in a certain sense compressed and we see in many of them a quite relevant distribution branch before the process of industrialization and that of urbanisation is well advanced. The relative importance of the two phases in terms of growth was very different: the big upward push had been experienced in the second one.

Looking at the economic factors underlying the expansion of the public sector in the second phase - which historically we place for Great Britain and the United States roughly in the period which begins in the early 1930's - we would say that the main cause of growth of public expenditure was formed by the increasing incapacity of the market to reach a situation corresponding to the supposedly best allocation of the resources of the country and an "acceptable" pattern of income distribution.

According to the classical model of perfect competition, the market mechanism would ensure the optimum allocation of resources in terms of consumers' preferences in an automatic way. And it would be so if the conditions outlined by the classical economists prevailed. But, as Keynes noted, the logical consistency of classical economics was perfect, but its postulates were only applicable to a special case, and it happened that "the characteristics of the special case assumed by the classical theory" were not "those of the economic society in which we actually live".<sup>1</sup>

No epoch or society really knew the complete fulfilment of these conditions but,

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1. J. M. Keynes, The General Theory of Employment, Interest and Money, London Macmillan and Co., 1957, p. 3.

for two centuries or more, reality has been sufficiently close to them to leave unchallenged the conclusion drawn by the classical economists of the superiority of the market economy over central direction.

Situations of lasting and generalised unemployment were not known for long periods of time and the idea that the great wastes in the economic history did not come from unemployment, but from uneconomic use of scarce resources was probably not far from the truth.

Meanwhile, the underlying reality gradually changed. In the closing decades of the last century and the beginning of the present, economists became increasingly preoccupied with the adequacy of the model of perfect competition in a society in which some firms had considerable power of control on prices and unions enjoyed certain degrees of monopoly on the available labour force. At the same time depressions began to become a serious public concern. Through the last part of the 19th century and the first decades of the 20th, it became more and more difficult to accept them as normal and necessary in a process of economic self-adjustment.<sup>1</sup>

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1. On the belief in this necessary function of adjustment made by the market system through depressions and the idea of the harmful character of public intervention, it is interesting to quote a passage of Schumpeter (one of the greatest authorities on the business cycle at the time): "In all cases ... recovery came of itself ... But this is not all; our analysis leads us to believe that recovery is sound only if it does come of itself. For any revival which is merely due to artificial stimulus leaves part of the work of depressions undone and adds to an undigested remnant of maladjustment, new maladjustments of its own". (J. A. Schumpeter, Essays, ed. by Richard V. Clemence, Cambridge, Mass., Addison-Wesley, 1951, p. 117 - Quoted by John K. Galbraith in The Affluent Society, London, 1958, p. 326.

The depressions of 1908 and 1921-1922 (and mainly the latter) already reached proportions which brought people to think that "there must be something very wrong in a system in which such faults were normal".

But, even in these two depressions, unemployment never attained half the figure it reached in 1932.

The importance of monopoly had been growing and the sector in which conditions of imperfect competition prevailed, considerably enlarged. At the same time rigidities in the interest rate and the lack of mobility of factors (such as that resulting from the organization of the labour market and other groups) made the maintenance of full or near full employment less probable in the absence of corrective devices.<sup>1</sup>

The instability of a system which allowed investment to fall from 15.2% of G.N.P. in 1929 to less than 1.5% in 1932 and unemployment to reach 22.8% of the total labour force in the United States, showed that the classical model or perfect competition was no more operational. Classical theory explained economic failure essentially as a result of inefficiency. But realities after 1930 spread the conviction that the generalised individual failure which occurred in the depression years was, instead, the result of a malfunctioning system in which automatic adjustment of the individual plans was prevented by rigidities and insufficient information.

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1. Keynes showed that the full-employment equilibrium level assumed by the classics as logical consequence of the operation of Say's law was a special case of the equilibrium level of employment in which the propensity to consume and the inducement to invest stand in a particular relationship to one another, but that there was no reason for expecting that such relationship would be verified in practice in the absence of some external intervention. (General Theory).

Thus the conviction became strong that a system which allowed huge unemployment for considerable periods of time, in addition to requiring big social sacrifices and generalized individual suffering, involved a great misallocation of resources and, at the same time, did not fulfil the minima requirements of security and justice demanded by the prevailing concepts of social philosophy. This deeply affected the traditional mood in what concerns public spending.

A good deal of the tasks which accounted for the main part of the increase in public expenditure after 1930 represented attempts to counteract the failures of the market mechanism in what concerns economic stability and individual security.

These circumstances formed, in our view, the main economic factor which led to the huge increase in public expenditure after the Great Depression, and particularly after the Second World War, in the most advanced countries.

Is this interpretation in contradiction with that of the demonstration effect thesis? We do not think it is necessarily so. If we correctly interpret this thesis on the growth of public expenditure we shall say that it is more concerned with the explanation of the time pattern of growth than with that other problem (less subject to statistical test) of the factors or forces which were behind the displacement effect, and which wars and other major disturbances tend to unleash.

We do not find in the Peacock-Wiseman argument any suggestion that in the absence of major disturbances the share of public expenditures in national income would not grow at all, and that the increase in this share, which in some countries took place after wars and social upheavals, has been independent from other factors or conditions.

Our own view is that the increase in the relation of public expenditure to national income has been pressed by forces connected with the transformations that

have occurred in the structure of the economy, and that wars and other social disturbances broke the resistances which opposed these forces, allowing them to operate.

The displacement effect, then, throws light on the process of adjustment of the ideas of the individuals as tax-payers and as beneficiaries of public goods and transfers (which seems to be so important in the determination of the level of public activity) and, at the same time, tells us when to expect major permanent increases in the level of expenditure.

But it leaves unexplained why the displacement effect was so different after the Second World War between countries at different levels or stages of economic development;<sup>1</sup> and it also leaves without proper explanation the differences of intensity of that effect after the First and the Second World Wars. Was it only a question of the differences in the amount of finance required by the two wars and in the process of financing them? We cannot find a plausible answer to that question except in terms of the changes in the psychological function of demand for public services, which, according to Rostow, tends to occur in the post-maturity stages of the economy.

There still remain to be explained the increase in public expenditure which has been taking place in the last decade in many underdeveloped countries. Even if it was smaller than in the most developed countries, it was of quite considerable proportions and does not fit into the historical pattern of the now developed economies. There is every suggestion, and some statistical evidence, that it was

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1. At least judging from what Oshima's tables suggest: See the study in American Economic Review, June 1957, already quoted.

much more pronounced than in the actual industrialized countries when they drove towards industrialization. Why? Can we explain this in terms of the broad explanation previously given for the general phenomenon of growth?

The first point to emphasize is that industrialization is not taking place to-day according to the pattern of the nineteenth century. There are all over the world the big industrial concerns and the degree of control of the markets which differs from that of the past century and a half. Secondly, not only has the organization of industry been modified, but social philosophy has also changed, such that nineteenth-century-style development is no longer accepted. Thirdly, and most important, people are now well aware of the deficiencies of the market mechanism to ensure rapid economic advancement. Economists maintain that market is a poor guide to policy in backward and stagnant societies.<sup>1</sup> And politicians in less-developed countries are taking it more and more for granted.

In the less-developed countries of our time what pressed for a rapid increase in public expenditures was first of all, the operation of a demonstration effect impelling them to much higher relative expenditures on social services than the actual industrial countries had to bear when they were in a similar stage of economic advancement in a setting in which the market is differently organized from that of the second half of the 18th century and of the 19th century, and in which people no longer rely on market forces to ensure the best allocation of resources in terms of rapid economic growth and the attainment of other social goals.

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1. That is a point in which many economists have insisted and which is more or less generally accepted in the United Nations quarters, influencing all the policy of the Economic Commissions for Asia and the Far East and Latin America. In the theoretical thinking, see for instance, Benjamin Higgins, Economic Development, Principles, Problems and Policies, New York, W. W. Norton and Co., Inc., 1960, Chapter 18.

4. The Process of Growth of Public Expenditure in Portugal.

In the light of the above, one is led to ask how does Portugal fit into these trends and how has it borne the influences of all the factors which have been mentioned? Here is where the economic, political and social conditions meet and reveal the true nature of the political process through which spending decisions are taken.

First we have the problem of urbanisation. We cannot be sure that the increase in public expenditures which was taking place in the beginning of the century was the result of the new wants which were being felt as a consequence of some degree of urbanisation.

From the outset, we must admit that without data on the expenditures of the local governments, where many of these needs were felt, we cannot make even a suggestion in this sense. Secondly, we must recognize that urbanisation was in Portugal, in the beginning of the century, a phenomenon of little relevance; so was industrialization.<sup>1</sup>

The increase in the expenditures per head can probably be best attributed to the attempt of the monarchy to meet some of the needs of the population at a time when the political climate was becoming increasingly adverse and the burden of an extremely heavy debt left little room for manoeuvre. Stable prices helped this growth.

Afterwards, and as it has already been pointed out, war, inflation and political instability, connected with the inelasticity of the tax system, blurred the effect of other possible influences.

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1. The urban population formed at the closing of the 19th century, 9% of the population of the country, which compares with about 22% for the whole of Europe including the czarist Russia. At the same time the product which came from manufacturing represented (according to Mulhal) only a little more than one-fifth of the total output of the country. And the whole process of installing some new industries has been exceedingly slow.

It was only after the Salazar Administration came into power, and the fiscal system was refashioned, and price stability restored, that new influences began to play their role.

The first concern which found expression in the policy of the new government, hence in the budget, was that of endowing the country with a basic framework for economic progress. Later came the establishment of a new set of bodies for co-ordinating the economy of the country and the launching of the foundations of the system of social security. After the war, both schemes developed, and, at the same time, the country entered a new phase in what concerns the development of the economy - that of a specific and systematic policy of economic growth with the development plans. In the meantime social insurance was spreading in coverage, thereby increasing its weight on the budget.

All that occurred by progressive degrees of feeling the need to supplement, stimulate, and partly conduct, the slow response of private enterprise to the new conditions of the country and of the surrounding environment.

Greater consciousness of the imperative of rapid economic growth and a greater sense of social responsibility began to develop, bringing new pressures to bear on the improvement of the economic and social conditions of the people.

So, partly as the result of the operation of the demonstration effect of a changing world outside, and partly as a consequence of the acceptance that market forces must be supplemented by public action, State activity gradually increased. But all that in a frame of mind of the fiscal authorities formed in the classical tradition of the paramount importance of balanced budgets and of the need for restraint in the levels of taxation. Here administrative decentralization and taxation for specific purposes helped to circumvent resistances.

This was, briefly, the way public expenditure expanded its share in the national income.

Economic and political factors, external influences and shocks, and administrative rigidities, combined to draw a pattern of growth which, sharing some of the more or less general or common trends of the expansion of the public sector throughout the world, presents some particular features, owing to special economic and social conditions of the country and events related to its political history.

5. Probable Future Developments of Portuguese Public Expenditure.

Does our study help in any way to establish the future pattern of growth of Portuguese public expenditure, or must it be circumscribed to an analysis of the past?

The drawing of conclusions about future developments from past experience, particularly in the field of public policy where so many unpredictable factors can strongly influence the decisions of the authorities, is very dangerous. However, the analysis of the past can bring to light patterns of behaviour, draw attention to particular forces and influences, and suggest probable developments. Furthermore the scrutiny of the process of growth of public expenditure and of the factors which determined that growth through a long period of time can supply a valuable knowledge of the incidence of the institutional set-up in fostering or checking the action of certain forces. Hence, one acquainted with past experience is better armed to analyse trends, examine movements, study influences and forces, and to weigh the probability of their continuing to operate in the future.

Should our aim be that of constructing a model of growth of the Portuguese public expenditure, it would not be impossible to establish numerical projections

for a certain number of years on the basis of certain hypothesis. But our purpose is not so ambitious. We recognize that many unknowns remain whose values could change the whole picture of growth. To suggest only some of them will be enough to show how such a prediction could deviate from the actual behaviour of expenditure.

Political stability and instability, for instance, have revealed themselves of remarkable importance in the growth of the Portuguese public expenditure in the past. On the other hand, the pattern of that growth during at least the last two or three decades undoubtedly owes a good deal to the particular set of institutions created in 1933. A change in the political system or the alteration of the political conditions of the country would not be without influence on the future development of expenditure.

The influence of the course to independence of the African territories on the Portuguese African provinces is also bound to produce a serious impact on the Portuguese budget.

Another important unknown is that of the way the private sector of the economy will react to the movement of economic integration and tariffs reduction in Europe. Portugal is a member of the European Free Trade Association. The impact of the first move of tariffs reduction on the Portuguese economy cannot yet be established, but the slowness with which the entrepreneurs have been reacting to the new conditions of European trade are being a cause of concern for the Administration.

Some steps have already been taken, such as the creation of an Institute of Scientific and Industrial Research and the reform of the Board of Exports Promotion, to cope with the changes in the economic environment. But whether the country can stick to a policy of giving opportunities to private initiative and wait, or has to

foster the required structural changes in industry and trade to meet the challenge of the new situation, is not yet clear.

These are only some of the suggestions on possible future developments which could strongly influence the course of governmental policy with a corresponding result on public expenditure.

However, the recognition of the hazardous character of any prediction in such a field does not mean that an examination of future probable influences and trends be frivolous. Indeed, on the assumption that the political scene does not change drastically, it seems possible to indicate some of the most plausible tendencies in the future development of public spending in Portugal.

First of all, being one of the basic pillars of the economic policy of the present Administration, price stability is bound to be maintained, unless some strong external shock forces the government to move from that position. Thus, inflation is not a probable cause to check the growth of expenditure in real terms as it has been in the past.

On the other hand, the policy of balanced budgets, which also forms one of the basic elements of the programme of "sound" finance of the present government, is not likely to be abandoned. Therefore, the growth of expenditure, if it continues, must proceed inside the limits of the growth of tax revenues. These are conditioned by two main factors: the rate of growth of the national income and the nature of a projected tax reform.<sup>1</sup>

It is not yet known whether it intends only to introduce some minor changes in the structure of taxation and shift the emphasis of indirect taxation from import

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1. The distribution of income is not very relevant because the Portuguese tax system is essentially proportional and the limits of tax exemption are rather low.

duties to purchase tax (in order to meet the loss of receipts resulting from the gradual abolition of the import duties on goods coming from the other members of the E.F.T.A., or whether it aims to give the government greater financial resources to promote quicker economic growth and enforce other objectives. The hints given till now on this subject do not allow any clear conclusion.

Considering the problem from the point of view of the forces pushing for an increase in the amount of the different categories of expenditure, there appears to be some ground for expecting that the regular growth of expenditure in real terms observed since 1950, has not stopped in 1958. It is very likely that it will continue for some years to come. In 1959 there was the biggest increase in the salaries of the civil and military servants for at least two decades. It intended to restore the purchasing power of the government staffs from the losses suffered during the inflationary years of the war (and which were never matched by the small increases of the time) and adapt the structure of the remunerations to the new requirements. At the same time, 1959 was the first year of enforcement of the Second Development Plan, which is due to increase by  $2\frac{1}{2}$  times the direct contribution of the budget to the Plan.

Since outside the central budget the expenditures of autonomous bodies (boards of economic co-ordination, etc.) seem to be increasing at a relatively regular pace, and some bodies, namely the Board of Export Promotion, are planning to enlarge considerably their action, the probability is still for an overall increase in the amount, and possibly in the relative importance of the expenditures of economic character. A possible obstacle to this trend is an eventual change in the institutional framework of co-ordination of the economy, by transferring part of the tasks of the so-called "Organismos de Coordenação Económica" to the "Organização Corporativa

as it is previewed by the law. This would reduce the size of the public sector. However, until now no steps have been taken in this direction although they have been advocated by the consultative Chamber: the "Camara Corporativa".

In the field of social expenditures (and social security in particular) some regular, though slower, growth is to be expected. This will result from the allowances for progressive coverages which are built into the social security programme, and the continued tendency for pensions to increase.

Pensions account for an increasing share of the outlays from social insurance funds and are likely to continue to do so for some time. This is to be expected since eligibility for a pension requires a minimum number of years of contributions, and its amount varies according to the accumulated contributions. Nevertheless, unless the system is extended to cover agricultural workers, no marked increase in the level of expenditures on social services is to be expected. In fact, it is doubtful whether the share of this category in total expenditures will continue to grow for very long.

Recently, policy decisions have tended to be made with more regard to development and the increase in productivity than to redistribution.

The other two categories which are most likely to be affected during the sixties are defence and the expenditures with the overseas territories. Portugal has tenaciously maintained a unique conception of assimilation and integration of population in her African and other territories. This conception, which forms the basis of official overseas policy, receives extensive popular support, and will be the position taken by Portugal during the coming years, notwithstanding international pressures. The National Assembly fully endorsed the policy of the government, and the rapporteur of the Accounts Committee suggested recently (in the report on the

State accounts for 1958) that expenditures on defence and overseas territories would probably have to be increased in order to prevent external influences from filtering through the long frontiers of the African provinces and disturbing the native population.

The assumption is that a policy of gradual assimilation which succeeded in Brazil can also succeed in Africa, and elsewhere, provided that an adequate policy regarding the native populations can be carried to completion free of disturbing influences. It is understood, however, that such a policy will be expensive. In particular, a great deal will have to be spent by the State on administrative, economic, social, and cultural improvement.

All these developments are extremely difficult to predict. It seems, however, quite safe to argue that the share of public expenditure in the national expenditure will not be reduced, given the continuing pressure of the requirements of economic development and the momentum of social expenditures. It can probably increase further, particularly if the climate in Africa deteriorates. But resistance is bound to arise to any substantial increase of this share, which cannot be considered modest in view of the standard of development of the country. The expedient of administrative decentralization seems to have been already pushed almost to its limit, so that further decentralization would endanger efficient control and make a unified financial policy (regarding stabilization for instance) almost unworkable. On the other hand, reactions have begun to emerge against the dispersion of the tax power of the State among semi-autonomous bodies.

Summing up, we would tentatively suggest that the most likely trend is toward an increase in expenditures in real terms at a pace not very different from that of national expenditure, unless some strong external shock forces public expenditures

to grow faster. Some further re-allocation among the different economic and functional categories is possible, particularly toward a relative increase in the expenditures on economic services, and possibly also on defence and Colonial administration.

In regard to the economic composition of expenditures, the enforcement of the Second Development Plan would lead one to expect an increase in the importance of capital expenditures.

The distribution of total expenditures among the different levels of responsibility will likely show a further increase in the share of the central government. This will result from the increased role of the central budget in the Second Development Plan and from progressive coverage of social insurance benefits. If the African situation should deteriorate, this trend would be accelerated.

APPENDIX ON SOURCES AND METHODS.

The object of this Appendix is to describe in greater detail than seemed advisable in the text, the methods followed in collecting and classifying the data presented, and to indicate the coverage of the study, as well as the sources used and the choices made when possible alternative solutions appeared.

This is not intended to be a discussion of theoretical problems. The discussion of the main methodological points of a more theoretical character, has already been made in Chapter II.

METHODS.

1. Geographical Coverage.

The area covered by the analysis is that corresponding to the Portuguese Metropolis, i.e., the Continental part of the country and the Adjacent Islands: the Archipelagos of Madeira and Açores.

The expenditure of the administrative public authorities, as previously defined, situated inside that area, was included even when payments were made outside the area, as in the case of the expenditure on foreign representation and Colonial administration. However, the expenditure of the colonial governments, which was not supported by the budget of the Metropolitan government, was excluded.

Since the area considered did not undergo changes during the period covered by the analysis, no problem of territorial change had to be faced.

2. The Concept of Expenditures Considered.

So far as possible, our totals of expenditure were collected so as to exclude mere financial transactions (such as lending and borrowing), internal payments, or payments between different bodies or government departments (either belonging to the same level or to different levels of decision-taking), accounting duplications, current trading operations of public bodies, and specific receipts, or receipts from payments made directly by those who received services from the government. In certain cases, however, the deduction from the total amount of expenditure, of specific receipts, was not possible. The most important case was that of the University fees. Such fees are actually paid in stamps and it has not been possible to separate them from the bulk of other government revenues. In some other minor cases, too, difficulties appeared in deducting specific receipts from the expenditure of particular bodies or departments. However, their total does not alter in any significant way, either the overall amount of expenditure, or the relative share of the different categories considered. Therefore, the principle was formally followed, although statistical difficulties prevented its full application.

According to our definition of aggregate public expenditure, the repayment of the principal of public debt was treated as a mere financial transaction, and thus it has been excluded from our totals. Loans granted to the private sector and repayable at a later date have also been excluded. The interest and other current charges of public debt, however, were included, since they represent effective expenditure.

3. Time Period and Time Unit.

The time period covered by the analysis is intended to be roughly the sixty

years since the beginning of the century. In actual fact, the figures relating to the central government cover a period of fifty-eight years (1900-1958), and fifty-seven years when a breakdown into economic and functional categories had to be made. For local authorities it has not been possible to extend the analysis over the same period. The farthest back that it has been possible to go was 1928, and when dealing with the economic and functional composition of expenditure, only a twelve-year period could be analysed, because of the lack of data.

The time unit considered was the calendar year, but since there was no correspondence between the fiscal and the calendar years for a large part of the period, conversions had to be made.

Major problems were posed for the period up to 1935, in which the fiscal year started on the 1st of July and ended on the 30th of June, and a complicated system of accountancy prevailed.

The conversion of the figures from the basis of fiscal years into calendar years did not present any difficulty, once the assumption of the absence of seasonal variations was made. Nevertheless, some choices had to be made due to the complexities of the accounting system.

The first choice was that of taking the figures on a cash basis, instead of on an accrual basis. This means that the amount of expenditure presented for a given year was that corresponding to the sums paid in that year, and not that corresponding to the orders of goods and services passed by the government and the pending financial obligations which matured during the course of the year.

It is well known that the transactions in national accounting mean "flows of value" (not effective payments) and they are recorded when a claim or liability is borne, rather than when the corresponding payment takes place. But not all

transactions can conform to this rule, and the government transactions escape to it to a great extent, for public accountancy does not supply an adequate account of claims and liabilities.

The Portuguese budget and final accounts present three major aggregates of total annual expenditure: the amount authorized by the budgetary laws for the year concerned; the amount which is considered to be due as a result of the spending decisions both of the current year, and of previous years not liquidated in the years concerned; and the amount actually paid during the year.

The amount of "authorized" expenditure does not reflect the true spending of the State because part of the authorization passed on the budget legislation never materialise into effective claims. The amount assessed as "due" is a better reflection of the situation, but, for a number of reasons, it is not always fully paid out. On the other hand, the amount "paid" during the year only reflects the "cash" transactions, but not the spending decisions taken by the State during the year. However, it is the amount which indicates the measure of the resource actually handled during the year by the government, and thus gives the best approximation to our concept of the overall influence of the budget on the economy of the country.

Since the budgetary reform of 1928, the difference between the amount of expenditures due for payment and the payments actually made during the year is negligible, since the expenditure of previous years paid in a given year is a very small proportion of the total amount paid. Furthermore, it more or less balances each other from year to year. The same cannot be said for the period previous to 1928 (particularly during the difficult financial period of the twenties, when significant items of expenditure were passed from one year to another in the

expectation of a more favourable financial situation for the Treasury). However, since a decision had to be taken about the total to include in our tables, the amount actually paid in each year either on account of that year or on account of previous years, was taken as representing the closest to the concept we had in mind.

There remain some additional complications resulting from the existence of different concepts of accounting period.

The "año economico" (financial year), to which the accounting laws determined that expenditure should be referred, was the period of twelve months that, up to 1936, began on the 1st of July and ended on the 30th of June. But there were two different processes of bringing to the account of one year the expenditures which legally belonged to it. Firstly, up to 1907-8, there were the concepts of the accounting period called "gerencia" and "ejercicio", the first one being one of 12 months corresponding to that of the financial year, and the second a period of 18 months during which transactions could still be made using the financial authorizations of the year concerned. In 1907 the "ejercicio" was abolished but two different concepts of accounting period still remained; that of "año economico", whose account was closed at the end of the 12 month period, and that of "gerencia", whose account remained open, first for five years and later for three years.

Since the budgetary reform of 1928, one concept of the accounting period has been maintained: that of the "año economico", although differently defined than previously. According to this concept, which is still in use, the expenditures entered in the account of a given year are those which were contracted during the financial year concerned and paid either during that year or during an additional period of 45 days of the following year (till the 14th of February). Where an expenditure already contracted during the fiscal year remained unpaid when that

supplementary period was over, it was entered in the account under a special item called "expenditures of past financial years". In broad terms, this item more or less balances from year to year.

The concept we considered in collecting the data was, from 1907 to 1928, that of "gerencia", and from 1928 onwards, that of "ano economico". They were those which represented the amount actually paid every year and, on the other hand, those which ensured the most possibilities for comparison through the whole period. For the years 1900 to 1908, since no final accounts have been published, the figures presented correspond to the estimates voted by the Parliament.

#### 4. The Deflation of the Expenditures.

The elimination of price changes from the aggregates, in order to obtain the "real" change in the amount of expenditure, required as has been pointed out in Chapter II, the use of appropriate price indexes. In practice, however, we had to use the only available index-numbers, although they did not meet the requirements of adequate deflators for this purpose.

The first difficulty which had to be faced lay in the fact that there is no index-number which has been calculated continuously since the beginning of the century. Therefore, three different index-numbers had to be used successively, notwithstanding the criticism which can be made of this procedure.

The first index (the only available for the period previous to World War I) is an index of retail prices of the form

$$I_n = \frac{P_n \cdot q_i}{P_0 \cdot q_i} \cdot 100$$

where the  $q_i$  represented the quantities consumed by a supposed average or typical

family worker, of 25 different goods, covering the main items in the categories of food, heat, lighting and cleaning. The  $p_n$  represented the respective prices in Lisbon<sup>1</sup> at the time to which the index referred. The  $p_0$  represented the prices of the same goods in 1900. This index was discontinued in 1916.

In 1920 the "Instituto de Seguros Sociais Obrigatórios e de Previdência Social" started the publication of another index (which was improperly called the cost of living index) including the same number of articles, belonging to the same categories, and using a similar form to the previous one. The base year was 1914. It was discontinued in 1934.

In 1934 the General Direction of Statistics undertook the construction and publication of another index of retail prices (also inadequately called the cost of living) taking 1914 as the base year. It included 61 articles belonging to the same categories of food, heat, lighting, and cleaning. It was a non-weighted index of the form

$$I_n = \frac{p_n}{p_0} \cdot 100, \text{ where the } p_n \text{ represented the price}$$

of the goods included in it at the dates to which it referred, and  $p_0$  the prices of the same goods in June 1914. This index has been retained by the actual Institute of Statistics which still maintains it.

The three indexes referred to above are not, strictly speaking, comparable: the first two are weighted indexes; the last one is a simple index. Furthermore, the first has not the same base as the last two, and the base prices of the last index refers to the month of July, while the others are based on annual averages of prices. Therefore, while a change of basis is not, strictly speaking, allowed, and

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1. Similar indexes were constructed for Oporto and Braga, but their coverage was still smaller: 14 goods for Oporto and 5 (!) for Braga.

it is not permissible to pass from the second to the third one, nevertheless, in order to obtain some kind of deflator we had no other way, but to ignore these difficulties and suppose that the juxtaposition of the three indexes gave an approximate picture of the "true" movement of prices since 1900.

The first index described has been used for the period 1900 to 1913; the second one for the period 1914 to 1929; and the third for the rest of our period - i.e., for 1929 to 1958.

#### 5. Population Figures.

In order to determine the rate of growth of the expenditure per head, variations in resident population had to be considered. The series regarding population are intended to represent resident population. However, the data on population do not refer to the population normally residing in the country, but, instead, to the de facto population, i.e., the population present at the time of counting. Since the Portuguese marine is of small proportions and armed forces abroad (with the one exception of the forces stationed in the Colonies) only amounted to some thousands during the First World War, the series of the de facto population are very close to those of resident population. The difference it makes to take de facto population instead of resident population, therefore, is negligible and does not alter in any way the values obtained.

The data used are those of the census of population for the census years. For the years between the censuses the figures refer to the estimated population at the middle of the year, calculated by the National Institute of Statistics on the basis of an appropriate logistic.

#### 6. Classification of Expenditure by Function.

The categories considered in the classification of expenditure by function and the main items included in each category were as follows:-

GENERAL ADMINISTRATION: Under the heading of "general administration" we included the expenditures incurred by the highest organs of the State, by the organs of the financial administration, and the civil and political administration of the country. In addition to that, there were included in this category such bodies as the National Institute of Statistics, which fulfil tasks of a general character not specifically related to a particular function. Thus, as expenditure on general administration the following were classified:-

- a) Expenditure on the supreme administration of the State: Comprising the expenditure on the Royal Family (during the monarchic regime), the Presidency of Republic, the head of the government, the national representation (Parliament and Corporative Chamber), and that of organs like the High Council of Public Administration and certain Commissions appointed by the government or the Parliament to study and report on problems of general character (e.g., the Commission for the Simplification<sup>of</sup>/Formalities in the Administrative Services).
- b) Expenditures incurred by the financial administration of the State: Including the cabinet of the Minister of Finance, the Under-Secretary of State for the Exchequer and the Treasury, the General Secretary of the Ministry, the Superior Court of Public Accounts, the administration of public debt, the General Superintendent of the Budget and the services of tax administration, public accountancy and related services.
- c) Expenditures on civil and political administration: Including the central services of the Home Office and the services of civil and political administration through the country.
- d) Other expenditure of a general administrative character, including the National Institute of Statistics, the conservation of the national palaces and monuments, and others of a general character.

PUBLIC DEBT: Under "public debt" there were included the interest on public debt and other current charges resulting from the outstanding national debt, such as those on the remission and conversion of debt, differences of exchange, and others. Interest paid to public bodies and repayment of the principal were excluded.

DEFENCE: Defence expenditure comprises that made by the Ministries of Defence, Army, Navy and the Under-Secretariat of Air and which have obviously not a civilian purpose. Health services and hospitals of the Army and Navy, as well as military instruction and military constructions were classified under this heading. So were the expenditures made on the forces stationed in the Colonies. The expenditure on institutions of general and technical education for the children and orphans of the military staff (e.g., the "Colégio Militar", the "Instituto Profissional dos Pupilos do Exército" and the "Instituto Feminino de Educação e Trabalho"), although depending on the Ministry of War, was classified as expenditure on education.

LAW AND ORDER: This category comprises two different kinds of expenditure: that on the maintenance of internal order, and that on the administration and enforcement of the law. In the first category we included the expenditure made on the forces devoted to the maintenance of order in the country: home-guard and the different kinds of police, with the one exception of the traffic police or road-police, which was considered in the category of communications, that is, in economic services. The expenditure made by the Ministries of the Army and Navy in certain perturbed periods for repressing revolutions, riots and other manifestations of social unrest were also considered as expenditure on internal order.

We classified as expenditure on law that made by the central services of the Ministry of Justice, the expenditure on courts, public prosecutors, prisons, criminal investigation, correction of delinquent youth, and civil registration. There was

also included under this heading the expenditure made by the Colonial Office in the first decades of the century on deportees and correctional institutions located in the Colonies for crimes committed in the Metropolis.

Some items of expenditure on youth rehabilitation might be better classified as expenditure on education, but the difficulty in drawing an adequate line between these items and those connected with the punishment of crime, together with the mixed character of many of them, prevented us from following this line which thus implied a greater degree of arbitrariness.

SOCIAL SERVICES: They were classified in this category as expenditure of the Ministry of Labour and Social Welfare ("Ministerio das Corporações e Previdência Social"), social insurance payments, public assistance and relief, family allocations, subsidies to institutions of charity, unemployment compensation and the participation of the State in housing schemes. Expenditure on public health has also been classified under this heading.

ECONOMIC SERVICES: This category covers the expenditure of the bodies and services dealing with the administration, protection, promotion, and stimulation of economic activity. As it has already been stated, the trading activities of these bodies were excluded from our totals. Expenditure on roads, communications and tourism was also included in this category.

Thus the main budget items which appeared in this category were those concerned with expenditure on agriculture, forestry and cattle-raising (including those of the institutions conducting applied research and experiment in these fields), mining and geological prospecting, industry and trade, inspection of credit and insurance, roads, harbours and light-houses, airports and weather forecasts, and the subsidies to agriculture, industry, export promotion, and to the railways, Post Office and

merchant marine (with the exception of the subsidies to the shipping companies which maintain regular routes to the African Provinces granted under special contracts for this purpose).

EDUCATION AND CULTURE: This category includes the expenditure on infant, primary, secondary technical, university and artistic education supported by the State, as well as those on postgraduate education, theoretical and applied research of a scholarly nature, youth organisations, sports and physical culture, arts, literary and scientific academies, public libraries, archives and museums. Expenditure on the teaching of the Portuguese language, literature and history in foreign countries and on cultural relations were also placed in this category and not under "relations with overseas countries".

RELATIONS WITH OVERSEAS COUNTRIES: The expenditure on relations with overseas countries comprise two main categories: the expenditure on relations with foreign countries, and the expenditure on Colonial administration.

The first of these categories comprises the expenditure of the central services of the Foreign Office, those on diplomatic and consular representation, on the participation of the country in international organisations, and conferences, negotiation of treaties, arbitration of international differences and demarcation of frontiers.

Under Colonial administration were classified the expenditure of the central services of the Colonial Office, those on the maintenance of sovereignty (including the expenditures made on the military forces stationed in the overseas Provinces), expenditure on economic development supported by the Metropolis and the subsidies granted by the Metropolitan Government for the construction of railways, submarine cables, harbours, and the interest of the colonial debt paid by the Metropolis and

the deficits of the colonial governments covered by the Metropolitan budget. The subsidies granted to shipping companies which sail regularly to the Colonies under special provisions in the contracts with the government were, as has been said, included in this category of expenditure.

OTHER NON-SPECIFIED: Some minor items of expenditure which did not seem adequately included in the categories described above, such as the subsidies to the dioceses and to parishes during the monarchic regime and the actual subsidies for the construction of churches, special commemoration ceremonies, and compensation to individuals or institutions for inconveniences caused by State action, and which did not result from the undertaking of any of the mentioned functions, were reunited in a residual category of "other non-specified".

#### 7. Classification of Expenditure by Economic Categories.

The only distinctions made in the classification by economic categories were between "expenditures on goods and services" and "transfers", on the one hand, and on expenditures on current and capital accounts, on the other. Thus, four different economic categories were formed: Current expenditures on goods and services, capital expenditures on goods and services, current transfers, and capital transfers. The criteria followed in the establishment of these distinctions were, as far as possible, those recognized by national accounting conventions.

Therefore, we considered as transfers those outgoings of the public authorities which had no counterpart in the supply of goods or services by the recipients, i.e., those expenditures which represent mere flows of purchasing power without being accompanied by a corresponding movement of goods or services and which, in consequence do not generate income. However, not only grants in money were classified as transfers, but benefits given in kind, such as food distributed in public schools

free of charge, clothing for the poor, temporary sleeping accommodation for the homeless, free medical services and the benefits of social insurance, either in cash or in kind, were classified as transfers.

The interest of the national debt too, was considered as a transfer. However, the interest of the debt of the local governments was classified as an expenditure on goods and services and distributed among the different functions according to the purpose of the loans from which it resulted. This difference of criteria can be debated but, in addition to the impossibility of establishing a relation between the interest of the national debt and the purposes of the loans, there is the fact that the major part of it was contracted for defence and other non-productive ends. This is also the procedure more commonly followed in national accountancy.

As capital transfers were classified those transfers which materialised as capital formation outside the public sector: either in the private sector or in the colonies. Government grants to hospitals, to charitable institutions, to the church, or to the colonial governments, with a specified purpose of helping construction or equipping services were considered capital transfers. So were the subsidies for railways construction and other capital projects in the colonies and the participation of the State in schemes of housing and capital grants to farmers to cover part of the cost of agricultural works, such as silos, farm steadings and irrigation projects.

The subsidies to the colonial governments to cover their deficits, though the expenditure which produced those deficits have certainly included a certain amount of capital expenditure, was classified as a current transfer; so was the interest on loans contracted by the colonies and railways companies which the State had to pay, although many of them corresponded to loans contracted for capital purposes.

In the distribution of the expenditures on goods and services between current and capital accounts the criterion followed was that of considering as capital expenditure only those expenditures which resulted in capital formation of a material character inside the public sector. Thus, all the expenditures on services, i.e., on non-material goods, unless they were part of a project of capital formation (such as the transportation of materials for construction, projects of works, etc.), were classified as current expenditure. Construction and equipment for the use of military forces (with the exception of dwellings for the military staffs and their families, and the construction of military factories and hospitals) were also considered as current expenditure. Expenditure on the repair and conservation of public buildings, the purchase of furniture and office equipment were also classified under the current account. Works of amplification and transformation of old buildings for new purposes, however, when they could be identified as such, were considered as capital expenditure.

We believe we have been consistent with the concept of capital formation commonly accepted in national income calculations. The amount of capital expenditure presented in our figures does not correspond, however, to the contribution of the public sector to the capital formation of the country, since it includes not only new construction and other new capital formation, but also the transfer of capital from the private to the public sector, as in the case of the acquisition of existing buildings and other property.

#### SOURCES USED.

##### I. - General.

All references to the sources used in the construction of the different tables are made here.

Where no particular issue of a periodical publication is indicated, it is understood that various issues of it have been used as a source for the data concerned.

In cases where no official figures were available or their distribution among economic or functional categories was not possible due to lack of details, estimates were made. These estimates, however, unless they merely affected items without relevance for the totals concerned, are indicated and the methods used are described.

Slight discrepancies between constituent items and the totals shown in the tables are due to rounding.

The tables which present the distribution of the expenditure of local governments by functions and by economic categories only give percentages. The absolute amounts were not presented in the tables by the sake of compressing the relevant information in as small and short tables as possible. Since these percentages are the result of direct calculations on the basis of the data presented in the source indicated for their construction - the "Estatísticas Financeiras" - it seemed that the inclusion of the absolute amounts of expenditure would not add anything to the discussion of the composition of local expenditures (which was the relevant problem).

Table I.

- 1) Expenditure of the Central Government:
  - (a) Expenditure appearing in the "unitary" budget of the central government:  
for the years 1899-1900 to 1907-1908 - "Orçamento Geral do Estado" of the years concerned; for the period 1908-1909 to 1930-1931 - "Conta Geral do Estado"; for the period 1930-1931 to 1957 - "Estatísticas Financeiras"; for 1958, "Conta Geral do Estado" of 1958.

(b) Expenditure of the bodies not included in the central budget:

- Social insurance: "Estatísticas da Organização Corporativa e Previdencia Social".
- Fundo de Socorro Social (Fund of Social Relief); Fundo de Abastecimento (Board of Supply); and Commissariado do Desemprego (Commissariat of Unemployment) - annual accounts of these bodies.
- Fundo de Fomento de Exportação (Board of Export Promotion) and Administração Geral do Porto de Lisboa (General Administration of the harbour of Lisbon) - data kindly supplied by the boards of administration.
- Administration of the harbour of Oporto and other harbours - for the period of 1899-1900 to 1920-1921, data presented in the "Conta Geral do Estado"; for the period 1920-1921 to 1952 - estimates on the assumption that the expenditures on capital formation of these harbours form the same proportion of total expenditures as those of the harbour of Lisbon. Total expenditures were collected from the preamble to the "Orçamento Geral do Estado"; for the period 1952-1958 and for the harbour of Oporto, data kindly supplied by the Board of the Administration of that harbour; for the other harbours estimates on the same basis of the period up to 1952.
- Post Office - for the period 1899-1900 to 1920-1921 data collected from the "Conta Geral do Estado"; for the period 1920-1921 to 1944 - data kindly supplied by the General Administration of the Post Office; for the period 1944-1958 - "Anuario dos C.T.T." 1958, Table No. 137, p. 127.

- Organismos de Coordenação Económica (Boards of Economic Co-ordination)- for the period 1933 to 1949, estimates; for 1949-1951 - preamble of the "Orçamento Geral do Estado"; for 1952-1958, reports of the Minister of Finance to the annual accounts of the Treasury.

- 2) Price Index: For the period 1900-1913 - "Boletim Mensal do Instituto Nacional de Estatística", September 1948, p. 517; for the period 1913-1958 - "Anuário Estatístico".

Table II.

- 1) Expenditures and index numbers: the sources used for Table I.
- 2) Population: "Anuário Demográfico".

Table III.

- 1) Expenditure of the local governments: "Estatísticas Financeiras".
- 2) Index numbers: The third of the indexes described in the methods employed for deflating our figures, i.e., the simple index of the General Direction of Statistics, continued by the National Institute of Statistics. The source was the "Anuário Estatístico".

Table IV.

The same sources used in Tables I. and III.

Table V.

For the years 1928-1929 and 1929-1930 the data were taken from the preamble of the "Orçamento Geral do Estado"; for the remaining period the source used was "Estatísticas Financeiras".

Table VI.

"Estatísticas Financeiras".

Table VII.

"Estatísticas Financeiras".

Table VIII.

Same sources as those used in Tables I. and II.

Table IX.

Same sources as used in Tables I. and II.

Table X.

Same sources as those used in Tables I. and II.

Table XI.

Same sources as those used in Tables I. and II.

Table XII.

"Estatísticas Financeiras".

Table XIII.

"Estatísticas Financeiras".

Table XIV.

- 1) Gross National Product: For the years 1938 and 1947 to 1951 - O.E.E.C., "General Statistics"; for the years 1952 to 1958 - "Estatísticas Financeiras", 1958.
- 2) Public expenditures (expenditures of the central and local governments together): for the expenditures of the central government same sources as those used in Table I. For the expenditures of the local governments "Estatísticas Financeiras".

The "Orçamento Geral do Estado" and "Conta Geral do Estado" are publications of the Ministry of Finance; "Estatísticas Financeiras", "Anuário Estatístico", "Anuário Demográfico" and "Estatísticas da Organização Corporativa e de Previdência Social", are publications of the National Institute of Statistics.

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