

The rise and demise of the Troika virtues (Portugal, 2011-2013)

Pedro Lains

Social Sciences Institute, University of Lisbon

November, 2013

Draft

The single largest cause behind the present crisis in Portugal is the euro or, rather, the way the euro was created; and the second is globalization, particularly, the shape it took since the fall of the Berlin Wall, the German unification, the European Union's Eastern enlargement, and China accession to the World Trade Organization, in 2001.

During the last 15 years or so, the Portuguese economy thrived between the scissors of accrued international competition and an overvalued exchange rate. Moreover, open financial markets and a substantial contraction of the country risk, at the sovereign, firm and individual levels, led to large inflows of capital and the increase in national public and private external debt.

By stating that these are the most probable causes of the present problems of the Portuguese economy I am not implying a negative counterfactual regarding the potential benefits of the euro or globalization, but rather that a better Eurozone and global governance is needed.

The international context was also relevant in defining the main causes of the crisis. We need to recall that, in 2008, the European Commission launched the somewhat pompously designated *European Economic Recovery Plan*, which “called for an immediate and co-ordinated effort to boost demand, suggesting a fiscal policy response equivalent to 1.5% of EU GDP. This figure includes actions at the EU as well as the Member State level.”¹

¹ Public Finances in EMU 2009 EUROPEAN ECONOMY 5|2009, p. 13

The road to a steep increase in Government expenditure, both at the centre and the periphery of the European Union, was then opened. Eventually, the international financial crisis spread to the sovereign debt and countries with weaker economies, larger external deficits and levels of government deficit and debt, were faced with an upsurge of their bond yields, leading to the need for financial assistance.

Yet we need to settle on the grounds of the major causes of the current crisis in order to proceed with a sensible discussion about it. Having said that, what happened in Portugal?

The movement in favour of the bailout was quite strong during the first quarter of 2011 and its pressure peaked with the interviews conducted by a well-known reporter (Judite de Sousa), at one main TV broadcaster (TVI), in four successive days from 4 to 7 April 2011, or about a month before the Memorandum was signed².

The main discussions was whether there should be elections or not, as many feared that elections would endanger further Portugal's possibilities in getting help to solve the State's urgent financial needs. The main Opposition party, then already led by Passos Coelho, together with the Christian-democrats and, presumably, the President of the Republic, took the stance that there should be elections.

That option was not opposed by analysts and pundits and not in particular by those who tend to express ideas closer to bankers and other members of the economic elite. So, elections there were which the Social-Democrats won, albeit only with a relative majority and a coalition Government with the Christian-Democrats was formed.

The new Government immediately promised to overhaul the Portuguese State, the economy and the structural bottlenecks that, according to many, were at the roots of slow growth and large public deficits and external debt. The key actor for the string of policies that unfolded was the Finance Minister, Vítor Gaspar, from the Bank of Portugal, and a former ECB and European Commission official. Gaspar unknown to the public, as he did not engage in the debate about the bailout, as many of other economists who, according to press

² See: <http://www.publico.pt/media/noticia/judite-de-sousa-banqueiros-deram-entrevistas-para-fazer-ultimato-a-socrates-1532296>; <http://www.tvi24.iol.pt/economia---negocios/judite-sousa-tvi-jornal-nacional-banqueiros-bcp-carlos-santos-ferreira/1244184-6379.html>

speculations, were invited but refused to accept what was probably one of the hardest jobs of the time and since then. Gaspar headed the Bureau of European Policy Advisors when it advised the European Commission to push the 1,5% fiscal policy adjustment, back in 2008, but in Government he pushed instead for austerity, roughly doubling, in fact, the size of the degree of austerity imposed by the Troika *Memorandum*.

Gaspar was of course not alone, as he had full support within the Government and was backed by many economists. In what became famous statements, the Prime Minister and Eduardo Catroga, a major player of the Social Democrats during the *Memorandum* negotiations, stated that the Government wanted to go *beyond* what the *Troika* imposed in terms austerity levels.

Let's now proceed with the slides:

Slide 2: The crowded first Troika press conference on 3 May 2011.

Slide 3: Passos Coelho, the then leader of the main Opposition party, PSD, about the Government program.

Slides 4 to 6: The history of the bail-out program, as it is told by the titles of FT's correspondent in Lisbon, Peter Wise (also the correspondent of The Economist. See below). It clearly shows that, as problems aggravated, the level of austerity was stepped up.

Slide 7: Who did the program?

Slide 8: The Troika press conference reveals that none of the representatives understood Portuguese.

Slide 9: So, how did they produce such a detailed program (extract from the Memorandum)?

Slide 10: A quote from an article by Peter Wise about the role of Nova Economics Faculty in the making of the Memorandum. This probably exaggerates the role of Nova, as the document also had large contributions from the Bank of Portugal, in representation of the ECB, the Portuguese government and the European Commission. The conclusion, however, is that it was largely made internally, which cannot come as a surprise, as Portugal is a developed economy.

We need to add that Pedro Portugal's and Francesco Franco's contributions were rather different in terms of economic theory. Pedro Portugal is clearly in favour of full liberalization of the labour market, whereas Francesco Franco's begs for internal devaluation through taxes, not wages, substituting for currency devaluation.

Slide 11: But Nova professors also pointed out lot of criticism. It is interesting to note that more publicity was given to the contributions than to the criticism. It is a sign of the times, where politicians get from the academia what they want – and not the other way round. Particularly relevant is what José Tavares writes. For more criticism, see the Nova document.

Slide 12: The beginning of the end: the 15 September 2012 demonstration against a reduction of a corporate tax compensated by wage taxes. This measure was in replacement of Francesco Franco's proposal. It as a kind of Margaret Thatcher "poll tax" effect.

Slide 13: Revealing the end of the popularity of austerity

Slide 14: Summing up: so why was the Memorandum so popular in the beginning?

Slide 15: "The Economist" aligned with what can be considered the "popular" view of Portuguese problems. But not the "Spiegel".

Slide 16: Too much infrastructure, too much construction, too much "non-tradables": simply don't show in the data.

Slides 17 and 18: Economic History matters.

Slide 19: Ditto.

Note

From the Troika press conference, May 2011:

32:14 Camilo Lourenço, a popular journalist, presents himself

33:24 Question: "Some of the measures are so obvious that didn't you wondered why haven't we the "Portuguese" implemented them so far?"

<http://www.imf.org/external/mmedia/view.aspx?vid=940641480001>