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Introduction

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INTRODUCTION

"Times change, as do our wills; What we are—is ever changing; All the world is made of change, And forever attaining new qualities."

—Luís Vaz de Camões (c. 1524–June 10, 1580)
—considered Portugal's national poet

The recent economic and financial crisis had a significant negative impact on the Portuguese economy: throughout the period 2008–2013, real GDP fell by more than 8 percent and the unemployment rate increased from 8.7 percent to 16.4 percent of the labor force. More recently, the Portuguese economy has gradually begun to recover. GDP is expected to increase by 1.6 percent in 2015, and the unemployment rate is forecast to decrease to around 13 percent. Additionally, the huge external and budget imbalances registered during the crisis are being redressed. Although the numbers are still not particularly impressive, the current recovery shows a positive response to what has been a very difficult internal and external economic environment. We owe this upturn to the swift implementation of a very ambitious program of structural reform, flanked by a strong commitment to eliminate macroeconomic imbalances.

It was toward the end of the Macroeconomic Adjustment Program (2011–2014) that the Martindale Student Associates visited Portugal to research the country's economy. The Martindale Student Associates Program is an undergraduate research program developed by the Martindale Center at Lehigh University. It enables undergraduate students from across colleges and disciplines to study, in depth, the economies of countries whose cultures and institutional and economic parameters differ greatly from those of the USA. It is a fascinating exercise and a stimulating way for students to apply their academic knowledge in different applied set-ups. The students' work culminated in the publication of this excellent journal that offers very interesting perspectives on Portuguese society and solid arguments and narratives in support of their analyses. Congratulations to the Martindale Student Associates and the Martindale Center team.

Economic Overview

Over the last 50 years, the Portuguese economy registered periods of very high growth rates, alternating with phases of dismal performance, resulting in a balance of payments crisis on three occasions. During the 1960s, the economy grew quickly and living standards increased significantly. In an effort to open its economy, Portugal joined the European Free Trade Association (EFTA), with positive results in trading flows. However, the oil shocks of 1973 and 1979 inflicted huge costs on the economy, which was heavily dependent on imported energy. On both occasions this severely upset the balance of payments and led to Portugal's request to the International Monetary Fund (IMF) for a Macroeconomic Adjustment Program, or "bailout." At this time, the Portuguese economy was already fragile as it was emerging from 40 years of Salazar's dictatorial regime. The termination of the dictatorship in 1974 and an uneven transition into a more market-based economy gave rise to substantial economic and social costs.

Some of the more important challenges the country faced during the 1970s in the aftermath of the 1974 Revolution include 1) changes to the economic system (the nationalization of critical sectors), 2) the introduction of price controls, 3) increases in wages above productivity, and 4) the need to absorb a great many Portuguese citizens—around 500,000 people—returning from former colonies. The following decade witnessed a gradual stabilization of the economic, social, and political environment, mostly because institutions were adapting to the new environment and due to the fact that Portugal had joined the European Economic Community (EEC) in 1986. Portugal's increasing economic ties with the most developed nations in Europe helped usher the country into a new phase of prosperity.

Another positive impulse came along in the mid-1990s with the perspective of Portugal joining the Eurozone at its inception (the single currency came into existence in 1999). This expectation encouraged a rapid nominal convergence and a drop in inflation and interest rates in alignment with levels enjoyed in core European countries. Increasingly integrated, the Portuguese economy began to follow the European cycle closely, with the convergence of real income. It is important to acknowledge, however, that the growth pattern during the 1990s—especially in the second half—and in the 2000s was unsustainable in the sense that it was not (fundamentally) productivity-grounded (supply side), but rather expenditure-based (demand side). As a result, the country's indebtedness increased significantly, notably in terms of foreign investment liabilities.

Portugal has, unquestionably, made enormous progress over the past 40 years: in social areas (health and education), in infrastructure (roads, telecoms), and in the efficiency of the public sector (e-Gov). However, because some important economic sectors remained sheltered from competition (both internal and external), the economy was still unable to address its chronic trade deficit. To sustain the increase in Portugal's import levels (machinery, consumption) during the boom periods, exports really needed to increase much faster than they did. I am not suggesting there was no increase in exports—there was. But Portugal was facing an additional challenge during this period: globalization was pummeling a number of critical traditional sectors (textiles, footwear, and clothing)—a factor requiring even faster resource reallocation toward other, more dynamic sectors. Around this time, during the 2000s, China was joining the World Trade Organization (WTO), and several Eastern European countries were joining the EU. All were competing in the same markets and with the same products in which Portugal had previously enjoyed a comparative advantage in international trade. Consecutive external deficits brought about a rapid deterioration in the International Investment Position (IIP), which increased to more than 100 percent of GDP—one of the highest in developed countries. The importance of these factors was downplayed by economists at the time, who argued for the irrelevance of current account deficits within a monetary union. They felt that with no possibility of an attack on a country's currency, speculators would be unable to generate a currency crisis and that the macroeconomic adjustment would occur automatically once other variables—namely labor and capital mobility—shook down.

Effectively, during the euro period, GDP was growing—albeit less than spectacularly. Moreover, belonging to a monetary union provided a certain sense of security. Meanwhile, as previously mentioned, the continued accumulation of external debt was increasing the country's economic vulnerabilities. Risks materialized with the financial crisis of 2008, when the international shock was amplified by a lack of internal mechanisms that might have made it possible to implement some counter-cyclical policy measures. Budget deficits and public debt—already elevated—increased rapidly. Concurrently, the banking system became under-capitalized due to the crystallization of losses from non-performing loans. Facing significant need for external financing, and with foreign investors fleeing to safer investments, much needed funding sources were drying up. Within this context, a sovereign debt crisis emerged in 2010, with Greece (May 2010), Ireland (November 2010), and Portugal (May 2011) applying for bailout programs. This time the European Commission (EC) and the European Central Bank (ECB) participated with the IMF as part of the institutional set-up, forming the so-called "troika" program. Although the depth of the problems facing these three countries was very different, they had one common characteristic: a significant amount of external debt. Although international investors were no longer able to speculate on the currencies of these three countries, they were still able to sell off their portfolios of sovereign debt en masse, generating a liquidity crisis, which rapidly became a crisis of solvency. Despite relative success in terms of convergence of real income to EU levels over the last few decades, the fact remains that Portugal needed three Macroeconomic Adjustment Programs during this period, displaying an inability within the country to plan for leaner times during times of plenty.

It is common knowledge that Portuguese sailors and explorers were renowned in the 15th and 16th centuries as being at the vanguard of European overseas exploration. With an assumption of risk at the very heart of the Age of Discovery, they navigated the unknown, discovering and mapping the coasts of Africa, Canada, Asia, and Brazil. It is interesting, therefore, to reference Erin Burton's article "The Impact of Risk Aversion on Economic Development in Portugal," which examines how a nation's attitude toward uncertainty can influence its economic performance.

The Macroeconomic Adjustment Program 2011–2014 ("Troika")

Portuguese external financing conditions deteriorated gradually throughout the period of the financial crisis and more so following the bailouts of Greece and Ireland. The government, corporations, and banks began to lose their traditional investor base; even when it was still possible to tap international investors, interest rates sky-rocketed to the point that they became prohibitive. During the period 1999–2007, the Portuguese Republic was able to gain access to finance in the international bond market, 10 basis points (0.1 percent) above Germany in tenures up to 10 years; in the peak of the crisis this spread was above 1,000 basis points (10 percent). At the beginning of the crisis, the Portuguese banks and investors stepped in to replace international players, guaranteeing the necessary funds to maintain business as usual. However, the country's excessive expenditure over its generated income (external deficit) was clearly unsustainable. In this context, a Memorandum of Understanding was signed in May 2011 between the Republic of Portugal and the "troika," which included a set of measures—examined in Shaan Gurnani's paper, "The Financial Crisis in Portugal: Austerity in Perspective"—to be adopted over the following three years. These measures were to be coherent among themselves and self-enforcing, and should address macroeconomic challenges in a way that would assure the country's economic recovery. The Macroeconomic Adjustment Program was built around three main pillars: 1) public finance sustainability, 2) financial stability, and 3) structural reform. In terms of the public finance pillar, the aim was to reduce the general government deficit from 11 percent of GDP in 2010 to below 3 percent of GDP (especially given that the existing elevated level of public debt—96 percent of GDP in 2010—was well above any measure of prudence). Next came a program specific to the banking sector aimed at guaranteeing the stability of the financial sector. The article "Banco Espírito Santo and European Banking Regulation" by Tyler Sloan rightly addresses this issue. Finally came the structural reform package, designed to increase the potential GDP growth rate—the most crucial long-term challenge facing the Portuguese economy. Portugal's growth rate over the last 15 years has been lower than expected for a "catch-up" country. Several factors contribute to this low growth rate, the most prominent of which are low levels of competition and insufficient flexibility. In this context, the structural reform program was based on measures designed, on the one hand, to increase the flexibility of the labor and product markets and, on the other, to improve the regulatory framework and conditions promoting investment. Research from the IMF, the OECD, and the EC all show that delivering on these measures would significantly increase potential GDP.

The Path Going Forward

Portugal exited the Macroeconomic Adjustment Program in June 2014, as expected, with an improved macroeconomic position: public finances were put in order, and the trade deficit was eliminated. The unemployment rate is decreasing, private consumption is returning to more normal levels, and investment is picking up (although levels are still low, FDI is improving). Furthermore, investor confidence returned to the Portuguese market: the government, banks, and corporations regained access to international markets.

One of the most important issues facing the Portuguese economy is the need to continue improving international competitiveness. The results over the last few years are very encouraging: exports have been increasing at high rates, with improving product and geographical diversification. The article "Portugal and Its Former African Colonies: A Unique

Opportunity" by Jade van Streepen analyzes the links between Portugal and these former colonies, which have potential for further exploration and could yield mutual benefits.

Investment is a crucial variable when it comes to increasing capital stock. Looking ahead, Portugal will need to make a special effort to enable new and innovative firms to enter the market. Attracting foreign capital is also the motivation behind the Golden Visa Program, the focus of the article "The Integration of Immigrants in Portugal" by Brandyn Bok.

Investment in human capital is of paramount importance to increasing potential GDP. An analysis of this issue with interesting insights is addressed by Michael Gallucci in his article "Portuguese Emigration and the Brain Drain: The Power of Movement."

When it comes to areas of potential comparative advantage, the Martindale students focus on two promising sectors: Katherine Walters examines the field of biomedical R&D in her article "Enhancement of Research and Development in Portugal: Stimulation for Innovation and the Economy," while Whitney Challenger analyses the potential of the new maritime economy in her article "The Blue Economy: Opportunities Hidden at Sea."

One of the unfortunate legacies of the financial crisis is the high unemployment rate, particularly youth and long-term unemployment. There is a need to develop inclusive growth policies to reduce different types of inequalities that have emerged alongside the crisis. Some of these social issues are addressed by Haley Robinson in her article "The Changing Role of Women in Portugal."

Continuing in the area of social reform but on a more specific topic, the article "Decriminalization of Drugs in Portugal: A Controversial Experiment for Public Health" by Kathryn Kundrod offers some important reflections on a theme often absent from the political agenda.

Green growth is clearly an important objective for long-term sustainability. The article "Renewable Electricity: Lighting the Way or Casting a Shadow?" by Catherine Withers is particularly relevant in a context where there is a clear need for changing policies worldwide.

Overall, this set of articles offers a very interesting perspective on the Portuguese economy, evaluating threats and opportunities, with insights looking forward. As suggested by the poet, a changing world demands new qualities. This collective work from the Lehigh University Martindale Student Associates represents a relevant contribution to our debate on the changes that need to be made in the Portuguese economy to assure long-term performance improvement.

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