

**PORTUGAL, A SECOND ENGINE WITHIN THE EU?**

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presented at the

2001 International Conference

Academy of Business and Administrative Sciences

Brussels, Belgium

July 23-25, 2001

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## **PORTUGAL, A SECOND ENGINE WITHIN THE EU?**

The last two decades has witnessed Portugal transform from the poorest nation in Europe to one of the more fast paced economies in the region. GDP growth between 1980 and 2000 was 2.6 equaling the average of all the OECD countries. During this period Portugal surpassed Spain, Austria, Denmark, the United Kingdom, Finland, Belgium, Sweden, France, Germany and Switzerland. The only countries that had greater growth in the region were Ireland, Luxembourg and the Netherlands. (OECD in Figures, 2000ed.) Portugal is an emerging economy according to Hoskisson and Eden who categorize such countries as “low-income, rapid growth using economic liberalization as their primary engine of growth.” (Hoskisson & Eden, 2000)

In 2000 Portugal’s GDP growth was 3.3 which was above the European Union (EU) average. This growth resulted primarily from increased employment. Unemployment also fell to a low of 4 per-cent during this period. (OECD Economic Surveys) The bright employment situation resulted from a high degree of wage flexibility and active employment polices.

Successful economic policies in Ireland have been instrumental in giving the EU a sense of social and economic integration. Ireland has often been regarded as the engine driving

economic growth in the region throughout the last decade . During this period GDP growth in the country was 7.1, the highest in the EU. (OECD Figures, 2001 ed.) Significant Foreign Direct Investment (FDI) into Ireland fueled this growth which, in turn, helped move the EU forward toward harmonization. Employment grew at 6.25 per-cent in 1999 and 4.75 per-cent in 2000. (OECD Economic Surveys) Such rapid growth, however, has put pressure on the infrastructure of Ireland. Roads and public transport have become congested. Inflation is creeping upward. GDP growth is expected to slow down as a result of labor shortages and diminishing exports. Ireland has been an engine of growth during the past decade within the EU. Now Portugal may follow as the second.

Portugal is the only country in the EU classified as an emerging economy by Hoskisson and Eden. The country has experienced a rapid transition from an agricultural economy in the early seventies to one based more on manufacturing and services. The Hoskisson and Eden categorization of an emerging economy as one of, “low income, rapid growth using economic liberalization as their primary engine of growth” fits Portugal well as might be noted by the following: GDP per capita in 2000 was US\$17,600 ranking it eighth from the bottom of OECD countries and below all other EU members. (OECD in Figures, 2000ed.) GDP growth in 2000 was 3.3, a figure greater than the EU average. The country has become more friendly toward FDI and lessened its suspicions of foreign firms. Portugal is also benefiting immensely from its decision to join the European Monetary Union (EMU) in January, 1999. The business climate has been positive and EU funds continue to flow into the country thus attracting further investment. The economy has been operating efficiently and near its potential.

EU funds were instrumental in helping Ireland improve its infrastructure and, in turn, the rapid growth of its economy. Unfortunately, inflationary fears (highest in the region) are now prompting concern that wages will spiral. This, along with labor shortages, might well slow down Ireland's engine of economic growth. On the other hand, Portugal has successfully been moving forward to a skill-based economy (OECD Economic Surveys) and inflation has remained reasonably low and stable. "Portugal offers an emerging market within the framework of the EU. Portugal's emerging market status means new opportunities and high growth rates. EU membership and participation in the first tier of the Monetary Union mean stability and continued growth due to EU infrastructure funds". (U.S. Department of State FY 2001 Country Commercial Guide)

Portugal is not viewed as a priority country to do business with. Perhaps, because it is considered an emerging economy, many marketers look at it as slower and more difficult. (EBRD, 1998) Or perhaps, although democratic, the ruling party is socialist and some feel such systems are risky to do business with. The concern being that socialism advocates government ownership or control of the basic means of production and/or distribution. However, the fact has been that, "Following accession to the EU, Portugal began dismantling its system of state ownership and the country has adopted an aggressive privatization program." (U.S. Department of State FY 2001 Country Commercial Guide) The privatization program is considered to be one of the most ambitious among OECD countries. "It is one of the more far-reaching of any country in terms of scope, continuity and methodology. According to the OECD, cumulative

privatization proceeds over the 1990-98 period as a percent of 1998 GDP ranked Portugal second highest after Hungary among all OECD members.”

([www.portugal.org/information/economic](http://www.portugal.org/information/economic)) However, state ownership still exists in finance and transportation. Regarding the former, government policy mandates that it keep some control of the banking sector. Thus, Portugal’s largest savings bank, Caixa Geral de Depositos (CGD), remains under government control. Regarding the latter, the transportation sector has not attracted any buyers as the state railway TAP, as well as the port terminals, are deficit ridden. If these two sectors become fully privatized there should be further positive effects on the economy.

Economic growth as measured by real GDP growth during the year 2000 in Ireland was 10.7% and in Portugal, 3.3%. Forecasts for 2001 and 2002 are 7.5% and 7.1% respectively in Ireland and 2.6% and 2.6% respectively in Portugal. The average for the Euro area in 2002 is forecast to be 2.9%. (European Commission, “Spring 2001 Forecasts for 2001 and 2002”, April 2001) These forecasts would indicate Portugal’s economic stability during this period and compare favorably to most other countries in Europe. The forecasts also indicate Ireland’s growth to be decreasing at a rather rapid rate. Inflation is running high in the country. In 2000 it was the highest in the Euro area at 5.3%. This compares to 1.6% the previous year. (U.S. Department of State FY2001 Country Commercial Guide: Ireland) Today (June 2001) it is 5.4%. (Associated Press, 25 June 2001) If inflation continues to rise in Ireland it is likely that pressure will be placed on wages which, in turn, will hurt Ireland’s international competitiveness. Portugal is not immune to the increasing inflation in the Euro area. In 1999 it was 2.4%

([www.photius.com](http://www.photius.com)) and in 2000, 2.8%. Although it has come down dramatically from a high of 28.8% in 1984 to below 10% in 1992 ([www.portugal.org/information/economic](http://www.portugal.org/information/economic)) it has risen from the 2.8% in 2000 to a mean annual inflation of 4% in 2001, a figure much higher than forecast. (Portuguese Business Information, 16 June 2001)

Antonio Guterres, Portugal's Socialist prime minister, won the October, 1999 election by defeating the center-right opposition with a significant twelve percentage point margin. This was his second win. At that time he was considered one of the more popular leaders of any EU country. His reforms during his previous four year tenure (1995-1999) strengthened the flow of FDI into Portugal. (The Economist, 16 October 1999) However, in June, 2001, Guterres received his lowest public approval ratings since he initially became prime minister in 1995. The center-right opposition pulled ahead of his Social Democratic Party for the first time in six years. Inflation rose to 4.8 percent in May, 2001. The central bank predicts that economic growth will slow to as little as 2% this year. In a report at the end of last year the bank had predicted growth in 2001 to be 3.5 % (as contrasted to 2.6% predicted by the European Commission) and an inflation rate no greater than 3.3%. (The Associated Press, 3 July 2001) Guterres has acknowledged that there is a crucial lack of confidence in the Portuguese economy, both within the country and internationally. (Associated Press Wire Service, 28 June 2001) Excessive government spending appears to be a major culprit of the downturn in the economy, particularly in the area of health. Opposition parties as well as business leaders accuse the government of mismanagement and have pressured Guterres to relieve Finance Minister Joaquim Pina Moura and Health Minister Manuela Arcanjo of their duties.

Guterres's government has suffered a sharp decline in credibility and popularity.

Portugal's buoyant economy, that for the past four years has been following in Ireland's tracks and helping to fuel both social and economic integration in the EU, is suddenly, and unexpectedly, braking. The 2% growth rate now forecast is less than the EU average. (Business Europe, New York, 4 April 2001)

In June, 2001 the Irish Central Bank is predicting real GDP growth to be 6.5% (as contrasted to 7.5% predicted by the European Commission) and inflation to average 4.75% during 2001. The growth figure pales in comparison to the "remarkably" strong performance over the past seven years. (Deutsche Presse-Agentur, 25 June 2001) The Bank believes government must slow growth further in order to avoid overheating of the economy. The 5.4% inflation rate the country presently is experiencing results primarily from increasing wage demands which are not likely to level off for some time. EU finance ministers have criticized Ireland for not doing more to slow down the economy. However, since the country is unable to set its own interest rates it has limited ability to do so. (Note: since 1999 interest rates are set by the European Central Bank in Frankfurt which tends to set rates that suit the slow growth economies of Germany and France). The Bank, in its quarterly report released 26 June 2001 states, "By any standards, monetary policy is overly expansionary for Irish economic conditions. This means that other mechanisms must be used as far as possible to facilitate a growth slow down." (The Associated Press, 25 June 2001) Fortunately, indicators are that Ireland will manage the slow down and remain a positive force in EU social and economic integration. The country has exhibited excellent skills in the administration of its economy throughout the

past several years. Examples are: the directing of EU funds into infrastructure projects of lasting value and its ability to attract many foreign investors by setting low levels of corporate tax along with cutting the bureaucracy. (The Economist, 19 May 2001) Ireland has also kept a tight reign on government spending and has exercised “tough cuts” dating from the late 1980’s. These were made as part of the series of “National Wage Partnership Programs” negotiated between the Government and the private sector which ushered in a period of cooperative industrial relations as well as reductions in taxation rates. They also targeted Irish Government programs to attract FDI in growth sectors such as computers, financial services, and pharmaceuticals. (U.S. Department of State, FY2001, Country Commercial Guide)

In the “Macroeconomics Scenario for 2000” prepared by the Portuguese Government it states that it had been doing a credible job of correcting many economic imbalances but needed to adopt structural reforms in health services, education and social security. A recent European Council pronouncement on Portugal points out that the “most urgent” policy actions of the country concern “the implementation of a new basic law for the budget and a new law on social security, pensions, and health care expenditure control.” ([www.portugal.org/information/info](http://www.portugal.org/information/info)) Recently, the European Commission has been criticizing Portugal for not curbing public spending which represents a higher percentage of GDP than any other EU member.

On 21 June 2001 Joaquim Pina Moura, the Portuguese Minister of Finance, resigned after the Cabinet refused to accept his package of spending cuts. Gutteres believes the

cuts would affect re-election chances. The Health Minister Manuela Arcanjo also resigned after trying to instill fiscal discipline and order into the chaotic health service. (Portuguese Business Information, 23 June 2001) Top business leaders in Portugal have now formed a think tank to deal with what they consider to be a pending economic crisis in the country. On 07 July 2001 Portugal's Weekend Newspaper headlined, "Government in a Mess." Guterres is looking increasingly isolated in his party. (Portuguese Company and Business News (2 July 2001)

Michel Camdessus, former Managing Director of the International Monetary Fund, stated in a 1999 speech to the Warsaw School of Economics that emerging economies must have a framework in which government, business and financial institutions deal with each other in a transparent manner. This is essential as they transition to a developed economy. (Camdessus) In another speech to the European-American Business Council he put forward his firm conviction that countries in transition must have fiscal discipline, supported by a responsive monetary policy within a sound financial system. (Camdessus) Camdessus's comments would indicate that Portugal is not moving forward in its transition to a developed economy. The second engine within the EU has been derailed. Transparency and fiscal discipline need to return in order to get back on track. Portugal has shown it has the resources and the talent. What it now needs is strong and sustainable political and business leadership.

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