

Notes and Reflections

THE PORTUGUESE CRISIS, INTERNATIONAL RESCUE AND ECONOMIC GROWTH

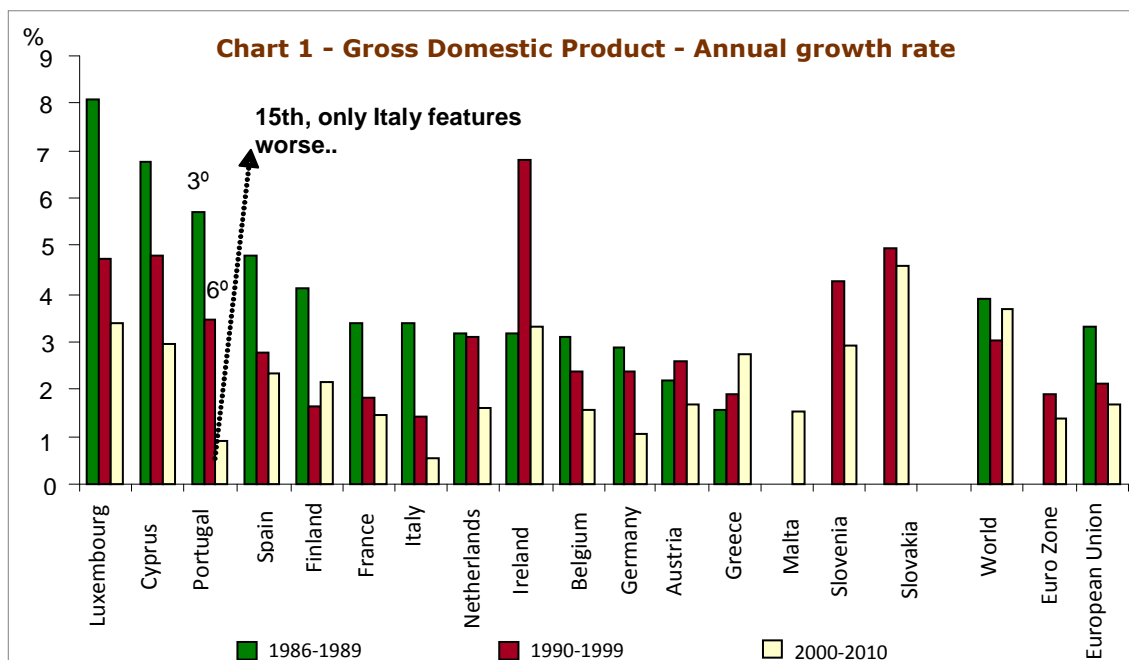
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The model on which economic growth was based in recent decades is depleted, and this depletion can be observed in the stagnation of economic growth over the last decade, the worsening of the imbalances, and in particular by increasing difficulties in securing the financing of the economy and of the state in acceptable conditions.



One must not think that the situation will be easier for Portugal due to the fact we entered a club of rich countries. In fact, we believe that a less restrictive economic policy, especially monetary policy, on the part of European entities could facilitate and alleviate the transition of the Portuguese economy to a new model. However, we must not have illusions about the limits of solidarity this club we are part of is prepared to concede.

The crisis we are currently experiencing, which emerged at the convergence of an international crisis with national foundations, is particularly complex due to the restrictions imposed on the Portuguese economy. The need for consistent and profound changes, if implemented with common sense and dialogue, has now become extremely urgent.

1. Portuguese economy and current restrictions

Monetary policy does not depend on us and may not be the most favourable. Further, given the weight and influence of Germany, any acceleration of the German economy, which is anything but unlikely, can lead to changes in monetary policy in a manner contrary to our interests. If this possible lack of synchronization is joined by some anti-inflationary orthodoxy, which is particularly disadvantageous in the current context, we have reasonable grounds to fear the effects of the euro zone monetary policy on our economy, namely due to the continuation of a strong common currency. Even the financing of our economy, hitherto heavily dependent on the goodwill of the European Central Bank, is likely to be faced with additional difficulties soon.

The state budget policy is and will remain limited by the Stability and Growth Pact, which in future will be even more rigid as a result of the sovereign debt crisis in several European Union countries and the set of constraints, obligations and penalties it will



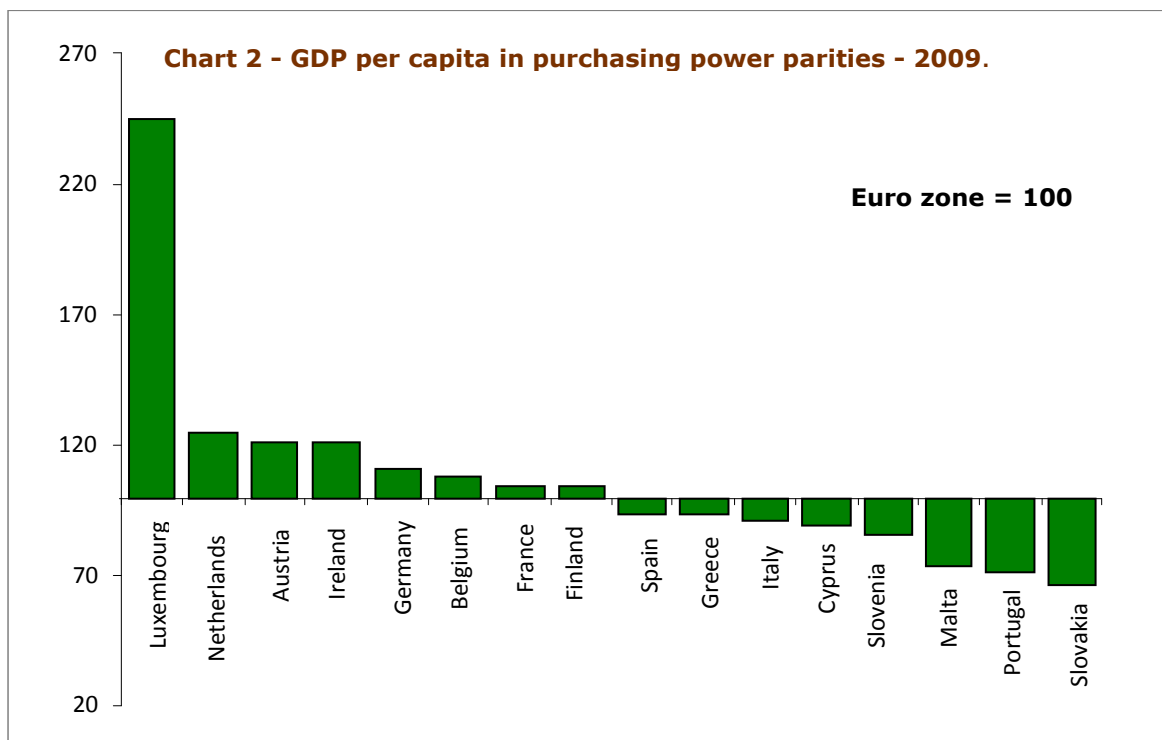
bring. The restrictions and resulting consequences will be even greater for the Portuguese economy.

The lower growth trend of our major partners, notably Spain, is also another factor hindering the growth of our exports and the improvement of some of the imbalances.

The European Union's external context is also very difficult for an economy such as Portugal's, which is uncompetitive and has a weak export tradition. The development of globalization and the growing importance of emerging countries have increased competition on our economy in areas and products where we have some relevance. Competition from new EU Member States and emerging economies (trade, attracting foreign direct investment, shared EU aid and business delocalization) is a tremendous challenge for the competitiveness of our economy and a further difficulty to our recovery in sustainable conditions.

On the other hand, labour costs rose and, due to globalization, there are many other alternatives that affect very negatively the attractiveness of the country with regard to international and even national investment. Moreover, as a result of European agreements and the difficulties which now Europe is facing, funds will certainly be reduced soon.

In this context, our peripheral geography, as mentioned above, stands out even more strongly, hampering the location of new businesses and forcing new relocation processes. We also believe that the actual systems to support economic activity will move further away from European standards, thus further hindering incentives to invest and produce, which will lead to a tendency for balances to adjust at lower levels in terms of products, wealth and quality of life and welfare. And lest we forget, in this respect, that, in terms of per capita income, our economy continues to compare poorly with the rest of Europe.





The social crisis that tends to deepen, with a whole procession of misery and suffering, the weakness of the government in the current policy framework and the lack of tradition of peaceful and fruitful social dialogue, will greatly hamper the possibility of a social pact, which is of great importance under current conditions, undermine social cohesion, and lead many Portuguese to resume the uncertain paths of emigration.

2. Future prospects or the labours of Hercules

In addition to this crisis of productivity and competitiveness, expressed in the trend for widening imbalances, the international crisis has brought about a lack of demand that has destroyed a significant part of the productive apparatus, as attested by the numerous company bankruptcies and massive increase in unemployment. Unfortunately, this was coupled with a sovereign debt crisis that forces pro-cyclical policies that will continue to destroy productive capacity and generate unemployment. As a result, recession and stagnation seem to have found ripe conditions to settle in, leading the Portuguese to general impoverishment.

In such a situation, it is urgent to undertake a programme of structural adjustment and growth that dramatically reduces more immediate imbalances and pursues a policy that enables overcoming major obstacles and build a model of sustainable growth to ensure an annual growth rate of the economy above 2.5%. If we do not fulfil this goal, it will be very difficult to accommodate the consequences of past imbalances and restore the fundamental balance in a framework of social cohesion.

Thus, the direction we point to and believe reflects a broad consensus among economists can only be one of product growth, productivity and competitiveness, which will confer Portuguese economy a new feature: to become an international producer.

To this effect, the first fundamental guideline is to reorient supply towards tradable goods, particularly for export to new countries and regions of higher potential growth. The stimulus to export goods and services becomes a permanent orientation axis using all tools capable of delivering results in this area, ranging from developing an export credit and credit insurance policy to the allocation of tax benefits and implementation of an aggressive economic diplomacy.

This approach requires the development of more sophisticated strategies and business operations, involving a marked improvement of the country's capacity for innovation and productivity. This implies increased qualifications and skills on the part of entrepreneurs and workers and the implementation of active and selective public policies.

To solve a problem one must first identify it. And in the case of resources, we should understand that the weaknesses of businessmen and of Portuguese workers are rooted not only in organizational issues but also in its intrinsic quality, which can be improved with more and better training.

Improving the business environment, particularly through the timely operation of the judiciary system, and the removal of bottlenecks on infrastructure, such as the new airport or the rail and road links from our ports to the Spanish hinterland, should be included in the group of correct priorities to be delineated.



It makes sense to support some specific sectors, particularly where there is some consensus on the matter, mainly when dealing with sectors still far from maturity and consolidation, such as renewable energies or the electric car, or that may be associated with more specific resources, as the sea or the Mediterranean diet, where comparative and/or competitive advantages may already exist or be created. In this sense, competitive re-industrialization and the further development of agro-industrial activities emerge as guidelines to be implemented.

To be competitive and of high quality, supply needs our economy to be better equipped to attract national and international investment. Better and more investment will increase economic activity, output, employment, and income. However, one must not forget that an investment policy is both a policy for growth and for employment, which has perhaps the most sustained and real effect. Without the creation of job opportunities, improved qualifications and training alone may not achieve the desired objectives. Such measures require selective policies aimed not only at national investment but also at attracting international investment.

Given that public investment is severely limited, in the present context it should be very selective and focused on overcoming the structural bottlenecks that streamline existing private investment. Public investment in innovation and technology, modernization and development, should be strengthened in future as a means to induce a sustained growth of private investment in this area and more generally in the economy.

From our point of view, rather than create more favourable expectations of future cheaper redundancies for companies, action is needed on the factors that can influence direct investment in Portugal, particularly in terms of costs and taxes.

The restructuring of the tax system may be an indispensable tool to encourage investment. In a country without its own currency and monetary policy and with budgetary limits on a lavish management of finances due to existing restrictions (imposed by excessive debt), tax policy is a key instrument for the management of resources. Thus, the fact that the country already holds a high tax burden should not lead us to fiscal drag by simply defending its maintenance.

This means a policy that significantly reduces the costs of doing business and positively discriminates, in terms of taxation, the businesses and workers who contribute to the consolidation of our external accounts. This shock could incorporate a change in the financing system of Social Security, through a significant reduction in company contributions offset by tax increases or fees in the area of consumption and in sectors which hitherto have been protected.

At present, the development strategy still requires, from the supply side, wage costs control, although, of course, with employees having a share in eventual productivity improvements. A more flexible labour legislation with regard to management of working time may also contribute to improving business efficiency. However, it should be noted that wages and employment law have not been major obstacles to economic growth in Portugal, and their worsening to the detriment of workers will not be a condition for future development.

It must be stressed that, with regard to earnings, the average growth in nominal wages in the public sector was 3.4% between 2000 and 2009, whereas the average inflation in this period was 2.6%. This exposes the weakness of the argument that suggests that

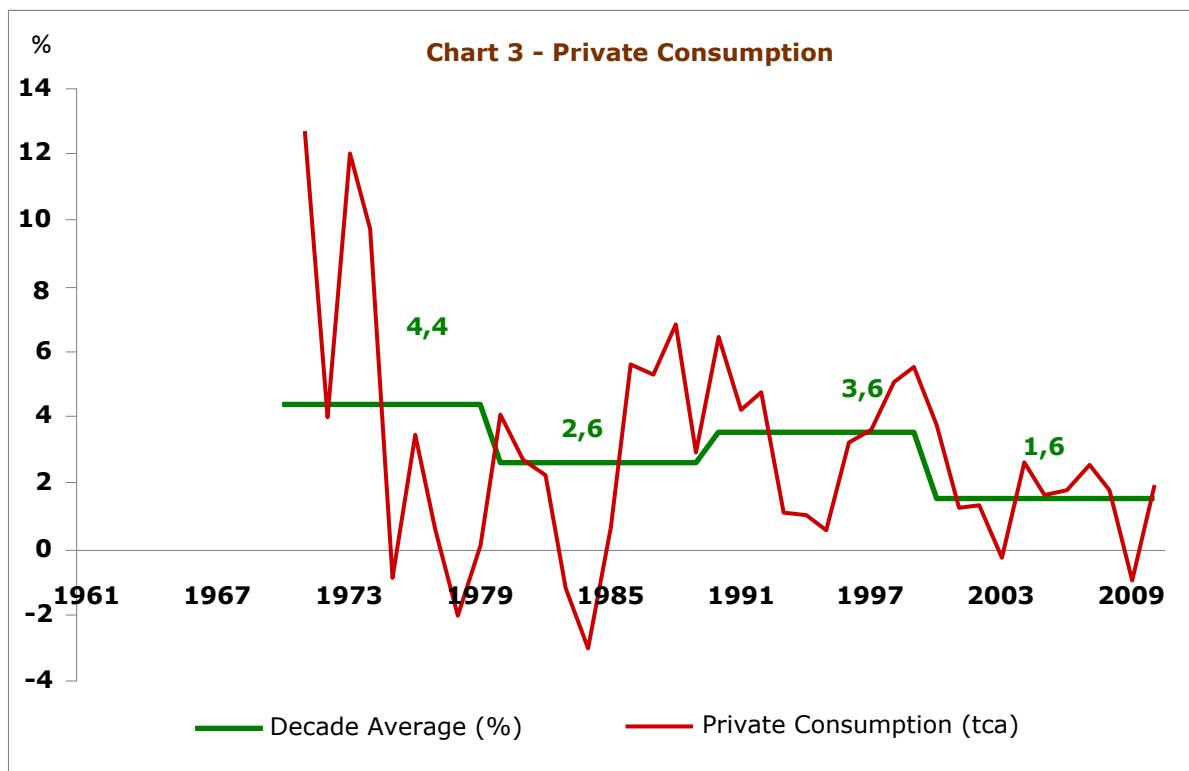


budget imbalances are responsible for the increase in wages. Furthermore, the average reduction in public sector wages by 5% in 2011 means that, between 2000 and 2011, the increase in real wages was 1.9%, i.e. less than 0.2% per year! This cannot be compared with the 6.6% real growth (annual average) in the 1990s, or 6.8% in the 1980s.

At this point, it should be noted that the development of the traded goods sector that is necessary to achieve the appropriate level of economic growth, to which we referred above, may be insufficient if we only insist on the exporting part. Indeed, the urgency and depth of the adjustment of supply that is required by the current magnitude of the imbalances, requires a broad process of increasing domestic production to replace products currently imported. The fact that there are many difficulties in its implementation and that it is "outmoded" should not hamper the changes in behaviour and attitudes that will enable it!

With regard to demand, it is therefore necessary to change attitudes and behaviours in order to reduce imports and stimulate increases in consumption especially aimed for domestic production. Some import substitution can be made operational immediately, and this only requires the will to do so. Most developed countries have induced *informal protectionist* attitudes and behaviours, as operative and effective as traditional prescriptions, which are obviously incompatible with the open economies of today.

To this effect, some taxes may have to be increased, penalizing consumption, so that others can come down significantly to allow companies to reduce costs and leverage investment. Moreover, it should be pointed out that private consumption has grown over the past decade well above the GDP, with a strong focus on import.





In the area of institutional reform, it is indisputable that some progress has been made among which we would highlight two examples: the reduction of bureaucracy, with several noteworthy measures, and social security reform, removing it from a clearly unsustainable path. However, in many other areas, reform attempts were unsuccessful, as in public administration, or produced totally opposite results, as is the case of justice.

In the short term, it is essential to reduce the size and cost of the state, increasing its efficiency. Examples of measures that need to be implemented include controlling public spending and eliminating unnecessary costs. This can be achieved by reducing the number of institutes and keeping only those of a technical or regulatory nature, and reducing the number of employees. Streamlining the autonomous public sector, particularly by promoting the physical and financial control of State-Private Partnerships (PPPs) in order to reduce the enormous damage they cause to the country, is certainly a national requirement. To pursue a policy of zero-based budgeting could also be a disciplinary tool of public spending.

Justice is also a key sector to enable us to pursue a strategy of sustainable development. In the past, the main defect of justice was its slowness and inefficiency, particularly in key areas for economic development. At present, one senses and speculates about more serious anomalies, such as the politicization of justice, which questions the third pillar of the Rule of Law and discredits the country. Without the introduction of a clear institutional break in this sector that can be perceived externally, the attractiveness of the Portuguese economy will hardly be noticed.

Education and training at various levels continue to limit the development of the country, despite the significant progress made and the much expenditure spent in this area. In any case, the improvement of their quality and raising the quality of our human resources should remain as an essential guideline. Simple measures, such as increasing the number of taught hours per week in subjects like mathematics, Portuguese and sciences, can significantly alter current results.

3. The need and limits of external assistance

We are not unaware of the high social cost of many such measures, which therefore tend to be permanently postponed. But we believe that its postponement will have serious consequences for the country. The risk that our current operating model will collapse, with the consequent need for more restrictive measures as far as the standard of living of the population is concerned, is growing each day.

In this regard, when preparing a text for JANUS 2011 in October 2010, we wrote: *"It is for this reason that we stress the urgency, and also on behalf of such urgency, for external help to address this situation. We believe that such a programme will not run in an environment of total dependence of the so-called markets, i.e., in permanent harassment by international speculators pushing up the price of money in usurious fashion."*

Also in this framework we wrote then: *"For all this, resorting to the International Monetary Fund should be considered without prejudice and in a cost / benefit approach whose result we regard as positive. This is because it would create a stable framework for economic policy in, say, three years, as it would increase the credibility of policies"*



nationally and internationally, reducing the cost of difficult measures that need to be implemented, and also because the financial effort would be less costly than continuing to resort to financial markets. By doing this we would be acknowledging the errors of our former economic policy, but this fact is not lost on anyone."

The time wasted turned a request for assistance into an international bailout. Nevertheless, the negotiations currently underway with the "international troika" do not fundamentally change the direction we have been proposing, quite the opposite. It is necessary to take into account that the policies proposed by those international bodies cannot fail to be guided by an orientation of "*cosmopolitan*"¹ " nature that is limited and insufficient to meet the dual ambition of the national "Political Economy": the adjustment of national accounts (public and external) and the resumption of sustained growth in economic activity.

The implementation of such a programme requires a great deal of agreement on the part of social partners, breaking with tradition and finding new ways of consensus. However, in its absence and independently of the external support that we have to request at this stage, it is essential that employers, workers and government officials understand the basic truth that there is no royal road to sustained economic growth and improved well-being of the Portuguese, and that they must unite around a coherent, clear-sighted and pragmatic social agreement. Only then, and if this is done urgently, we will avoid the dark path that is outlined on the horizon right now.

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¹ List, Friedrich (2006). *Sistema Nacional de Economia Política*. Lisbon: Calouste Gulbenkian Foundation