

TESTIMONY OF THE INTERVENTION

PANEL II – INVESTMENT, GROWTH AND CORPORATE COOPERATION

A Portuguese Economy: Past and Future

Rui Rio

“The way forward must be growth through exports or substitution of the imports and public or private investment and consumption. Consumption is a positive consequence of a good performance in our production.”

“Thank you for the invitation.

I will make an intervention on what is my vision of what the Portuguese economy has been in recent times.

You will realize, therefore, that it will have to be exactly the opposite of what it was.

The remaining members of the panel will then make assessments on a less macroeconomic basis.

Portugal came to this economic situation because of many mistakes it made, of course, but I would highlight 5 great mistakes from Portugal that brought us to this particularly difficult economic situation, which we lived with great intensity, although now with less, but which strongly affects us.

The first reason we rarely talk about is that we have not taken advantage of the pre-euro and pre-currency periods. I’ll explain exactly what I mean by this. This was the first big mistake, an historic one per se.

The second we all know it. It was the rampant indebtedness of the Portuguese economy in its public and business versions.

The third big reason was the fact that we have accumulated very weak economic growth for many years.

Then there are two other reasons, one very important that we rarely talk about, namely the fact that we have made a lot of public spending, but above all, we have not measured the quality of the expense. There is good and bad public spending and we have made a lot of public spending without effectively measuring its quality.

Finally, the granting of rights that we gave to people and that we knew would not be sustainable in the future, but that for electoral or popular reasons, it would look good to take certain measures without paying attention to the future and the implications of these.



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CONCLUSIONS

This has been building up over the years. I'm not talking about any specific year, I'm talking about something that happened over the years and this is what brings us economically to the current situation, which is why we have to do differently.

There is another reason that has to do with what I usually call the "crisis of regime" and that has to do with the weakness of political power, although they are very important questions to explain some decisions that have been taken, they stay outside this eminently economic logic.

Why do I say that the first was the non-use of the pre-euro period? From the second half of the 1990s, between 1996 and 2000, we had three factors that were frankly positive and that none of us in this room will have the opportunity to relive and neither will our children.

We had a revolution in escudo's interest rates. We were on the escudo and as we approached the single currency, the escudo interest rate began to move towards the euro interest rate.

This would mean that if we apply this saving, in the interest rate reduction, let's imagine from 12% to 6%, this gain applied to the debt stock would give enormous expense savings. A unique thing that will only happen again when we move to another single currency.

If we had done so during the period when we had great economic growth, with great growth rates and the revenues of brutal privatizations that we had at the end of the twentieth century, we would have gathered three factors that are a highly favourable situation and, I repeat, will hardly repeat themselves in the coming decades, not to say centuries.

As we began to move more assertively towards the Euro, the markets, the country and Europe began to believe that we would succeed.

In 1995 we had a gross domestic product deficit of 5.2% and in 1999, at the beginning of the 21st century, and at the beginning of the single currency, those 5.2% changed to 3%. We were able to fulfil what was required to enter into the single currency, but with the gains we had made, for the reasons I mentioned, we could have brought the budget into balance.

Only interest-rate gains on public debt, driven by lower interest rates, brought the deficit to 2.7%. Even if we only took advantage of this and nothing else, we did not have 3%, we had 2.7%. To these 3% we still have to add what is called "misalignment", which is the case of the SCUTS, that is, debt that was hidden and that would appear later, but that in the budget of the respective years did not appear. If they were 3% in 1999, in 2000 they were 3.2% and in 2001 they were already 4.8%, plus the 'misalignment'.

I think it's worth reflecting on. It is not that we will have such an opportunity, but we will have other opportunities and if we learn from the mistakes, perhaps they will not repeat themselves and perhaps we will know how to better take advantage of the opportunities that the different conjunctures can offer us, as in part the one we are living.

I think the mistakes of this, come, in my opinion, from two factors.

In part, by an ideological option, in which it was understood that the greater the level of state intervention, the more we would warm up the economy and the more we could grow. This is somewhat outdated nowadays, given the size of the debt that

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many countries have, starting with ours.

On the other hand, electoral sympathy. If I use money and do public spending, I do more things, I'm nicer and I get more votes. I think that was what was behind the bad use of what we had at our disposal. In this particular case, if you start naming who is responsible for this, the responsibility is entirely of political power, there is no doubt about it!

Then we had the rampant indebtedness, the gross external debt. What the country, as a whole, owes to the outside.

At that time there was a trend of consecrated economists who said that in the single currency scenario the problem of external indebtedness to Europe was not present, just as at the time of the escudo no one spoke of the external debt of the Minho or the Alentejo because everything was in the escudo space of Portugal. With Portugal in Europe, within the Euro area, there would also be no external debt to Spain, France or other Euro countries.

In practice it came to show that people who believed in this and had the technical baggage to do so were not completely correct, because foreign debt actually continued to count.

There is a time when the markets tell the country, as far as public debt is concerned, "enough, I will not lend more", or the bank, which is in debt for the same reason, says "I will not lend anymore." This is what happened.

One day and for that reason we had to call TROIKA, precisely due to this principle of the devaluation of external indebtedness.

Then there is also one thing, which I think, we all in this room had a realization that did not correspond to reality. At that time, it was thought that Portugal from the moment it entered the European Economic Community in the 1980s would be like Germany, like Sweden or like other developed countries.

After we came in, we thought we would always grow and always improve. But it turned out not. And this leads to people having confidence in the future, naturally have behaved differently.

All this led to the fact that at the beginning of the twenty-first century, for almost ten years, we had a deficit in the balance every year, meaning that every year we exported much less than what we imported and therefore our debt was increasing. For 10 years, at 10% of annual GDP. Take a good look at the situation for which Portugal walked in, without at the right time the brake was hit to stop things.

In practice, external debt is what? Is to use external savings for lack of of internal savings. Reducing foreign savings and the Portuguese banks not having domestic savings, there will have to be indebtedness abroad, looking at the external savings form of being able to lend it inside. This situation is sustainable to some extent. We have passed this point far beyond what we should have, and there are still consequences of that today.

The three major components of indebtedness are of course the public sector, businesses, and families.

Public indebtedness is what the state spends, which is the sum of all deficits. Every year, since April 25th, we have a deficit state budget, and there is not a year in which the State has received more of what it spent. It spent more of what he received every year.

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We had forty-three deficits. We had 51% of GDP in public debt at the beginning of the 21st century. Now we have 130%. We went from 51% to 130% and I have some notes here about my reading of the reasons for this.

Debt of the companies that in 1995 was 68% of GDP, at the beginning of this century was already 100% and when TROIKA arrived, in 2011, it was already 160%.

I would, however, draw attention to one issue – not everything is the fault of political power. Here political power has a lesser responsibility than banking, which in this case has a giant responsibility.

The companies have responsibility, who have gone beyond what they could in debt, but more than that, it is the responsibility of the bank that did not know the quality of the loan projects that it gave.

And families also have their responsibility more centred in the bank, which had a debt of 38 percent of GDP in 1995, 70 percent at the beginning of the 21st century, and 102 percent when TROIKA arrived. By 2015 it was lower, at 85%. I did not see the last numbers, but I'm afraid it's already growing again.

Being the household debt quite high, it may not be as serious because 80% of it went for home purchase and therefore the asset is there, it is useful and exists. If it were all for travel or for new televisions, new automobiles, that would be different. This corresponds to the remaining 20%.

If we look at the gross saving rate of households, based on their disposable income and if we go back to 1960, we see that Portugal was a country where we found people barefoot on the street. It was a poor country, but that in the 1960s, the household saving rate was 4.9% of disposable income. In 1973, with the 25th April at the door, this rate had jumped from 4.9% to 22%. At the beginning of the 21st century the 22% were already at 11% and in 2015 it was at 4.5%, less than in 1960!

At this moment it is already even lower than the 4.5%, it's around 3%. A country that can not have a minimally acceptable savings rate does not have the sustainability to make an investment, necessarily having to go into debt and that is precisely what has happened and has resulted in very weak economic growth.

Very weak is a word I am using with great kindness, because if we look at the panorama between 1986 - the year Portugal joined the EEC - to 2015, we realize that in the first 14 years the Portuguese economy, between 1986 and 2000, grew in real terms 70% and between 2001 and 2015, it grew 0%.

This is worse because by the time we got to the beginning of the 21st century, after we had grown 70%, we arrived with a public debt of 51% of GDP, but 14 years later, without any growth, debt was already at 130% of GDP. It is not easy to find a country that has been indebted in this way and where the growth rate has been zero.

I am talking until 2015, so all these combined effects explain the reasons why Portugal spent that less good phase. Even today we are highly conditioned by all these errors. We must internalize that we should look closely at the past as a way of preparing the future, so that we can correct and act in the sense that things do not repeat themselves.

One of the reasons for this weak economic growth has to do with the fact that all of us, but particularly Portuguese banks, have supported the production of non-tradable goods, that is, goods that can not be transacted in the foreign market and which can not be imported or exported.

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The fact that they are basically supported, these sectors, means that our economy is losing competitiveness and aggravating its balance of payments, its external balance.

The best example is civil construction. Much of the credit has been granted to construction, but this is not a tradable sector. In many cases, there was even two loans granted, one for the construction and another for the purchase. These were credits channelled into something that is not transacted in the foreign market, when what Portugal needed, needs and will need, is precisely to strengthen its position in the foreign market and its competitiveness.

We have to support the competitive sectors that can get out there and sell out there; or are implemented here, by import substitution. This is something that must be present in all of us if we are to change what Portugal has to do.

The way forward must be growth through exports or import substitution, investment and public or private consumption. Consumption is a positive consequence of a good performance in our production.

Of note is the lack of quality of public expenditure. This is the responsibility of political power, it has nothing to do with sectors. There is good public spending and bad public spending. For those who came from the North Region like me, they have come to the brink of a public investment that is abandoned and that is a focus of expenditure.

We have been left with the Monastery of Alcobaça, the Monastery of Batalha and we are going to leave these great public works. Dom Manuel I, had the Monastery of Batalha built and someone had the football stadium, or 10 football stadiums, built for a championship that lasted 3 weeks.

Here we have the difference between what is good spending and bad public spending. Sometimes there is a certain demagoguery in saying that public spending is bad, but no, public spending is necessary, in adequate quantity, and above all, in quality.

To end the fifth reason, the granting of rights without sustainability. It has to do with various sectors of our society, such as social security.

I know people who are retired, in their early 40s. Of course, this is not sustainable for the future. With the average life expectancy increasing, how can it be sustainable for a person to retire at around 50?

I saw this when I worked in the civil service. This is highly unreasonable. When we make a decision, rather than looking at its effects in the immediate, we have to look at its long-term effects.

This is what it means to be solidary, to be serious and honest with who is younger and with whom will succeed us, otherwise we will create problems ahead that have no solution. It is one of the reasons, in my opinion, that not only Portugal, but many countries do. Especially countries of the democratic regime because of the elections and the pressure, to try to be nice.

There has to be a lot of effort when doing these things, fundamentally measuring what will be the future effect of the measures that are being taken.

In conclusion, I did not want to fail to say that the main responsibility of all the things I said is clearly of political power.

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When I speak of political power I do not mean party A, B or C. I refer to political power as a whole.

The second responsibility is clearly from banking. A very great responsibility in what Portugal has gone through and in the conditions we still feel, though not as heavily as some years ago.

Then there is a wide network of responsible people and entities we could name. TROIKA, and I'm sorry for the outburst, also have responsibility from the moment they entered.

The way TROIKA entered Portugal, petulant, arrogant, with the idea that they came to teach us everything, that they came to make and to make it happen, but after all the results were not positive. GDP fell by almost 7%, unemployment reached 17%, we lowered pensions and wages, increased the tax burden, increased the deficit, as well as public debt.

Only the external deficit improved, but much by merit of the Portuguese companies and their exports. It is clear that the responsibility is not TROIKA's, but by the requirement that they presented us with which they entered in Portugal, we expected more encouraging results."