

The Case for Economic and Monetary Union: Europe and Portugal*

Francisco Torres

*Chairman of the Parliamentary Subcommittee on EMU and PSD Spokesman for European Affairs.
Universidade Católica Portuguesa and Banco de Portugal (on leave).*

* Earlier versions of this summing-up note were presented at the Konrad Adenauer Foundation, in Brussels, and at the Universidade Católica Portuguesa, Associação Industrial Portuguesa and Instituto de Defesa Nacional, in Lisbon. They have given rise to an occasional paper of the Brussels' Initiative Group and to a paper in the journal *Temas de Integração*. I wish to thank seminar participants and Annette Bongardt and Jeff Frieden for comments. The usual disclaimer applies.

1. THE CASE FOR EMU IN EUROPE

1.1. The vulnerability to asymmetric shocks

A small open economy tends to lose less (gain more) than a larger closed economy by giving up its monetary autonomy and joining in a monetary union with its trading partners. Foreign exchange transaction costs and exchange rate uncertainty tend to affect mainly small open economies. This is because a relatively important fraction of their trade is done with other countries and therefore they face large (and potentially unstable) foreign exchange markets. As the degree of openness increases, the benefits of adopting a common currency increase and the costs of relinquishing control over an autonomous exchange rate policy diminish. This is because a devaluation has a much stronger impact on the price level of a relatively open economy than on the price level of a relatively closed economy.

Regarding the similarity of trade and industrial structures of each of the possible participants and the EU, respectively, it is to be expected that for the core countries in Europe, Germany and its closest neighbours, shocks are notably more symmetric than for the European Union as a whole. According to 1992 data on the correlation between average intra-EU exports and exports of each EU member to other EU members (see Gros and Vandille, 1995), the trade structures of Ireland, Denmark and Portugal deviate moderately¹ and the trade structures of Finland and Greece deviate substantially from the EU average. But of course shocks affecting the monetary union may be symmetric, in which case there is no need for an autonomous exchange rate instrument.

As pointed out by Barry Eichengreen and Fabio Ghironi (1996), not only is there no consensus on the empirical evidence on both the output costs of surrendering monetary policy autonomy and the efficiency gains of eliminating exchange rate uncertainty and transaction costs (evidence on the stimulating effects of a monetary union on economic growth is even weaker), but historical correlations between economic variables such as output and prices change with the process of monetary integration. For

¹ In the case of Portugal, the specialisation pattern at first became even more pronounced (from 1986 until recently) but especially since 1995 it is becoming more similar to the European average. See Torres (1998d).

instance, while integration might increase the flexibility of the union it could also contribute to a reduction of the similarity of economic structures due to higher concentration of industrial activities. This concentration of industrial activities would in turn increase the union's vulnerability to asymmetric shocks.

However, as argued by Alessandra Casella (1993), these industrial regions do not coincide necessarily with political jurisdictions: on the one hand, they can be common to several countries and, on the other hand, they are in general much smaller than a country. In that case, specialisation does not lead to increased vulnerability of the union to asymmetric shocks. Besides, specialisation in Europe tends to take place within the same sectors (foreign direct investment in the wake of the internal market led to a convergence of production structures) at different price and quality ranges. Furthermore, it can also be argued that more economic integration will reduce rather than aggravate that vulnerability². This is because, on the one hand, spending decisions in one country will be more directly felt by the other members of the monetary union and, on the other hand, productivity shocks will be more rapidly transmitted among members. As a consequence, business cycles will be more highly correlated and the potential need for unilateral policies such as exchange rate devaluations is reduced.

In any case, exchange rate flexibility can only have a transitory impact and hence does not dispense with the need for long-run real adjustment of a country's economic structure. Besides, nominal exchange rate devaluations are totally ineffective if they cannot affect the relative price of domestic and foreign goods (the real exchange rate, a relative price).

Labour market flexibility and fiscal transfers

The labour market in the European Union is characterised by high and persistent unemployment. After reaching record heights in 1994, the beginning of economic recovery in 1995 brought about only a slight fall in unemployment rates and does not point to a return to the levels of 1990. The recent evolution of EU unemployment thus appears to confirm the

2 Jeffrey Frankel and Andrew Rose (1996) look at data from 20 industrialised countries from 1959 to 1993 and conclude that the greater is the degree of integration between countries, the more highly synchronised are their business cycles.

view that the natural unemployment rate after each economic cycle remains at a higher level, transforming cyclical unemployment into structural unemployment. Long-term unemployment, as the average length of unemployment, is today significantly higher than in the 1970s. In any case, these developments seem to have little to do with external shocks or exchange rates³.

In the European Union, collective wage negotiations (emphasising job security), legal provisions and generous unemployment benefits led to wage rigidity (prices could not respond to demand changes) and higher unemployment, in particular of the young and less qualified. This situation contrasts with the US, where flows in and out of unemployment have been faster; the same is true for job creation by the private sector (in the EU public sector job creation has been very important)⁴. In the absence of collective wage negotiations in the US, larger wage flexibility meant that the fall in demand for less qualified work due to technical change in production technology translated in lower real wages rather than higher unemployment.

In Europe wages respond quite rapidly to price movements (there is little nominal inertia), although less so to unemployment. In Portugal and Sweden, and in Holland according to some studies reported below, wages are highly elastic with respect both to inflation and unemployment: the wage response – the semi-elasticity – to unemployment is only smaller than in Japan, in absolute values. Therefore, foregoing exchange rate autonomy seems not to be very costly.

In terms of flexibility, what is then important for the smooth functioning of a European monetary union is the capacity of real wages to adjust to asymmetric shocks. Labour mobility in Europe is low (although not lower than labour mobility within most EU-member countries)⁵ but, since one can expect that prices move faster than production factors, that fact seems not to be crucial for the decision whether any EU country should participate

3 A recent study by Daniel Gros (1997) confirms this view.

4 According to the European Commission's 1997 issue of *Panorama of EU Industry*, employment growth in the European private sector over the past 25 years amounted to a yearly average of 0.3 per cent, compared to 1.0 per cent in Japan and 1.8 per cent in the US.

5 Although the inefficiencies that are partly responsible for an undesirably low labour mobility (apart from cultural and linguistic barriers), such as very distorted housing markets, should be eliminated, cyclical migration as a means of offsetting asymmetric shocks in Europe is not a socially adequate solution even for cyclical unemployment.

in EMU. This is true even if one rejects money neutrality and takes the view that discretionary exchange rate policy can affect output: real wage flexibility would provide for the necessary alternative adjustment mechanism. For the same level of economic integration and regardless of the view on the efficacy of exchange rate adjustments (New Classical or Keynesian), a higher degree of real wage flexibility implies lower costs of participation in EMU and less urgency for other types of mechanisms (such as a federal budget or emigration) to help smooth country idiosyncratic shocks.

Inter-regional fiscal transfers (a co-insurance fund) to offset the lack of labour mobility are not expected to be a characteristic of a future monetary union in Europe: on the one hand, such a scheme requires deeper political integration and, on the other hand, although such transfers may be critical in areas such as the US that are characterised by a high degree of labour mobility and therefore by a risk of depopulation of declining regions, this is not the case in Europe (see Blanchard and Katz, 1992, and Torres, 1996). Besides, these transfers may be useful to smooth adjustment in the occurrence of transitory shocks but they are not a substitute for real wage flexibility in the presence of permanent shocks.

Cohesion countries seem to have understood the importance of the economic and social cohesion principle, enshrined in the Treaty, when compared with any other type of transitory transfers linked to the functioning of EMU. That expression of solidarity at the European level, by requiring the setting-up of long-term priorities that go together with participation in the internal market (which imposes higher standards on consumer protection and environmental quality) and with the rules of access to those funds, contributes to render employment creation sustainable and to avoid situations of high unemployment cum dependency on continuous fiscal transfers such as the Mezzogiorno within Italy, Andalucia within Spain and the new Länder within Germany.

1.2. Adopting a credible monetary constitution

Joining a monetary union that is based on institutions that deliver price stability is, as stressed by the modern political economy literature, probably the best way to implement a solid strategy of sustained economic development. The reason is that this option also precludes many of the

transition costs (the output losses of a disinflation strategy) of such a regime change. Fixed exchange rates, unlike other policy targets, are easily observable by the private sector but also easily implemented by the authorities (see Torres, 1989). Also, as put by Rebelo (1997), making the costs of government activity more transparent to the public gives elected officials better incentives to focus on improving the productivity of the private sector instead of playing redistribution games.

With irrevocably fixed exchange rates, the authorities raise the political costs of inflation because their anti-inflation commitment is constantly monitored by the private sector and any different behaviour would imply a loss of competitiveness for the tradables sector. Accordingly, one could argue that, as a tendency, high inflation countries tend to gain more than low inflation countries by sharing their monetary autonomy in a common monetary institution⁶. Eliminating inflation in this way, abolishing different currencies, does away with the need to waste resources on hedging against exchange risks. A common monetary institution that delivers price stability is therefore a welfare improving mechanism in a double sense.

This argument has been understood in academic circles but its importance has been disputed if not contested by Keynesian economists and others. They claim that the exchange rate is still a very important adjustment mechanism not only in the case of unexpected asymmetric shocks but also in the face of foreseen developments such as world trade liberalisation and EU enlargement to Central European countries. It is argued that regions characterised by persistent differences in productivity growth or even by any other type of persistent differences as well as different structural characteristics of the economy (non-wage labour costs, savings ratios, or demographic structures) should not form a monetary union.

Although these are problems unrelated to the exchange rate regime⁷, the “economic” discussion around EMU has been centred on these very issues, at least for the weaker currency countries. Real versus nominal convergence is in fact the most popular line of discussion amongst politicians and political and economic commentators. Examples for most of the EU-countries can be found in Buiter (1996) and Jones, Frieden and

6 As inflation is rather low in most EU countries, I will not discuss here the costs and benefits of a monetary union from a public finance perspective. See Torres (1989) and (1996) for a discussion of this issue.

7 As Willem Buiter (1996) puts it, real convergence or divergence has nothing to do with EMU.

Torres (1998). Many of those politicians and commentators find it politically interesting to oppose what they call grey technocracy and/or monetary fundamentalism.

The root of one of the main misunderstandings about the entire process of monetary unification is, in fact, that many people tend to see it as a technocratic obsession and/or an ideological defence of the market. At the same time some of the forceful opponents of EMU happen to be technocrats (sometimes diplomats, central bank employees and even eurocrats) or ideological free-marketeters (as for example conservative economic advisers and independent economists in the UK and in Germany as well as in other European countries). Instead, the idea of adopting a credible monetary constitution can be seen as a means of doing away with the primacy of monetary policy over more important concerns of the society.

In fiscally-weak countries and in less developed democratic systems, EMU can be seen as a means of getting rid of national currencies and all the economic jargon that goes with them, typically the excuses technocrats find to cling to power and implement all kinds of mercantilist policies in the name of short-term real convergence. Most of the time these policies imply a sharp deterioration of social cohesion and quality of life, undermining long-term real convergence with the most developed regions of Europe.

On the other hand, few people present EMU as a desirable political reform instead of an external constraint. As a matter of fact, many politicians and bureaucrats just refer to it as an unavoidable development⁸. Presented in this way, EMU can be easily blamed for all the policy errors made by national governments, monetary authorities and other national or European institutions.

However, today most European governments (with a broad support in their respective parliaments concerning the goal of EMU) seem converted to adopting a credible and sound (counter-inflationary) monetary constitution⁹. The problem has been to motivate countries that already

8 Depending on the perspective: the only way of tying Germany into the European Union, achieving more political integration and faster enlargement to the East or maintaining access to the structural funds.

9 Unfortunately, some still see it as an unavoidable external constraint that goes together with an exogenous political objective to which their political leaders have converged. A good example is the cross-party political resistance to the author's proposal to enshrine in the Portuguese constitution, revised last summer, the objective of price stability in spite of a parliamentary resolution approved by the two major political parties in favour of monetary union and its objectives.

have credible monetary institutions – and therefore a low inflation rate – to share their monetary autonomy with recently converted higher inflation countries that could resort to old (inflationary) habits. The reluctance of low inflation countries to team up with countries with no prior solid record on price and monetary stability stems from that possibility. This is why in Germany the *Bundesbank* has always cautioned against a fast embarkment upon the European monetary integration project and the *Bundesverfassungsgericht* made it possible, in its ruling of October 1993, for Germany to pull out of EMU should it not deliver monetary stability.

The Maastricht approach to EMU

The gradualist approach to EMU was justified by the need to set up common monetary institutions and achieve nominal convergence among participating countries. As the Werner plan 20 years earlier, this approach was a product of the French vision of money driving politics and economic fundamentals (see Torres and Giavazzi, 1993), but ended up serving as a means for policy-makers, politicians and economists (as the Group of 155 in Germany), to express its reluctance concerning the *Bundesbank's* integration into less solid European monetary institutions¹⁰. The idea that the adoption of a single currency should be accomplished swiftly rather than gradually was defended by many (including the French) but it could not work without a clearer set of political rules, the monetary constitution of Europe, that would have had to be respected by all members in order to avoid bringing in insolvency problems.

An ex-ante specification of the rules is not part of the TEU, however. The stability pact is an intergovernmental solution to strengthen the enforcement mechanism of the excessive deficit procedure. Alternative rules concerning the allocation of resources and voting mechanisms within the ECB, the re-design of the System of European Central Banks in an attempt to make it more stable, and even the enforcement of a mechanism that would allow for the removal of the ECB's board of directors should it fail to maintain price stability are not defined either in the treaties nor at the intergovernmental level.

10 Because of high unemployment and the difficulties in reaching the Maastricht target for the deficit (with lower than expected tax receipts and higher outlays), at least one dimension of the German political debate in 1997 mimicked the debate elsewhere.

Strict entry requirements and variable geometry became then the only possible approach to EMU that would safeguard Germany's position without a major reform of the treaties. Paradoxically, this became early in the 1997 the main quandary in the process of European monetary integration since Germany too seemed to be in a difficult position to meet the Maastricht target for the deficit while Italy kept insisting that it would meet the criteria set out in the TEU and would not consider the possibility of delaying its entry in EMU's third phase beyond January 1999. It is now known that both Italy and Germany, as well as France and all the other EU countries except Greece, met the Maastricht criteria in 1997.

Variable geometry was initially understood as a core-periphery geographical divide, conceivably compatible with the notions of concentric circles and Europe *à la carte*. Of course it was possible to define variable geometry in the sense that it meant a sort of open core that would allow a group of countries to integrate further with respect to a common level, say the internal market with some degree of monetary co-ordination, based on the principle of potential non-exclusion and requiring the unanimous vote of all countries regarding the conditions for opting-in and the possibility of opting-out¹¹. But in the monetary domain to stay in the second tier would have been perceived as a political failure.

Besides, in a multi-speed EMU, it would have been more difficult for the catching-up countries to converge, in the sense that by being left out of EMU's third phase they could have become more vulnerable in the international financial markets. As a result, by the simple fact of being perceived as laggards, these countries could have been subject to speculative attacks on their currencies that would have sent them further away from the Maastricht entry requirements. To complicate matters, the core members, like the members of any club, would have tended to become reluctant to allow for the fast entry of more members (see Alesina and Grilli, 1994, for a formal analysis of this point). Furthermore, they would have tended to maintain the club for other domains of integration. In any case, if the 1999 deadline for the beginning of EMU's third phase were to be postponed, the result could be a serious set-back in both the

11 The concept of flexible integration, contained in the Amsterdam Treaty, is applicable to other domains of European integration. A similar notion – named positive variable geometry – was put forward by the author to the Committee on European Affairs of the Portuguese parliament in May 1994 and adopted in a parliamentary resolution in April 1995. Dewatripont et al. (1995) describe it in more detail: it features a set of mandatory competencies, the common base, and allows for deeper forms of cooperation, open partnerships.

on-going process of monetary integration and the existing level of economic integration. It can also be maintained that there could be no internal market if there were serious currency misalignments that would give rise to trade protectionism. This is probably the most robust political economy argument for completing the transition to EMU without further ado.

The argument is not trivial even for Germany since it hinges exactly on the idea of protecting the internal market from misalignments. This idea is further developed by Niels Thygesen (1996) who argues that protectionist demands, arising from a fragmented currency system, would include industrial subsidies in the strong-currency countries. As it is generally held that the Deutsche mark may appreciate substantially in the case of non-EMU, the Euro may have, after all, some direct advantages for Germany. It is vital for the interests of Europe to fast accomplish EMU.

Coordination between the "ins" and the "outs"

Some countries are not able (Greece) while others are not willing (Denmark, Sweden and the UK) to move to the third phase of EMU by January 1999. Accepting a multi-speed EMU entails the need to co-ordinate monetary and fiscal policies between the initial group of insiders and the initial group of outsiders. To allow for some flexibility in such an open partnership as a monetary union amongst the core countries, it is vital to better define and enforce the common base accepted by all EU-member countries. This is also the only way to avoid the temptation to free ride, through the possibility of opting out, on the positive externalities created by the existence of a monetary union.

The idea of creating an ERM for laggards (expanded in many discussions on the relations between insiders and outsiders and agreed upon in Verona by the EU ministers of finance) could be, as argued in Torres (1996), replaced to the advantage of all by the only available option for the outside countries, a unilateral peg to the Euro, which amounts to the same as participation in the monetary union without voting powers until fulfilment of the conditions¹². Unilateral action, namely the adoption of

12 Gros (1996) uses that possibility as a threat for misbehaviour inside EMU and Giovannetti and Marimon (1996) as a way of substituting the Maastricht entry requirements for better defined rules of the game.

currency boards (that is, abiding by a strict non-sterilisation rule), makes sense because unlimited support of such an ERM by the ECB would undermine its very reputation from the beginning; put differently, outsiders would be left on their own.

The emulation of the policies followed by the core would only make sense, however, for outsiders that were able and willing to join EMU within a relatively short period of time after 1999. They could then adopt the European single currency without taking part in the formulation of the common monetary policy.

Outsiders unwilling to join EMU within a relatively short period of time and/or likely to postpone that decision well beyond January 1999 or unable to meet the criteria set out in the TEU in the short-run (Greece may well meet the criteria before 2000) and/or still not members of the EU (future EU-members) could adopt inflation targets, as suggested in Dewatripont *et al.*, 1995, and in Persson and Tabellini, 1996, for all EU members; this seems to be the best available policy option in order to do away with the incentive to engage in competitive devaluations and help higher-inflation countries to build up an anti-inflation reputation. Some outsiders (such as Sweden and Denmark) might choose not to adopt explicit inflation targets and might stay out of EMU for many years or even forever. Nevertheless, they are expected to follow sound fiscal policies in any case so that this option is only important for countries that want to satisfy the convergence criteria (amongst which the inflation criterion) in order to join EMU.

A principal for the ECB

For EMU to work smoothly, political pressure from the various interest groups has to be directed away from the ECB and aimed at an institution that represents the European population. The easiest way to secure that goal while preserving the ECB's independence seems to be to vest the European Parliament (to which, among other European bodies, the ECB would already report according to Article 109b of the TEU) with the appropriate powers. This is because an institution that is representative of the European population and attaches more weight to long-term objectives such as price stability, safeguarding the well-being of all Europeans, can

better fulfil the role of a principal on whose behalf the European Central Bank should conduct its policies¹³.

It is crucial for the success of the entire European integration process to prevent the ECB and, for that matter, other EU institutions such as the European Commission, from being unaccountable. It does not make sense to leave to a European central bank the task of circumscribing its own set of competencies. Therefore monetary reform has to be accompanied by institutional reform in the European Union with a view to more democracy (and thus accountability), more transparency, and more proximity to the European citizens.

In fact, for the institutions of the European Union to be credible and therefore efficient in terms of attaining their objectives, they have to be accountable. Using the modern political economy wording: we do already have the commitment technology to deal with the credibility constraints national and European policy-makers face, therefore we should now also aim at committing preferences to deal with the political constraints authorities face and with the question of delegation of powers¹⁴. In game theory jargon: if institutions are not re-negotiating proof (if their boundaries are too informal) they are not credible; on the other hand, if they are too closely monitored they lack a commitment technology. Therefore, there is an optimal level of monitoring and enforcement. Putting it into common language: to achieve agreement on the design and establishment of lasting institutions, they must be accountable.

13 At present only the Council of Ministers comes close to that role. A countervailing economic council to the ECB (as suggested early this year by President Chirac and contested by EMI's president Duisenberg (then Governor of the Dutch central bank), could weaken its very credibility, allowing for interference and pressures that can mount at any time once economic conditions deteriorate. It seems that, in spite of renewed discussion over summer about this subject, the issue has now disappeared.

14 See Torres (1992) for a definition of credibility and political constraints. Recently, I discussed these questions in a seminar at the Universidade Católica on "credibility versus accountability in the process of European monetary integration" with Jeff Frieden, whom I thank for calling my attention for the political science literature on the agency model, and Jorge Braga de Macedo, who defends that the stability pact is a means of making macroeconomic policy accountable to future generations.

2. THE POLITICAL DEBATE IN PORTUGAL

Pushing for monetary reform

In 1989, the case for a European single currency was not perceived as a central question for Portugal. The idea of a monetary union in Europe was well received by the public in general as a long-term European goal although it was regarded with some scepticism with respect to Portugal's capacity to participate from the outset. The exchange rate crisis cum the European recession of 1992/93 together with the adoption of a convergence programme designed to allow Portugal to participate in EMU brought the issue to the forefront of the political debate. Attitudes towards a European currency have then changed with external economic conditions. Until very recently, there was a loud ideological opposition to EMU (and European integration) in spite of a clear political majority in favour. Most of this opposition disappeared when it became clear that Portugal would be able to join EMU from its very beginning.

Until 1992, the ambiguous Portuguese response to the need for institutional reform and European integration was mirrored by complete discretion regarding the future course of exchange rate policy and the timing of monetary reform. On the other hand, capital controls, credit ceilings and administratively set interest rates (by then only partly dismantled) gave the monetary authorities the illusion that monetary autonomy could last forever. Throughout the 1980s, the Portuguese government, although firmly committed to European integration, sided with Mrs Thatcher's government in its sceptical attitude towards rapid institutional reform, namely monetary reform, in the European Community. Only with the Country's first presidency of the European Council during the first semester of 1992 the Portuguese government's attitude towards the European integration process changed and the escudo joined the ERM: the initial sceptical view was abandoned and from siding with the United Kingdom Portugal turned versus the Franco-German axis.

The policy of capital controls pursued until 1992 had resulted in artificially high interest rates that were in turn responsible for a higher debt service of the treasury, significant losses by the central bank, and substantial distortions in the functioning of the economy; they moreover implied a transfer of resources from the productive sector to the sheltered financial

sector. These transfers angered social partners and the opposition that, paradoxically, sided with the central bank and blamed participation in the ERM and what was called the obstinacy of the Government with nominal convergence for the recession.

The political consensus needed to pursue the reforms was nearly broken, since the blame for high interest rates was placed on exchange rate policy (as a result there were constant calls for a devaluation of the escudo that grew with recession in the Portuguese traditional export markets, and in particular in sectors such as textiles and clothing) and on the convergence programme (responsible, according to that view, for the lower rate of growth of the economy)¹⁵. As in other liberalisation experiments, anti-reform interests (namely the banking system sheltered from external competition but also the traditional export sectors) tried to blame liberalisation for the international recession that was affecting the economy in order to resort to protectionism, allowing for specific rents (higher interest rates in the case of the banking system) and/or enhancing their political power (within the Government, the PSD and the Central Bank)¹⁶. It proved decisive, however, that full convertibility and ERM membership of the escudo had taken place or had been decided upon, in the case of the dismantling of controls, before the European recession and the exchange rate crisis. The period of exchange rate turbulence in the EMS, in spite of its negative effects, provided clear relief to the Portuguese economy¹⁷. During the same period, inflation came down from 9.8 per cent in May 1992 to 5.6 per cent in June 1993 and interest payments on the stock of outstanding debt, while rising in most EU countries, fell significantly in Portugal¹⁸. During the crisis, Portugal was also the only case in the EU whose foreign debt classification was upgraded.

15 Textile and clothing (with productivity levels at two thirds and one half of the Portuguese manufacturing average in 1989) experienced an initial rapid expansion with free access to the EC market but world-wide competition, fragmentation, lack of marketing and higher domestic interest rates (due to the policy of capital controls pursued in 1990 and 1991) accelerated those calls.

16 This was even recognised by the then prime minister, Aníbal Cavaco Silva, who stated that some segments of the administration had difficulties in digesting the new monetary regime (Silva, 1994, p. 512).

17 A monetary policy of capital controls designed to keep domestic interest rates stable at very high levels was substituted for a monetary policy of capital mobility and exchange rate stability (the escudo in the ERM) designed to keep domestic interest rates at the (much lower) international levels although more volatile (in the very short-term) in the wake of speculative attacks against the escudo.

18 Interest payments on the debt fell from 8.6 per cent of GDP in 1991 to 7.8 in 1992, 6.8 in 1993, 4.8 in 1996 and 4.2 in 1997. Meanwhile, the official inflation target, met in 1992 and 1993, was met as well in the four subsequent years.

The early 1990s proved also to be a most valuable learning period for policy-makers, social partners and economic agents in general (see Torres, 1998c). It was possible for the private sector to learn more about the policy rule and eventually understand it, while the various realignments were seen as a true escape clause beyond government control (to be triggered only in the case of asymmetric shocks).

Those circumstances granted some breathing space to the real sector of the Portuguese economy while accomplishing the change in regime. It was the first time for many years (since 1891, when the Portuguese currency left the Gold Standard, with the exception of a period of less than three months in 1931, when it returned to gold convertibility) that Portugal was living in a regime of full convertibility of its currency. While it had been impossible to pursue structural reforms without the liberalisation of the economy, it proved decisive to have had a clear economic and political strategy for achieving macroeconomic convergence before the European recession of 1992/93 and especially before the outbreak of the ERM crisis (see Torres, 1995). The escudo managed to survive the deepest post-war recession in Europe without leaving the ERM and without resorting to capital controls at any time.

Building up a cross-party consensus

While the expenditure of the state sector remained on target in 1992 and 1993, tax revenue fell much below its predicted value and social security expenditure exceeded its target in 1993, inducing a slippage in the process of fiscal consolidation. This interruption was mainly due to the recession (negative growth generated a lower total revenue that fell from 34.1 to 31.7 per cent of GDP and increased unemployment inducing higher social security transfers) and to the virtual collapse of the tax administration. Despite this discontinuity the Portuguese public debt ratio as a percentage of the average EU debt ratio kept falling from 1993 through 1996, when it became less than 1. In any event, the scale of the revenue slippage was totally unexpected and provoked a general sentiment of failure. The opposition to the strategy of macroeconomic convergence for participation in EMU and the debate on the costs and benefits of EMU became then centred on the issue of real divergence.

The maintenance of the objective of EMU participation during the recession of 1993/94 and throughout the electoral year of 1995 was only possible

because of the steps taken before, i.e. joining the ERM and liberalising all administrative controls on capital flows. As the elections approached, the opposition Socialist party converged to the same objectives concerning Portugal's participation in EMU. And, as political colours changed, the new Socialist-led minority government adopted the convergence programme of the previous executive, initially with some "national reservations" in order to ensure support from the right-wing anti-Maastricht party, the CDS-PP, and later, by May 1996, as a government commitment with the main opposition party, the PSD¹⁹. In October 1996 it became evident that both the Government and the PSD were clearly in support of satisfying as quickly as possible the macroeconomic convergence criteria in order to participate from the beginning in EMU²⁰.

The budgets for 1997 and 1998 aimed at satisfying all the necessary requirements established in Maastricht²¹. They were approved in Parliament with the abstention of the PSD, since the two anti-EMU parties had indicated early on that they would vote against a budget geared towards Portugal's participation in EMU. Already in February 1997, the PS and the PSD approved a parliamentary resolution in favour of the Portuguese participation from the beginning in the Third Phase of EMU.

Calls for co-insurance funds and common employment policies

In Portugal there has been a consensus among the major political forces²² and trade and business groups about the goals of active participation in

19 DAR n° 75 – I Série, 25/5/96: Question time: answer of the Minister of Finance to the author.

20 After several statements of the Prime Minister reaffirming his commitment to that objective, the consensus on the goal of Portugal's participation in the core group of countries moving ahead to the Third Phase of EMU was established in Parliament during the first debate of 1996/97 on the single currency. In October 1996 a special congress of the PSD confirmed its support for that objective. Both in the PS and in the PSD, and especially outside party circles, some sectors remained unsatisfied with such a convergence of views.

21 According to the new convergence programme with revised Eurostat data that lowered both the deficit and the debt to GDP ratios, the deficit to GDP ratio was set to fall to 2.9 per cent in 1997 and 2.5 per cent in 1998. The public debt to GDP ratio was set to fall to 64 per cent in 1997 and to 62 per cent in 1998. These projections for 1998 already materialised in 1997. Inflation and long-term interest rates were expected to satisfy the convergence requirements throughout the second half of 1997 and 1998. The projections were confirmed in April by the European Commission (CEC, 1997).

22 PCP and the CDS-PP have remained opposed to any external liberalisation of the economy and to European integration, although the latter seems to be making yet another complete turnaround concerning its stance on Europe.

the process of European integration and increased economic and social cohesion. This consensus translates into an active employment and social policy, in order to avoid what may be called “dependent federalism” (as in the Italian Mezzogiorno or, within the country, with respect to any particular sector of the economy or social group that comes to depend on fiscal transfers), and into participation in the major institutional reforms of the European Community, as a means of securing political and macroeconomic stability while preserving Portugal’s most self-praised “universal vocation”.

The objectives of inflation reduction and improved efficiency of labour, product and financial markets feature prominently in the adjustment effort, in line with the understanding that the most useful structural policy measures are those which reinforce the role of market mechanisms in resource allocation. While this understanding was stressed in several Government documents – namely in the Portuguese contribution to the White paper on Growth, Competitiveness and Employment (Ministry of Finance, 1993) and in the Strategic Options of the Government for 1997 (Ministry of Planning, 1996) – the political debate neglected it until very recently.

That is why there were constant calls from party circles and later on from within the current Government for automatic EU transfers (a safety net for EMU). When it became clear that it would be possible to fulfil the convergence criteria and that such claims would affect the very credibility of the Government’s commitment to EMU, the idea was suddenly abandoned²³. The Government seems to have understood that those claims would only aggravate displeasure of the net-contributor countries with cohesion and structural funds and, in this case too late, would imply the shifting of resources away from cohesion countries with relatively low unemployment, such as Portugal, to countries with high unemployment, such as Spain. When the Portuguese authorities fully understood that possibility they adopted the notion of “employability”. After German calls, during the ECOFIN meeting in September 1997, for an elimination of the Cohesion funds for countries participating in EMU, the Portuguese

23 At the same time, early participation in EMU was attacked on the grounds that Portugal should participate in an EMS II, a kind of “olive belt” monetary arrangement, with the other Southern European countries. This position changed dramatically just before the Italian Prime Minister Romano Prodi asked for a slower pace in the transition to EMU.

Government adopted (finally) a clear policy stance towards European funds and employment.

Public opinion

The discussion about Portugal's participation in EMU has evolved significantly since the objective was put forward in the Delors plan. Initially, the idea of a monetary union in Europe was well received by the public in general as a long-term European goal although it was regarded with some scepticism with respect to Portugal's capacity to participate. The case for a European single currency was not perceived to be a central question for Portugal. The Portuguese economy was seen by the Government, opposition and social partners as a catching-up and peripheral country that would still need a long transition period for monetary and financial liberalisation and had to concentrate on coping with the more immediate challenge of the Internal Market. The Portuguese public opinion and polity became used to what was until then the norm, namely that Portugal was granted a transitional period.

Against this background of relative indifference and the stubbornness of the authorities in not discussing the matter, the Parliament was, as in other instances of the process of European integration (such as the issue of the revision of the Maastricht treaty), at the forefront of the discussion: in 1990 it organised an open debate on Portugal, the EMS and EMU that prompted political debate and forced the authorities to take a position on the matter²⁴, although political commitment to EMU was not on the agenda until 1992. Contrary to most other EU countries (not to mention the special case of Finland described in Moses, 1997), the Portuguese Central Bank was never an enthusiast of ERM participation, free capital movements or European monetary integration; when reforms were accomplished or decisions taken, sometimes against its preferences, it followed the new rules.

With the European discussion about the ratification of the TEU, one renewed political party, the CDS-PP, adopted as its main political strategy an anti-Maastricht (anti-EMU) campaign. The exchange rate

²⁴ See proceedings of the Economic and Financial Parliamentary Committee hearing of April 4, 1990 (CEF, 1990).

crisis cum the European recession together with the adoption of a convergence programme designed to allow Portugal to participate in EMU brought the issue to the forefront of the public debate. At present, 46 per cent of the population support monetary union, compared with an EU average of 47 per cent, and 30 per cent are against monetary union, compared with an EU average of 40 per cent. Polls taken in December (Eurobarometer, 1997: 46) also indicate that the percentage of Portuguese that think they have insufficient information about the European currency remains the highest in the EU.

The policy debate

The most popular argument discussed amongst political economists, "economic gurus" and political commentators with no specific background has been that the exchange rate is still a very important adjustment mechanism in the face of permanent shocks such as world trade liberalisation and EU enlargement to Central European countries. It has also been argued that regions characterised by persistent differences in productivity growth or even by any other type of differences should not form a monetary union. Although these are problems that have nothing to do with the exchange rate regime, the entire "economic" discussion about the question of Portugal's participation in EMU centred on these very issues.

Of course, economists at the Central Bank and at the Ministry of Finance and academics with international experience, but also the two main political parties and a small part of the business community, have defended that, given the current macroeconomic disequilibria in Portugal, the convergence criteria and the stability pact are important and instrumental, independently of the TEU, to achieve sustained economic growth. Part of the business community, such as the Confederation of industry (CIP) and the Portuguese banking association (traditionally more sceptical than its associates), the left wing trade unions, the right wing PP (until recently) and the left wing PCP, the technocrat (Keynesian) and the so-called liberal, indeed conservative, wings of the PSD, the economic adviser of the President and many independents close to the PS and/or influential in the media have depicted the convergence criteria as a problem for real convergence.

Even the sectors more favourable to Portugal's participation in EMU, such as the centre-left UGT and the Portuguese industry association (AIP) have cautioned against the negative effects of EMU on unemployment and growth. But, besides the already mentioned arguments of persistent differences in productivity, EU enlargement and world trade liberalisation, no explanations were put forward to justify these presumptions. It seemed however that although people both could not explain why and how EMU would be a problem for Portugal and understood that exchange rate autonomy would not serve to resolve the structural problems that affect Portugal and Europe (on the contrary, it could only aggravate them), there was until very recently a generalised concern that Portugal was not up to the job, that somehow things would go wrong.

This mood seems to have improved with economic conditions, although polls are not yet conclusive. In any case, many still do not believe that the Portuguese economy could ever compete at any level within the Internal Market, especially with the forthcoming enlargement of the EU to Central European countries and the liberalisation of world trade. The pessimist, and sceptical in general, warn against the social and political unrest that will spread, from countries such as France, to the entire of Europe²⁵. In any case, apart from other "ideological" reservations, real versus nominal convergence remained the issue in the Portuguese public debate about EMU.

At the same time, however (mind the contradiction), most social partners (with the exception of CGTP), political economists (with the exception of some economic commentators, anti-EMU for ideological reasons²⁶) and public opinion at large have also cautioned against the possibility of being left out of EMU and the weakening of Portugal's position in the EU as a whole. They have realised that there is no alternative and that it is better to be inside than "out in the cold". This is in fact the reasoning the Government used to overcome ideological reservations (Keynesian or others) to EMU within the PS.

25 Some commentators have been busy, since 1995, announcing the end of the entire EMU project at occasions as different as Spanish lorry-drivers strikes, social security reform plans in France, reports on German unemployment and so on.

26 Anti-EMU positions and "anti-European ideologies" exist in all party circles and have gathered in many different *fora*, as for example, around the Mário Soares (himself a pro-European and a federalist) Foundation where European and North American right wing conservatives and traditional leftists share their distrust of the current integration process.

On the introduction of the Euro there has been much concern, voiced by the Portuguese banking association, over the issue of replacing all national currencies by one single European currency, given the importance of currency exchange trading in their activities and the financial set-up costs involved. In a recent hearing in the parliamentary committee on European Affairs, however, two private bankers when questioned by the author (see CAE, 1998, and Torres, 1998a) have watered down the importance of these costs. The public debate has now turned to these questions.

Variable geometry EMU

The notion of positive variable geometry has been accepted by the Portuguese parliament that adopted it in a resolution on the principles for the revision of the Treaty on European Union (see CAE, 1994, and Torres, 1995a and 1995b). As in other domains of European integration, Portugal would accept that if unable to participate from the beginning in EMU others could go ahead. It was feared, however, that, in practice, the first group of countries to take part in the Executive Board of the European Central Bank would move forward in all other domains of political co-operation, leaving the others effectively out of the political core. On the other hand, it was also feared that convergence would be more difficult for outsiders. That is why both the Government and the main opposition party started to defend by the end of 1996, after many quarrels about the subject, that Portugal should participate in EMU irrespective of any automatic transfers and of what would happen to other Southern countries, including Spain.

In fact, if Portugal was to participate from the start in EMU while Spain was not, there should not be any significant costs even in the short run. Unlike Ireland on Britain (see Kavanagh et al., 1997), Portugal is much less dependent on its bigger neighbour: Germany is by far the biggest client of Portuguese exports (in 1996 even France ranked above Spain), although Spain has become the biggest supplier of Portuguese imports and competes directly with Portugal in third markets. Besides, Spanish attitudes towards EMU are rather different from the UK's (even though the Labour government seems to have come a lot closer to them): if Spain was not to participate from the outset in EMU, it would most likely pursue a policy of exchange rate stability in order to join one or two years later.

Some (as the former Prime Minister Aníbal Cavaco Silva) argued that, politically, it would have proven very difficult to separate the two countries in the event that Portugal would perform only marginally better in terms of the convergence criteria. But, one could have argued, as I argued in different *fora*, that, if EMU was to go ahead with the core group of countries, Ireland, Finland and Portugal — all with bigger neighbours that could either hesitate to participate in EMU or fall short of fulfilling the convergence criteria — would provide a case in point for the fact that variable geometry was not an alibi for a European geographical divide. In any case it is now certain that both Portugal and Spain meet the conditions for participation in EMU right from the start.

3. IS PORTUGAL READY FOR EMU?

Trade integration and similarity of economic structures

From an economic viewpoint, the high degree of Portuguese trade integration with the EU points to high benefits and low costs of participation in EMU. Portugal's trade integration with the European Union is well above the EU average (80 per cent of total exports and 75 per cent of total imports in 1995 and in 1997). In 1997, with respect to Portuguese imports, Spain has remained (since 1991) the most important supplier (with a share of about 30 per cent of total imports from the EU), followed by Germany (21 per cent). France is Portugal's third most important supplier (with a share of about 15 per cent of total imports from the EU). Regarding the most important markets for Portuguese exports, the situation inverts: Germany leads (with a share of about 27 per cent of Portuguese exports to the EU) and France and Spain follow (with a share of about 18 per cent)²⁷. These three trading partners are followed by the Benelux countries, Italy and the UK.

With respect to the likelihood of asymmetric shocks affecting the future European monetary union, it is important to know how similar the trade and industrial structures of Portugal and the EU are. According to data on the correlation between average intra-EU exports and exports of each

27 Data refer to the first ten months of 1997. Instituto Nacional de Estatística, October 1997.

EU-member state to other EU members up to 1994 (see Gros and Vandille, 1995), the trade structures of Ireland, Denmark and Portugal deviated moderately, but not as much as the trade structures of Finland and Greece, from the EU average.

In fact, EC membership and hence better access to the internal market in 1986 triggered an initial rapid expansion of the traditional Portuguese manufacturing sectors (textiles, clothing and shoe production) and brought about an increased specialisation of the economy. But increased world-wide competition, fragmentation, poor marketing and higher domestic interest rates (due to the policy of capital controls pursued in 1990 and 1991), on the one hand, and the modernisation of the economy and foreign direct investment (FDI) inflows, on the other hand, have since then modified that trend towards more similar economic structures²⁸.

Notably, exports from the *Auto Europa* joint venture, a FDI by Ford and Volkswagen with investment outlays equal to 2.9 per cent of GDP that began production of multi-purpose mini-vans at its new car plant in Palmela (greater Lisbon area) by mid-1995, are estimated to have reached almost 10 per cent of total merchandise exports in 1996 and 1997. This investment has compensated the fall in employment in the textile, clothing and shoe-producing sectors (mostly based in the north of the Country), which have been experiencing job reductions that accounted for almost the entire employment reduction in 1995. This trend is likely to continue with the complete phasing out of the MFA agreement until 2005.

In addition, besides a precarious agricultural and traditional specialisation in manufacturing sectors such as textile and clothing, the Portuguese industrial structure has been highly fragmented (firms with fewer than 500 people account for 79 per cent of total employment). Such a structure is good for competition (and for the flexibility of the economy) but bad from a resource allocation point of view. For instance, in 1992 half of the industry R&D was still concentrated in 5 large firms in the electronics, telecommunications and paper sectors (OECD, 1996) and more than half geographically concentrated in Lisbon and the Tagus Valley. This concentration of domestic resources prevents a faster real convergence with the EU. On the other hand, most foreign direct investments that took

28 The Internal Market seems not to have increased sectoral specialisation in Europe but, on the contrary, led to specialisation in different quality/price ranges within the same sectors, as seems to be also the case for Portugal in the last two to three years.

place between 1989 and 1992 – after liberalisation and before the opening up of the Central and Eastern European countries – went to the tertiary sector (banking, insurance and business services) which experience a substantial increase in productivity.

In short, the structure of the Portuguese economy still deviates from the EU average. Although the specialisation pattern became initially more pronounced, it seems now that the structure of the Portuguese economy is becoming more similar to the European average, not in the last place because of foreign direct investment. Still, differences in the industrial structure will persist (changes in the industrial structure take time) and with them the possibility of asymmetric shocks relative to other EU countries. However, exchange rate considerations seem irrelevant to tackle that problem both because of the high Portuguese wage flexibility and because of the permanent nature of the foreseen shocks (EU enlargement, liberalisation and globalisation). What is then important is to look at what are the institutional features that will constrain the capacity of response of the economy to modernisation and deeper European and world-wide integration.

Labour market institutions: Portuguese *de facto* flexibility

In Portugal, the number of workers covered by collective bargaining is around 70 per cent. There are two unions: one socialist (the UGT) and the other communist (the CGTP). The level of bargaining is predominantly sectoral and there is limited co-ordination between bargaining units. Firm-level bargaining is still very rare while national agreements are attempted each year. Benefit entitlements before tax as a percentage of previous earnings before tax (the so-called gross unemployment benefit replacement rates) are rather high for Portugal: they stand at 65 per cent during the first year and 39 to 43 (if there is a dependent spouse) per cent during the second and third year (data refer to 1995; see Martin, 1996). Eligibility criteria for unemployment benefits are strict: applicants have to have worked 1.5 years out of the last two. There is a minimum wage (around PTE 60,000 in 1998).

Within this institutional setting and against the background of high persisting unemployment rates in the EU even during economic growth phases (a problem that manifested itself especially in the 1980s), it is

noteworthy that the Portuguese experience contrasts with that of its Iberian neighbour, Spain. In 1997, after having peaked at 7.3 per cent in 1995, the Portuguese yearly average unemployment rate was 6.8 per cent. This rate compares favourably with the other EU member states, in that only Luxembourg (3.6 per cent), the Netherlands (5.5 per cent), Denmark (6.0 per cent) and Austria (4.4 per cent) reported lower rates in 1997. While Portugal and Spain had had a comparable level of unemployment at the end of the 70s (around 8 per cent, higher than an EC average of 5 per cent), in 1997 Spain reported an unemployment rate of 21 per cent. Both Portugal and Spain have experienced high budget deficits and indeed that fact has contributed, through high interest rates, to the rise of structural unemployment; the same holds, to a lesser extent, for several other factors such as unemployment benefits, institutional factors regarding the way unions work and the deterioration of terms of trade. But in contrast to all other countries, specific effects (unobserved components) are responsible for 40 to 50 per cent of unemployment rates – negatively in the case of Portugal and positively in the case of Spain (see Scarpetta, 1996).

The large weight of the state sector in Portugal first ensured low unemployment in the 1980s, albeit at the expense of raised economic costs in terms of high inflation, while wage increases were then traded for job security, keeping unemployment low. Low unemployment compensation benefits (practically inexistent until 1977) also increased the cost of being out of work²⁹. That model, as opposed to Spain's, led to both the lowest wages and the lowest strike rates in the EU.

A possible explanation for the fact that Portuguese unemployment did not persist at ever higher levels after the 1980s despite structural adjustment but actually fell could be what Nancy Bermeo (1994) called trading wage increases for job security, given that it was impossible to liberalise firing practices in Portugal. Still today, according to the OECD (1994), Portugal (although followed very closely by Spain, and much ahead of other countries) has the highest index of employment protection. But the fact that Portugal had low unemployment benefits and, in practice, a rather loose employment protection legislation may have also led to a higher

29 The average replacement ratio of the OECD was 34 per cent in 1995, 25 per cent in the period from 1987 to 1991, 7 per cent in the period from 1979 to 1985 and 1 per cent in the period from 1973 to 1977 (Blanchard and Jimeno, 1995).

responsiveness of wages to unemployment³⁰. This may have in turn led to a less adverse effect of disinflation on employment and to less unemployment persistence — the explanation stressed by Olivier Blanchard and Juan Jimeno (1995).

Disinflation and structural adjustment in Spain took place three years before the country's accession to the EC, just after the oil price increase and while the labour share still reflected the wage explosion of the 70s. It was of a labour-compensating nature: high wages with high unemployment. Portugal delayed its restructuring until there was an upswing: the oil price was falling, the labour share was already much smaller, privatisation and flexibilization were becoming effective and transfers and investment associated with EC membership were gaining momentum, in turn opening up (the hope for) employment possibilities³¹. The timing for stabilisation and structural adjustment may also reflect the fact that there has always been a consensus among political parties and social partners on the pursuit of an active employment policy to ensure social cohesion (although a large part of these programmes has been financed by the Community support frameworks). Two episodes during the recessions of 1983/84 and 1993/94 illustrate well this idea: in the face of a serious and widespread unemployment threat, the unions immediately accepted lower wage increases. In 1983/84 many workers accepted to work without being paid for several months in order to avoid being on the dole. This *de facto* flexibility of the labour market, in spite of its rigid regulation, shows that the Portuguese economy has some capacity to adjust to uneven shocks in a monetary union.

Although it seems that there is no hysteresis in the Portuguese unemployment rate, one should not ignore possible labour mismatch problems (see OECD, 1996, for a description) which would indicate that the economy may have entered a more difficult period of employment adjustment. Vítor Gaspar and Sílvia Luz (1997), following Blanchard and

30 Small firms tend to circumvent regulations by not paying social security contributions and by relying on short-term contracts. Also, a significant number of workers with permanent contracts have been laid off during the recession of 1993/94, suggesting that there is a *de facto* flexibility in the labour market (OECD, 1996).

31 Sacrifice ratios (the number of percentage points between real production and equilibrium production for each point less in the inflation rate) confirms that view for the period 1980-94: Italy and Portugal have ratios of 0.65 and 0.66, respectively, while Ireland and Spain have ratios of 1.0 and 1.47, respectively. See Barbosa and Machado (1996).

Katz (1997) and using quarterly data from 1983 to 1996 to arrive to a wage curve, conclude that there is real wage flexibility even in periods of low inflation and exchange rate stability.

Variations in the Portuguese unemployment rate correlate with the cyclical fluctuations of economic activity (Okun's law). With higher unemployment in 1995 than in 1994, nominal wage growth in the Portuguese economy as a whole fell slightly (although less pronouncedly than in the previous years). In 1995 the flexibility of wages to labour market conditions was expressed in average wage rises of 4.4 per cent (based on the collective wage bargaining regulation), while real wages per worker are estimated to have risen by 1.4 per cent that year. This rise having been lower than productivity gains, labour unit costs fell while firms' profit margins rose from 1994 to 1995.

In Portugal wages are highly elastic with respect both to inflation and unemployment: the wage response (the semi-elasticity) to unemployment is one of the largest among European countries (only smaller than in Japan and Sweden, in absolute values)³². Real wage flexibility is a substitute for international labour mobility. Therefore, foregoing exchange rate autonomy seems not to be very costly. A *de facto* flexibility of the labour market, in spite of its rigid regulation, shows that the Portuguese economy has some capacity to adjust to uneven shocks in a monetary union.

Institutional requirements

The new statutes of Banco de Portugal, approved only in October 1990, although the new law had been ready for approval in December 1989, gave the central bank a high degree of economic independence while maintaining an average degree of political independence (increased to the US level in 1995, see below), as compared with other OECD countries. See Torres (1998b) for a discussion on Portugal and Grilli, Masciandaro and Tabellini (1991) for the criteria of political and economic independence. By 1995, the statutes of the central bank were amended by Decree-Law

³² See, among others, OECD (1992) and Luz and Pinheiro (1994). According to some studies reported in Gaspar and Luz (1997) also in the Netherlands wages are highly elastic to unemployment (-0.17), slightly above, in absolute terms, the value for Portugal (-0.16). Increasing wage bill differentials (see OECD, 1996) also suggest high nominal and real wage flexibility. On the other hand, the rate of structural unemployment has almost not changed since the beginning of the 1980s.

235/95 prepared by the PSD government and presented for ratification in parliament by the PS after the October 1995 elections in the beginning of the new political cycle. The ensuing Law 3/96 of 5 February 1996 established the maintenance of price stability as the primary objective of the Central Bank, taking into account the general economic policy of the Government. The Bank became the sole responsible for the conduct of monetary policy, having the obligation of co-operating with the Government in the definition of the exchange rate policy and to implement it. The overdraft facility and direct purchases of Government were officially abolished. In the new law, and as in most European central banks, the Bank retained responsibilities for banking supervision; the Governor is also obliged to inform the Parliament about monetary policy matters following the publication of the Annual Report of the Bank.

The remaining legal inconsistencies with the TEU and central bank statute requirements (see CEC, 1996; EMI, 1996) were dealt with by the Decree-Law 144/VII, approved in Parliament in November 1997, and subsequently transposed into the Law 5/98 of 31 January 1998³³. Moreover, the Portuguese Constitution, i.e. former Article 105, was revised, eliminating inconsistencies with the TEU. Unfortunately, there was still cross-party political resistance to the author's proposal to enshrine in the constitution the objective of price stability (the constitution refers to the statutes of the central bank) in spite of a recent parliamentary resolution approved in February by the two major political parties in favour of monetary union and its objectives³⁴.

Structural funds

The implementation of the European Single Market directives has greatly contributed to accelerating the pace of other reforms, as diverse as environmental quality and consumer protection. The total amount of EC transfers in 1996 and 1997 reached 4.3 per cent of GDP. Part of these

33 The Governor of the Central Bank had discussed, at the parliamentary Subcommittee on Economic and Monetary Union, all these inconsistencies and the necessary changes contained in the Decree Law presented to Parliament by the Government. The proceedings of those meetings and the report on the Decree Law, elaborated by the author, can be found in CAE (1998).

34 There was even cross-party resistance to the author's proposal to revise Article 105 of the Constitution. But fears that Portugal could be left out of EMU's third phase due to a potential inconsistency of the Country's fundamental law with the TEU led to an exceptional re-opening of Article 105 already in the second reading of the revision process. See Torres (1998b).

transfers, the structural funds (3.1 and 3.0 per cent of GDP in 1996 and 1997, respectively) and the cohesion fund (0.2 and 0.4 per cent of GDP in 1996 and 1997, respectively) have exerted pressure for internal reform – given that they had to be matched by national public expenditure, they required a definite establishment of long-term priorities in Portugal. It was possible to exert parliamentary pressure on the Government regarding the use of structural and cohesion funds, namely with respect to a better distribution of these funds in favour of the environment. Net transfers of the EU are of course much lower and, with the exception of 1995 (when they overtook private transfers), they are expected to fall continuously, although Portugal should remain a net receiver until full integration of new member States³⁵.

Estimates of the impact of the first Community Support Framework (CSF) of 1989/93, based on a general equilibrium model, point to an additional GDP growth of 0.4 pp in the short run and 0.5 pp in the long run. The official estimated impact of the second CSF, 1994/99, based on an input-output model, is also a 0.5 pp increase in the rate of growth³⁶.

The CSF for 1994-99 aimed at reducing the main weaknesses of the Portuguese economy that regard: education, economic infrastructures, the productive structure (characterised by an excessive weight of low-productivity industrial sectors and a very low-productivity agricultural sector), social security, disadvantaged social groups, the environment and regional imbalances.

Privatisation and competition policy

Portugal is amongst the largest “privatisers” of the OECD (OECD, 1996): from 1989 to 1995, more than 30 state-owned firms were privatised, yielding a revenue equivalent to 11 per cent of GDP. The biggest chunk of sales (about two thirds of total revenues) were in the banking and industry sectors that had been nationalised in 1975; in 1996 and 1997, the privatisation of the remaining shares in some banks and partial privatisation of public

35 This is because the bulk of EU expenditures is related to the Common Agricultural Policy. Given the structure of the agricultural sector, Portugal is reported to be a net contributor to the EU in this sector.

36 See Gaspar and Pereira (1995) for the general equilibrium model and Ministry of Planning (1993) for the input-output model.

utilities (telecommunications and electricity), motorway operating concessions, cements, and others amounted to 2.7 and 4.5 per cent of GDP, respectively. While regulatory reform in the financial sector already took place, it is still being implemented in the utilities sector. Public transport companies, television, steel, and chemicals have not yet been restructured. TAP – Air Portugal, the national carrier, features among the most heavily subsidised airlines in the EU, along with Air France and Olympic Airways from Greece. In 1995 efforts to improve product market competition included: transcription of EU-directives concerning public procurement policies, financial control over public enterprises by the audit court, simplification of the notification procedures for foreign direct investment, more consumer-friendly credit regulations. In 1996 and 1997 further measures were taken in order to ameliorate public utilities' responsiveness to consumers and to adopt more consumer-friendly insurance regulations. But, as stressed in Barros and Mata (1996), while the legal provisions seem satisfactory they have not been properly enforced: there seems to be a generalised bias regarding the interpretation of the principles (concerns with domestic firms' competitiveness and other businesses' rights dominate over concerns with the consumers' surplus and social welfare) and decisions are left to several non-independent sectoral supervision bodies and a competition authority that does not rank clearly above the former³⁷.

Exchange rate developments

The escudo was forced to devalue several times since the beginning of the ERM crisis. In November 1992, following the second realignment in the EMS and the devaluation of the Spanish peseta, in May 1993, following only partially the third devaluation of the Spanish peseta, and in March 1995, "following the decision to change the central rate of the peseta [by 7 per cent], the Ministers and central bank Governors also agreed on a downward adjustment of the central rate of the Portuguese escudo by 3.5 per cent in line with the market rate prevailing since August 1993" (EMI, 1996: 31). After this latter adjustment the escudo recovered to levels close to those prevailing at the end of 1994. Because the financial markets had

37 The first Competition law dates from 1983 and has been revised in 1993 (Decree-Law 371/93).

been associating the escudo with the peseta, the authorities followed, since the beginning of the period of turmoil, an intentional policy of de-linking the two currencies. This policy has been relatively successful (as can be seen by the reduction of daily exchange rate volatility and of the need for official intervention in the foreign exchange markets). Interest rates on 10-year government bonds fell 300 basis points in the following 12 months.

In nominal effective terms, the escudo behaved in a rather stable way since it joined the ERM in April 1992. Over the last years, the behaviour of the escudo against a basket comprising the currencies of 26 industrialised countries (BIS data) was one of the most stable of all EU currencies. In real effective terms (using the CPI as a deflator), the Portuguese escudo was by far, from joining the ERM until recently, the most stable currency in the EU: its real effective exchange rate appreciated by less than 1 per cent until the end 1996. Since 1987, it appreciated 27.2 per cent, more than any other EU currency. This is because from 1989 to 1991 there has been a substantial rise of unit labour costs. In any case, only now the effects of exchange rate stability are becoming apparent as far as the reduction of capital costs is concerned, which in turn contribute to the present economic recovery (GDP is estimated to have grown around 3.5 per cent in 1997).

Sustainability and conditions for fiscal consolidation

Contrary to most EU countries, no special measures were taken in Portugal (on the expenditure side) to reduce the budget deficit to 2.5 per cent of GDP in 1997. In fact, government current spending depends basically on the public sector wage bill that grew more in 1997 than in most other EU countries. As in 1995 and 1996, fiscal consolidation was achieved largely through higher tax receipts due to stronger economic growth and tougher tax enforcement. The Government intended to tax both firms and the self-employed (declaring below-minimum-wage incomes) on their imputed earnings before implementing a more comprehensive fiscal reform. The danger of slippage comes in the short run from the possibility of deficient expenditure control, namely in regard to health (that happened in 1997, although even higher tax receipts and both tax enforcement and lower than expected expenditures on social security, maintained the deficit ratio below the target).

Although the level of public debt continued to be excessive in 1997, around 64 per cent of GDP, it is expected to fall below 60 per cent by the end of the century. Portugal is not making a big effort in order to reduce the deficit and the debt: the general government primary balance reached a level of 4.2 per cent of GDP in 1992 but remained quite small thereafter amounting only to 1.2 per cent of GDP in 1996 and 1.8 per cent of GDP in 1997; contrary to what happened in all other EU members, non-interest expenditures grew (more than in any other EU country) between 1993 and 1997 and there was a dramatic fall in the implicit interest rates on public debt and indeed a reduction in interest payments from 1991 to 1997.

Nevertheless, concerning the sustainability of public debt, given the growth-adjusted effective interest rate and not taking into account any stock-flow adjustments, Portugal is in a situation similar to the Netherlands and Denmark and clearly better than the European average, with a falling debt ratio and a positive primary gap. The latter is the difference between the actual primary balance and the debt-stabilising primary balance. The fulfilment of the debt criterion and indeed of the stability pact hinges then upon the capacity of increasing the primary surplus from 1998 onwards (already for 1998 the effort is not great: the budgeted primary surplus is only 0.9 per cent of GDP). Cutting public current spending would increase confidence and reduce the growth-adjusted effective interest rate but pressure to increase taxes tends to have the opposite effect.

In addition, the speed of debt reduction will be also determined by the receipts from privatisation and pension expenditures. There is still some scope for future privatisation in 1998 and to a lesser extent in 1999. But those receipts will contribute with only less than half of its total amount to debt reduction (as a rule until 1992 they contributed with 80 per cent and much less so thereafter, reaching a peak of 77 per cent in 1996 and falling again to 63 per cent in 1997). In the longer run, fiscal sustainability depends on the capacity of restructuring the social security system whose deficit (2.6 per cent in 1994) would reach 8.5 per cent of GDP in 2035 if no measures were taken, according to OECD simulations (OECD, 1996).

4. CONCLUDING REMARKS

Although not all future EMU members have similar economic structures, recent evidence suggests that more economic integration may actually

reduce rather than aggravate their vulnerability to asymmetric shocks. Business cycles tend to be more highly correlated in integrated countries in which case the potential need for unilateral policies such as exchange rate devaluations is reduced. In any event, exchange rate flexibility can only have a transitory impact on the economy and hence does not dispense with the need for long-run real adjustment of a country's economic structure. Besides, nominal exchange rate devaluations are totally ineffective if they cannot affect relative prices.

Labour mobility in Europe is low but, since one can expect that prices move faster than production factors, that fact seems not to be crucial for the decision whether any EU country should participate in EMU. This is true even if one rejects money neutrality and takes the view that discretionary exchange rate policy can affect output. In terms of flexibility, what is then important for the smooth functioning of a European monetary union is the capacity of real wages to adjust to asymmetric shocks.

Since fiscal integration raises issues of re-distribution, automatic fiscal transfers are regarded as inappropriate without an important leap forward in the process of European political integration. On the other hand, although such transfers may be critical in areas such as the US that are characterised by a high degree of labour mobility and therefore by a risk of depopulation of declining regions, this is not the case in Europe. In any case, cohesion countries seem to have understood the importance of the economic and social cohesion principle, enshrined in the Treaty, when compared with any other type of transitory transfers linked to the functioning of EMU.

Joining a monetary union that is based on institutions that deliver price stability is, as stressed by the modern political economy literature, probably the best way to implement a solid strategy of sustained economic development. This option precludes many of the transition costs (the output losses of a disinflation strategy) of such a regime change. Besides, eliminating inflation through the adoption of a single currency that delivers price stability does away with the need to waste resources on hedging against exchange risks, being therefore a welfare improving mechanism in a double sense.

The problems of persistent differences in productivity growth or any other type of differences are unrelated to the exchange rate regime. Real versus nominal convergence became however the most popular line of discussion amongst politicians and EMU is seen as a technocratic obsession

and/or an ideological defence of the market. This is the cause of one of the main misunderstandings about the entire process of monetary unification. In fact some of the forceful opponents of EMU happen to be technocrats (and even eurocrats) or ideological free-marketeters. Instead, EMU can be seen as a means of getting rid of national currencies and all the economic jargon that goes with them, typically the excuses technocrats and short-sighted politicians find to cling to power and implement all kinds of mercantilist policies in the name of short-term real convergence.

A postponed Third Phase (as proposed by the group of 155 German economists) would not do way with any of those reservations. It could only constitute a serious set-back in both the on-going process of monetary integration and the existing level of economic integration. The internal market, based upon the principle of a level playing-field, is not compatible with serious currency misalignments that would give rise to trade protectionism. Were a country to credibly meet the convergence criteria by joining EMU by 1999 (if membership immediately reduced its debt burden and deficit due to a fall in interest rates to German levels), and to approve internally the reforms that make convergence sustainable, EMU should be completed without further ado. Italy may have been in this situation although it is now ready to join EMU from the start.

The idea of creating an ERM for laggards agreed upon in Verona by the EU ministers of finance could be, as argued in Torres (1996), replaced to the advantage of all by the only available option for the outside countries, a unilateral peg to the Euro. This is because outsiders will be left on their own in any case since the ECB could never intervene (and would not do so as several statements by central bank members have already made clear) in support of such an ERM without undermining its reputation from the very inception of EMU. An emulation of the policies followed by the core would not make sense, however, for outsiders unwilling to join EMU. The same is true for countries likely to postpone that decision well beyond January 1999, unable to meet the criteria set out in the TEU in the short run and/or still not members of the EU, which could adopt inflation targets.

Deepening the European Union still depends on the realisation of a monetary union but EMU will only succeed with further political integration. In the long run, the ECB will only be credible if fully accountable, as the Bundesbank in Germany and the Federal Reserve Bank in the US (which can be dissolved by a simple majority in Congress). To ensure the independence of monetary policy from the political business

cycle while guaranteeing its proper accountability, the European Parliament should be granted the appropriate powers to fulfil the role of a principal for the ECB.

It is not sufficient to make the ECB accountable to the public opinion, through peer pressure of independent economists and/or statements made by the Council of Ministers and the Commission whose members already have the right to participate in its board meetings. Too informal an accountability does not guarantee lasting institutions. Moreover, public opinion is not an agency that could fulfil the role of a principal. Although EMU is already a much more democratic arrangement than other international experiences such as the Gold Standard both among participating countries and between institutions and individuals, namely at the intergovernmental level through the stability pact on fiscal policy, it is necessary to assure a proper delegation of powers to the ECB at the federal level. In the cases of the Fed and the Bundesbank it is their autonomy that is informal not their accountability and both institutions are considered to be credible.

Portugal should aim at reducing the main weaknesses of its economy, making good use of the available structural funds to modernise and restructure its economy, instead of delaying structural adjustment in the hope for more structural funds, a federal co-insurance fund or exchange rate adjustments.

As in most other EU countries, the challenge of EMU has worked as a mechanism for economic stabilisation and as a pre-condition for structural reform and long-term development. It has created the necessary consensus to overcome specific interests in the pursuit of social and economic welfare. The political consensus took long to build – much longer than in countries such as Ireland or Spain – and it faced a strong and loud opposition – a time-lagged mimic of France’s – but seems to be mature with respect not only to EMU but also to the wider goals of European integration.

REFERENCES

Alesina, Alberto and Vittorio Grilli (1994), “On the Feasibility of a One – or Multi-Speed European Monetary Union”, in Barry Eichengreen and Jeffrey Frieden (eds.), *The Political Economy of European Monetary Unification*, Boulder: Westview Press, 107-28.

- Barbosa, António P. and José A. Machado (1996), "O Custo da Desinflação Portuguesa: uma Nota", *Boletim Económico Trimestral do Banco de Portugal* 46, (September) 47-50.
- Barros, Pedro P. and José Mata (1996), "Competition Policy in Portugal", Working paper 15/96, Lisbon: Banco de Portugal (September).
- Bermeo, Nancy (1994), "Comments on Francisco Torres and Guillermo de la Dehesa", in John Williamson (ed.), *The Political Economy of Policy Reform*, Washington, DC: Institute for International Economics, 197-206.
- Blanchard, Olivier J. and Lawrence F. Katz (1992), "Regional Evolutions", *Brookings Papers on Economic Activity*, 1, 1-75.
- Blanchard, Olivier J. and Lawrence F. Katz (1997), "What We Know and Do Not Know about the Natural Rate of Unemployment" *Journal of Economic Perspectives*, 11, 51-72.
- Blanchard, Olivier J. and Juan F. Jimeno (1995), "Structural Unemployment: Spain versus Portugal", *American Economic Review, Papers and Proceedings*, 85, 2, 212-218.
- Buiter, Willem H. (1996), "Two Cheers for EMU", *European Economic Perspectives* 9, Centre for Economic Policy Research (July), 5-7.
- CAE (1994), *Transparência, Alargamento e Emprego – Teses Portuguesas na X COSAC*, Comissão de Assuntos Europeus, Lisboa: Assembleia da República.
- CAE (1998), *Opções Europeias de Portugal: UEM*, Comissão de Assuntos Europeus, Lisboa: Assembleia da República.
- Cadilhe, Miguel (1990), "Luzes e Sombras da UEM", *Revista da Banca*, 16, 199-214.
- Casella, Alessandra (1993), "Comment on Krugman", chapter 8 in Francisco Torres and Francesco Giavazzi (eds.), *Adjustment and Growth in the European Monetary Union*, Cambridge: Cambridge University Press.
- CEC (1996), "Report on Convergence in the European Union", Brussels: Commission of the European Communities (November).
- CEF (1990), *Proceedings of the hearing on "Portugal, the EMS and EMU"*, Comissão de Economia e Finanças, Lisboa: Assembleia da República.
- Dewatripont, Mathias, et al. (1995), *Flexible Integration. Towards a More Effective and Democratic Europe, Monitoring European Integration* 6, London: Centre for Economic Policy Research.

Eichengreen, Barry and Fabio Ghironi (1996), "European Monetary Unification: the Challenges Ahead", chapter 4 in Francisco Torres (ed.), *Monetary Reform in Europe*, Lisbon: Catholic University Press.

EMI (1996), "Progress Towards Convergence: 1996", Frankfurt: European Monetary Institute (November).

Frankel, Jeffrey and Andrew Rose (1996), "The Endogeneity of Optimum Currency Area Criteria", CEPR Discussion paper n° 1473, September.

Frieden, Jeffrey, Eric Jones and Francisco Torres (1997), "The Challenges of Economic and Monetary Union for Smaller Member States: A Comparative Perspective", in Jeffrey Frieden, Daniel Gros and Erik Jones (eds.), *Towards Economic and Monetary Union: Problems and Prospects*, Cambridge: Cambridge University Press.

Gaspar, Vítor and Sílvia Luz (1997), "Desemprego e Salários em Portugal" in *Boletim Económico Trimestral*, Banco de Portugal, Dezembro.

Gaspar, Vítor and Alfredo M. Pereira (1995), "The impact of Financial Integration and Unilateral Public Transfers on Investment and Growth in EC Capital Importing Countries", *Journal of Development Economics*, 48, 43-66.

Grilli, Vittorio, Donato Masciandaro and Guido Tabellini, (1991), "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries", *Economic Policy*, 13, 341-392.

Gros, Daniel and Guy Vandille (1995), "Trade Structure Similarities", Brussels: Centre for European Policy Studies, mimeo.

Gros, Daniel (1996), "Towards a Credible Excessive Deficits Procedure", chapter 7 in Francisco Torres (ed.), *Monetary Reform in Europe*, Lisbon: Catholic University Press.

Gros, Daniel (1997), "A Reconsideration of the Cost of EMU. The Importance of External Shocks and Labour Mobility", in Jeffrey Frieden, Daniel Gros and Erik Jones (eds.), *Towards Economic and Monetary Union: Problems and Prospects*, Cambridge: Cambridge University Press.

Gros, Daniel and Guy Vandille (1995), "Trade Structure Similarities", Brussels: Centre for European Policy Studies, mimeo.

Jones, Erik, Jeffrey Frieden and Francisco Torres (eds.), *Joining Europe's Monetary Club: The Challenges for Smaller Member States*, New York: St. Martin's Press.

Kavanagh, Ella, et al. (1997), "The Political Economy of EMU in Ireland", chapter 6 in Jeffrey Frieden, Erik Jones and Francisco Torres (eds.), *Joining Europe's Monetary Club: The Challenges for Smaller Member States*, New York: St. Martin's Press.

Luz, Silvia and Maximiano Pinheiro (1994), "Wage Rigidity and Job Mismatch in Europe", Working Paper 2/94, Lisbon: Banco de Portugal.

Macedo, Jorge Braga (1996), "Selling Stability at Home, Earning Credibility Abroad", chapter 2 in Francisco Torres (ed.), *Monetary Reform in Europe. An Analysis of the Issues and Proposals for the Intergovernmental Conference*, Lisbon: Catholic University Press.

Martin, John (1996), "Measures of Replacement Rates for the Purpose of International Comparisons: A Note", *OECD Economic Studies*, 26, 99-115.

Ministry of Finance (1992), "Portugal from P1 to Q2: A Strategy of Sustained Regime Change 1986 – 1995", abridged version by José Braz in Francisco Torres and Francesco Giavazzi, *A Single Currency for Europe: Monetary and Real Impacts*, London: CEPR Report (March).

Ministry of Finance (1993), "Contribuição Portuguesa para o Livro Branco sobre o Crescimento, Competitividade e Emprego", Lisbon: Ministério das Finanças (October).

Ministry of Planning (1993), *Plano de Desenvolvimento Regional*, Lisbon: Secretaria de Estado do Planeamento e Desenvolvimento Regional (July).

Ministry of Planning (1996), *Grandes Opções do Plano para 1997*, Lisbon: Ministério do Equipamento, do Planeamento e da Administração do Território (October).

Moses, Jonathon W. (1997), "Finland and EMU", chapter 4 in Jeffrey Frieden, Erik Jones and Francisco Torres (eds.), *Joining Europe's Monetary Club: The Challenges for Smaller Member States*, New York: St. Martin's Press, forthcoming.

OECD (1992), "Economic Survey on Portugal", Paris: Organisation for Economic Co-operation and Development.

OECD (1994), *The OECD Jobs Study*, Paris: Organisation for Economic Co-operation and Development.

OECD (1996), "Economic Survey on Portugal", Paris: Organisation for Economic Co-operation and Development.

Persson, Torsten and Guido Tabellini (1996), "Monetary Cohabitation in Europe" CEPR Discussion Paper N° 1380, May.

Rebello, Sérgio (1997), "What Happens when Countries Peg their Exchange Rates? The Real Side of Monetary Reforms", *European Economic Review*, forthcoming.

Scarpetta, Stefano (1996), "Assessing the Role of Labour Market Policies and Institutional Settings on Unemployment: A Cross Country Study", *OECD Economic Studies*, 26, 43-98.

Silva, Aníbal A. Cavaco (1994), "Combinação de Políticas de Estabilização num Quadro de Integração: a Experiência Portuguesa", *Brotéria*, 138, 5/6, 493-515.

Thygesen, Niels (1996), "The Prospects for EMU by 1999 – and Reflections on Arrangements for the Outsiders", paper presented at a CEPR workshop in Rome on Monetary Co-Existence in Europe, February.

Torres, Francisco (1987), "Policy-Making in Small Open Economies", Working Paper 10/87, Faculdade de Economia e Ciências Empresariais, Universidade Católica Portuguesa.

Torres, Francisco (1989a), "Regras Externas e Consistência de Políticas numa Pequena Economia Aberta", Universidade Nova de Lisboa, Faculdade de Economia, Working Paper N° 109, January.

Torres, Francisco (1989b), "Small Countries and Exogenous Policy Shocks", European University Institute, Department of Economics, Working Paper N° 89/374.

Torres, Francisco (1989c), "Sobre a Adesão a uma União Monetária com Liderança e Mobilidade Perfeita de Capitais", *Economia*, XIII, 2, 233-254.

Torres, Francisco (1990), "Portugal, the EMS and 1992. Stabilisation and Liberalisation" chapter 10 in Paul De Grauwe and Lucas Papademos (eds.), *The EMS in the 1990's*, London: Longman, 225-246.

Torres, Francisco (1992), "Politics and Economics: A Review Essay", *Economia*, XVI, 2, 281-286, 1992.

Torres, Francisco (1994), "The European Periphery: Portugal", chapter 4, in John Williamson (ed.), *The Political Economy of Policy Reform*, Institute for International Economics, Washington, DC, 141-152.

Torres, Francisco (1995a), "A Conferência Intergovernamental de 1996 e a União Económica e Monetária" in *Acompanhamento Parlamentar da Revisão*

do Tratado da União Europeia na Conferência Intergovernamental de 1996 – Volume 1, Comissão Parlamentar de Assuntos Europeus, Lisboa: Assembleia da República.

Torres, Francisco (1995b), “A UEM e a Conferência Inter-Governamental de 1996”, chapter 5 in Álvaro Vasconcelos, Francisco Torres et al., *Portugal no Centro da Europa*, Lisbon: Quetzal.

Torres, Francisco (1995c), “Portugal and the EMS. The Politics of Monetary Integration”, in João Loureiro (ed.), *Portugal e a Integração Monetária Europeia*, Porto: Universidade do Porto Editora, 80-91.

Torres, Francisco (1996), “The Political Economy of Monetary Reform in Europe”, chapter 3, in Francisco Torres (ed.), *Monetary Reform in Europe. An Analysis of the Issues and Proposals for the Intergovernmental Conference*, Lisbon: Catholic University Press, 61-82.

Torres, Francisco (1998a), “A Convergência Política na UEM” in *Opções Europeias de Portugal: UEM*, Comissão de Assuntos Europeus, Lisboa: Assembleia da República, 325-52.

Torres, Francisco (1998b), *Da Ambiguidade e Conflito à Moeda Única. As Razões de uma Batalha Política*, forthcoming.

Torres, Francisco (1998c), “Modelling Credibility in the Transition to a Monetary Union: Discretion, Secrecy and Rules with Escape Clauses”, Universidade Católica Portuguesa, manuscript in progress.

Torres, Francisco (1998d), “Portugal Towards Economic and Monetary Union: A Political Economy Perspective”, chapter 8 in Erik Jones, Jeffrey Frieden and Francisco Torres (eds.), *Joining Europe's Monetary Club: The Challenges for Smaller Member States*, New York: St. Martin's Press.

Torres, Francisco and Francesco Giavazzi (1993), “Introduction”, chapter 1 in Francisco Torres and Francesco Giavazzi (eds.), *Adjustment and Growth in the European Monetary Union*, Cambridge: Cambridge University Press.