

Interview with José da Silva Lopes: the adoption of the euro by Portugal (Lisbon, 23 October 2007)

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[Miriam Mateus] From 2001 onwards, with the adoption of the euro, do you think that that measure has been advantageous for Portugal or not?

[José da Silva Lopes] It was advantageous, though I disagree with the conditions of joining, and I might even accept that we should have joined later. We didn't join in 2001, it was in 1998, if I'm not mistaken, because the currency itself appeared afterwards, but we had already joined. In fact, the escudo disappeared at the end of 1998, so the euro started to circulate in 1999, although escudo banknotes were still used, as in other countries.

So, the euro brought many advantages to Portugal. To begin with, it brought the advantage to which we consumers attach great importance: when we go to Finland or to Germany, we use the same currency as we use in Lisbon. This makes us feel very comfortable and at ease, and, nowadays, in fact, I'm starting to have very little patience with going to England and having to change money, so that's true. Now that's more symbolic than anything else, though it's also ... it also involves currency conversion costs, it has a certain impact. I think that it's been estimated that it can represent around 0.5 % to 1 % of GDP, so it has a certain impact. That's the advantage that people notice straight away, and it's quite important, but it's not fundamental.

The other important advantage is that we're protected against speculation. For example, with these crises that have occurred recently with oil and other things, such as the balance of payments, if Portugal didn't have the euro, there'd be speculation against the escudo, which would be incredible. We might even have had to have really high interest rates, and we would have had to have balance of payments restrictions ... well, something complicated, as we did have. I was Governor of the Bank of Portugal at a time when people had to put up with speculation, and I know how difficult life was. That problem has disappeared, and that's also an important thing.

Meanwhile, we had a huge fall in interest rates. That was because, when the currency was the escudo, there was an element of risk, so to speak, in financial investment in Portugal that doesn't exist now. When a financial investment was made in Portugal at that time, there was always a risk of a devaluation or something, which meant that interest rates were higher. So that anyone who invested money in Portugal ... Suppose the interest rate was 7 % in Germany. Anyone who had money would prefer to invest 7 % in Germany rather than 10 % in Portugal, because there was a risk that the escudo would be devalued, and that at a certain time the investment in Portugal at 10 % would be worth less than an investment in Germany at 7 %. So there was a very high risk premium.

As soon as we started to use the single currency and the European Central Bank guaranteed that the currency was credible, interest rates in Portugal fell. Originally, in the early 1990s, we had interest rates of around 13 % to 14 %, and then they fell sharply to 3 % or 4 %. That was a great advantage for all the Portuguese, one of which we didn't take proper advantage, but that's another story. But it was a great advantage for all of us, including for the state, which paid less to service the public debt, etc.

So we had the advantage of a fall in interest rates, we had the security of avoiding speculation, we had the advantage of international transactions being free of currency conversion costs. We had a problem now, though: previously, we could devalue the escudo, but now we can't devalue our currency because it's the euro. So now our currency is what the euro determines. This means that the euro either appreciates or depreciates against the dollar, but no one talks about the relationship between the Portuguese currency and the German currency any more. The Germans manage to revalue their currency against ours — which is a little difficult to explain in terms that the general public would understand — but the Germans manage to revalue their currency against ours very easily: their wages increase less than ours do. But, since we're southern Europeans at heart, reckless ... we still raise wages even when we can't. And, meanwhile, we take advantage of lower interest rates and begin to spend heavily.

It wasn't only ... it was the Government that launched ... what it saved in interest on the public debt, it began to spend on other things, instead of having a balanced budget policy, it was 'time to spend'. It was companies — interest rates were low, it was 'time to invest' and to invest even when it wasn't a very good idea; it was consumers — interest rates are cheap, it was 'time to spend'. I'm in banking, so I'm also to blame for all these goings-on, we're lending money for people to buy second homes, to spend their holidays in Tahiti ... The Portuguese are now the most indebted nation in Europe after the Netherlands. Yes, the Netherlands, I don't know why exactly, but there you are, the Netherlands is more indebted than we are, or rather, our families are.

But we took advantage of what the euro had to offer. Instead of showing some restraint, we took advantage to exploit it to the hilt, because the euro also offered us another option: not only are interest rates lower, but now we also have much easier access to external credit. Nowadays, when we need money, or when someone wants money — I'm in banking, remember — if a customer asks us for a loan, even if we don't have Portuguese depositors' money to lend them, we ask a German bank to lend it to us. So the Germans save, and we spend. That's very nice up to a certain point, until the day comes when the Germans announce that they're not lending us any more money. When that time comes, we'll see how things stand.

So we didn't know, the country didn't have the discipline. But it's probably difficult, because it's not ... people might say it's the government, but it's not the government at all, it's all of us. If we'd had greater discipline the euro would have been much more of a success than it was, but, instead, it's been a problem. But it's not only because of that. The major problem with the euro is that we couldn't devalue any more. We used to devalue before. When I was at the Bank of Portugal, one of my most commonly used weapons was to devalue the escudo. Every time I devalued, Portuguese exports became cheaper for foreign customers, and imports from abroad were more expensive for Portuguese importers. I used to devalue — and I'm very much at fault in that area — and I used to succeed in evening up the balance of payments. Naturally, it lowered real wages, which was something about which we didn't talk very openly, but we managed to maintain some balance. We can't do that now.

In my opinion, we joined the euro at an overvalued exchange rate, because we began to fix the Portuguese exchange rate long before we signed up to the euro — we began to fix it in 1989, and we joined the euro in 1998. Obviously, the conditions for participation in the euro imposed that on us. If we hadn't fixed the exchange rate previously, we wouldn't have succeeded in joining the euro at that time, but we should have joined at a rate ... we should have organised things so that the exchange rate wasn't what it was. We set the exchange rate at more or less 200 escudos per euro, when we should probably have set it higher, 220, 230 or 240, I'm not really sure.

... I think that it's difficult to explain that to the general public, but I think that we made a major mistake. It's obvious that, if we'd followed the policy that I think was necessary, we might not have succeeded in joining the euro in 1998, we might have joined a little later. Meanwhile, we had to tighten our belts because inflation in Portugal was much higher than in other countries. Germany and other countries had 3 %, 4 % or 5 % inflation at the time, while ours was 14 % or 15 %. And the major problem was that we wanted to join the euro with that inflation. But it's difficult to explain. And we were setting the exchange rate as we joined. The consequences were bad. Not all economists will agree with me, but I think that that's where we went wrong. Even so, I think that joining the euro was worth it. But now we're going to suffer, we've been suffering since 2001, and we'll continue to suffer.