
Limits to the government's role on economic growth

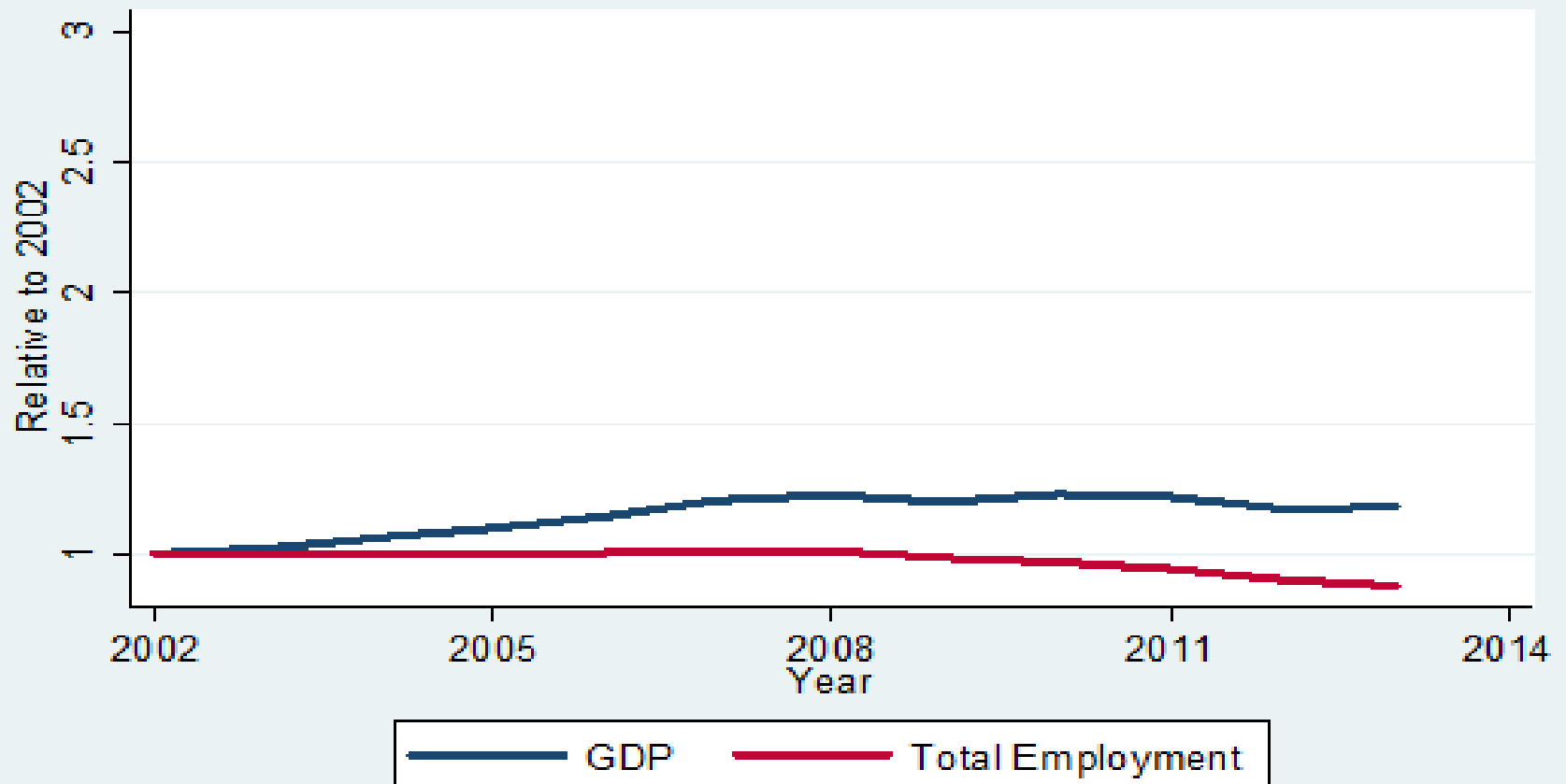
Furnas, October 9th 2014

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These are my views and not necessarily the views of the Federal Reserve Bank of New York or the Federal Reserve System

Are there limits to government role on growth?

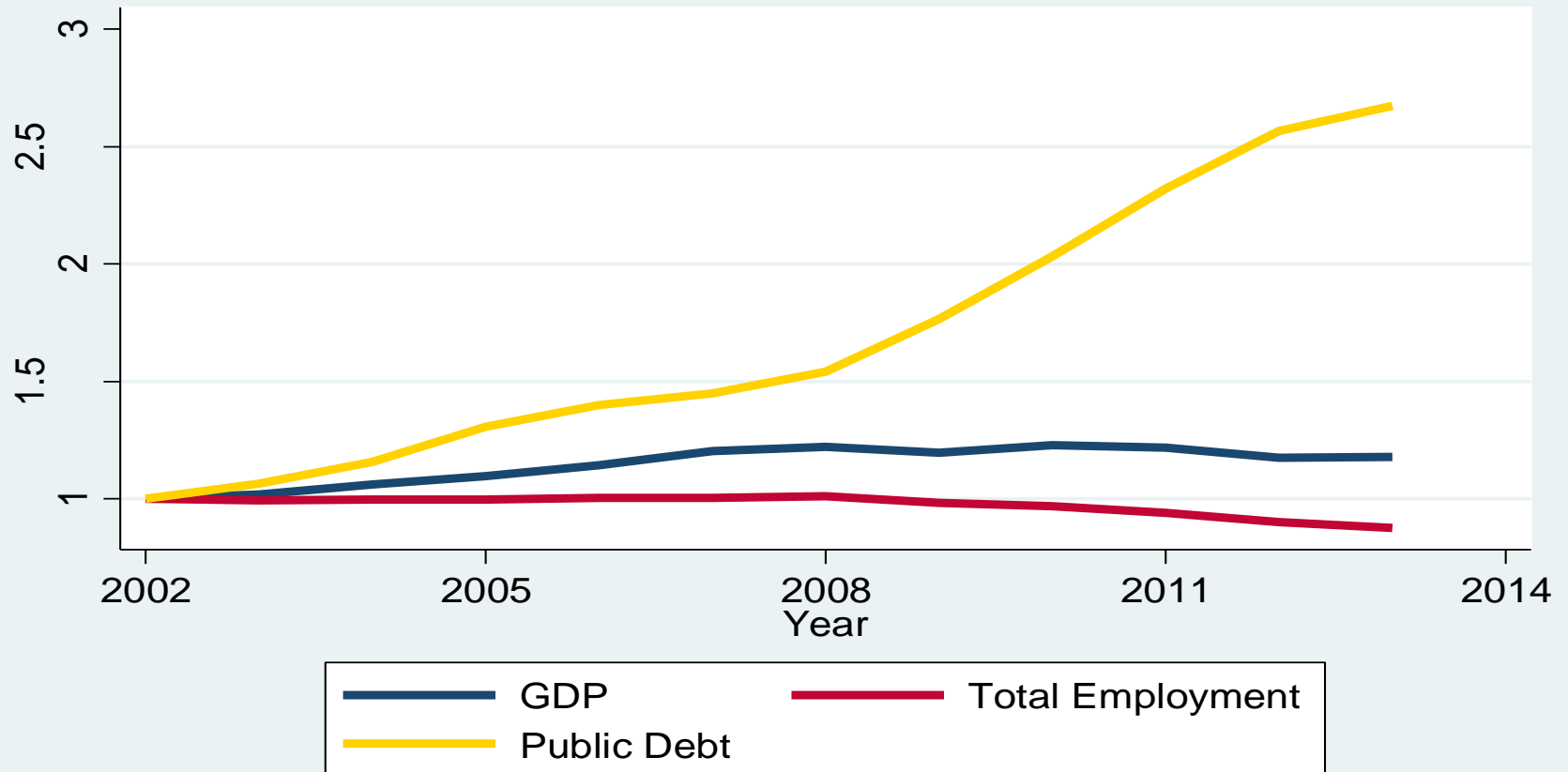
Portugal: GDP & Total Employment
Base Year = 2002



Source: Eurostat, IFS

Are there limits to government role on growth?

Portugal: GDP, Total Employment, Public Debt
Base Year = 2002



Source: Eurostat, IFS

WHEN SHOULD GOVERNMENTS INTERVENE?

When should governments intervene? Public goods

- **Public goods have two characteristics:**
- **Non-rivalry:** This means that when a good is consumed, it doesn't reduce the amount available for others (e.g. benefiting from a street light doesn't reduce light for others).
- **Non-excludability:** This occurs when it is not possible to provide a good without it being possible for others to enjoy (e.g. providing law and order).
- A public good is often under-provided in a free market because of its characteristics of non-rivalry and non-excludability.

When should governments intervene? Market failures

- **Negative externalities**
- A negative externality occurs when an individual or firm making a decision does not have to pay the full cost of the decision.
- When a negative externality exists in an unregulated market, producers don't take responsibility for external costs that exist-- these are passed on to society; too much of the product is produced and sold resulting in a deadweight welfare loss.
- **Examples**
 - Pollution
 - Financial stability

Are there other possibilities?

- Outside the provision of public goods and the correction of market failures, a strong case needs to be made for government intervention (be it outright provision of goods and services; participation in corporations; provision of support, financial, regulatory or otherwise,)
- Not clear the government has unique skills to identify “losers” from “winners”
- Clear that the government has unique powers; so any government intervention has far reaching implications

Positive analysis

- When the price does not reflect the cost, this will lead to excessive consumption
 - Products/services offered at zero or near zero prices
- Partnerships in which the controlling partner shares on the benefits but is protected against the losses will lead to excessive risk taking
- By virtue of its unique powers, when the government “intervenes” in a firm/sector of activity, it affects
 - The incentives of that firm/firms in that sector of activity
 - Incentives of competitors
 - Incentives of suppliers and buyers that interact with those firms

Portuguese government's participations in corporations

1. Empresas Públicas não Financeiras

1.1. Comunicação Social

1.2. Cultura

1.3. Gestão de Infra-estruturas

1.3.1. Infra-estruturas Aéreas

1.3.2. Infra-estruturas Ferroviárias

1.3.3. Infra-estruturas Portuárias

1.3.4. Infra-estruturas Rodoviárias

1.3.5. Outras Infra-estruturas

1.4. Requalificação Urbana

1.5. Saúde

1.6. Serviços de Utilidade Pública

1.7. Transportes

1.8. Parpública

Portuguese government's participations in corporations

1.9. Outros Sectores

- Cooperativa Cultural Recreativa Gafanha da Nazaré
- Estrela, SGPS, SA (ex-Companhia de Cervejas Estrela, SA)
- Imobiliária Construtora Grão-Pará, SA
- Mac Coelho
- Matadouro Regional do Barroso e Alto Tâmega, SA
- Matur - Sociedade de Empreendimentos Turísticos da Madeira, SA
- NET - Novas Empresas e Tecnologias, SA
- Parquinverca - Cooperativa Abastecimento Alimentar, SCARL
- SANJIMO - Sociedade Imobiliária, SA
- Sociedade Águas da Curia, SA
- Sociedade Imagem Real, Ld^a

2. Empresas Públicas Financeiras

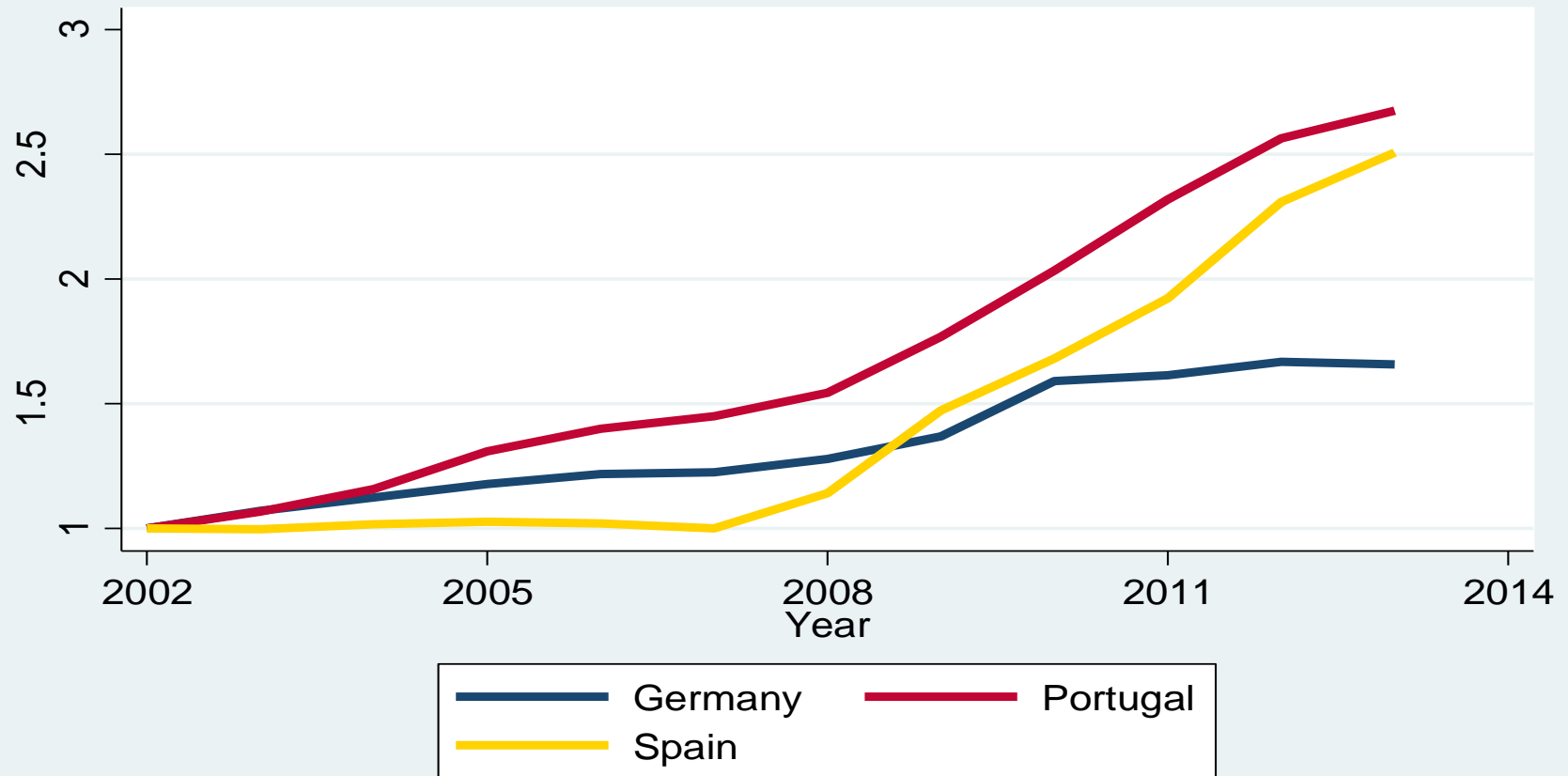
- Banif
- Caixa Geral de Depósitos

Source: Ministerio das Financas

PORTUGAL VERSUS GERMANY AND SPAIN

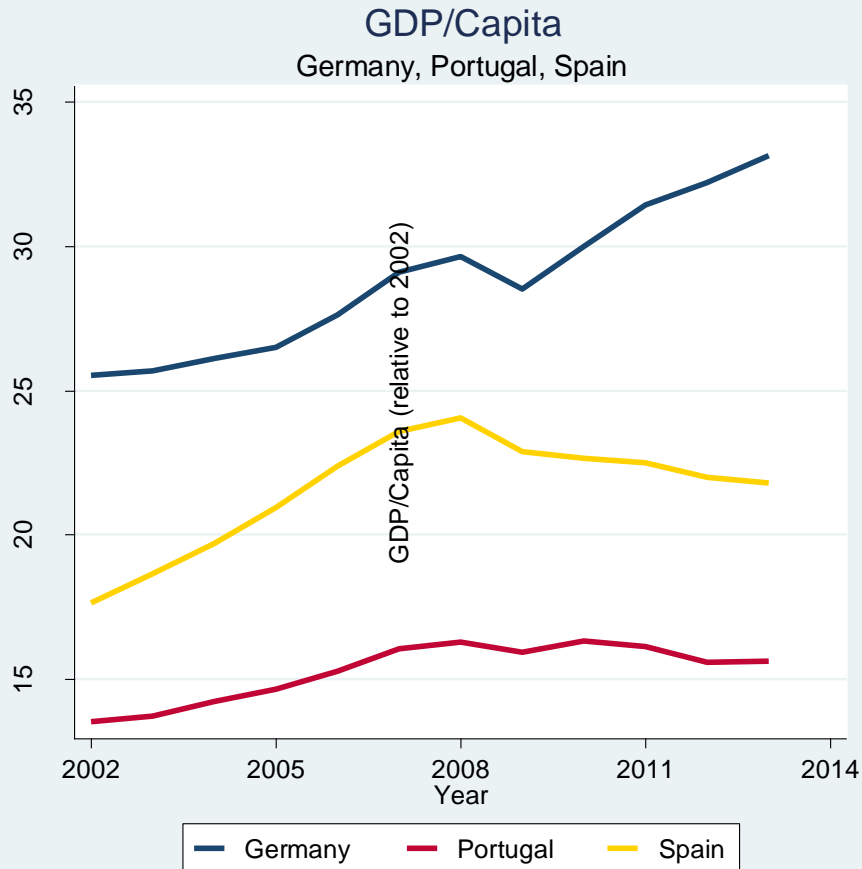
Portugal vs Germany and Spain: Public debt

Total Public Debt: Germany, Portugal, Spain
Base Year = 2002

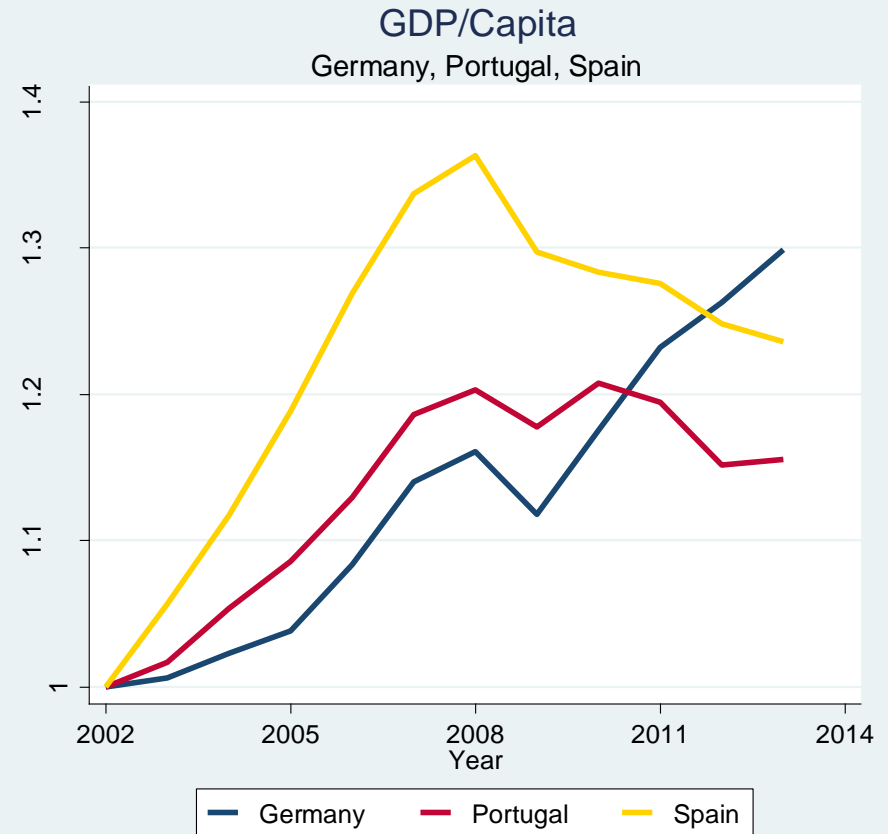


Source: Eurostat

Portugal vs Germany and Spain: GDP per capita



Source: International Financial Statistics

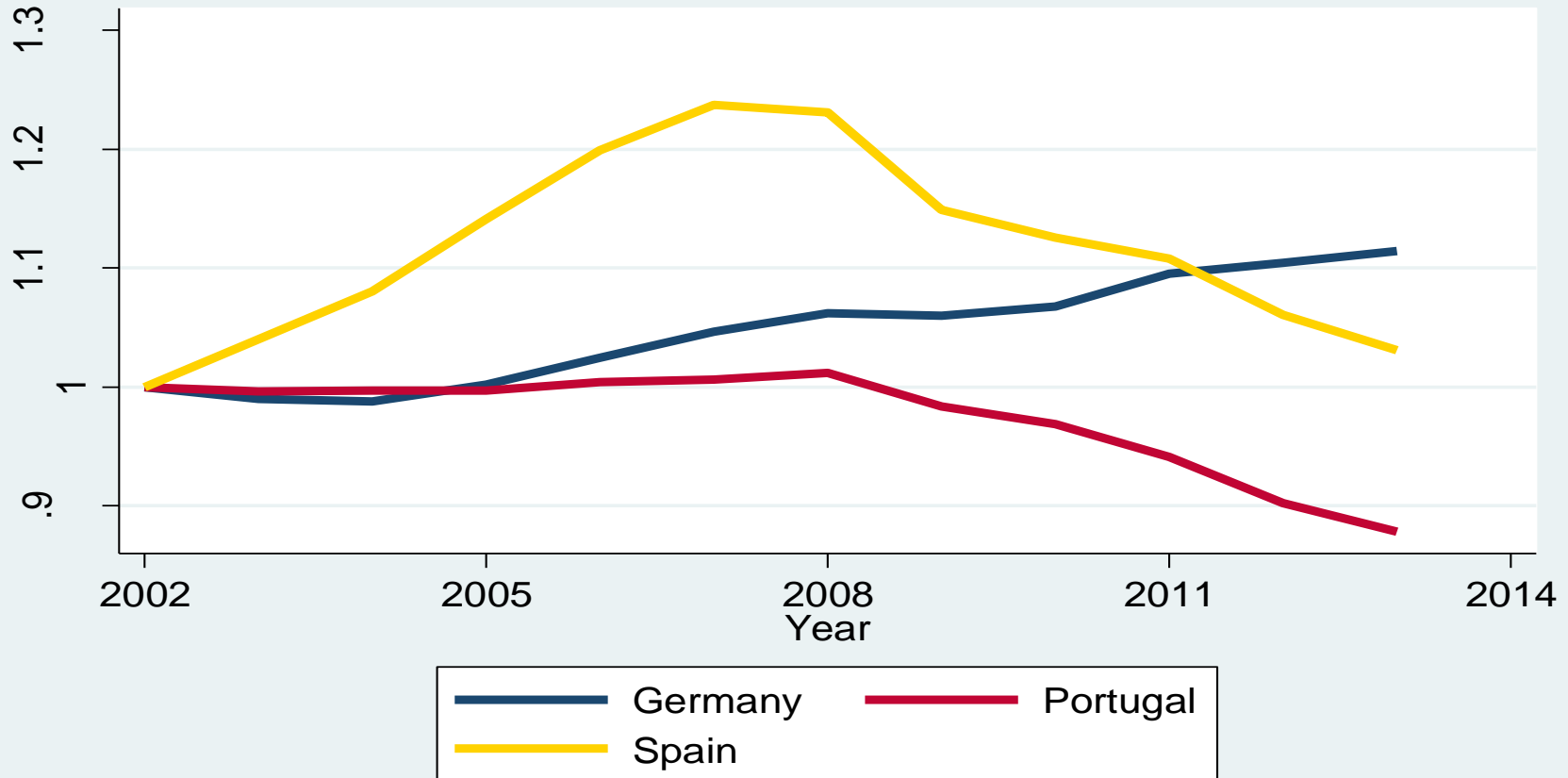


Source: International Financial Statistics

*Base Year = 2002

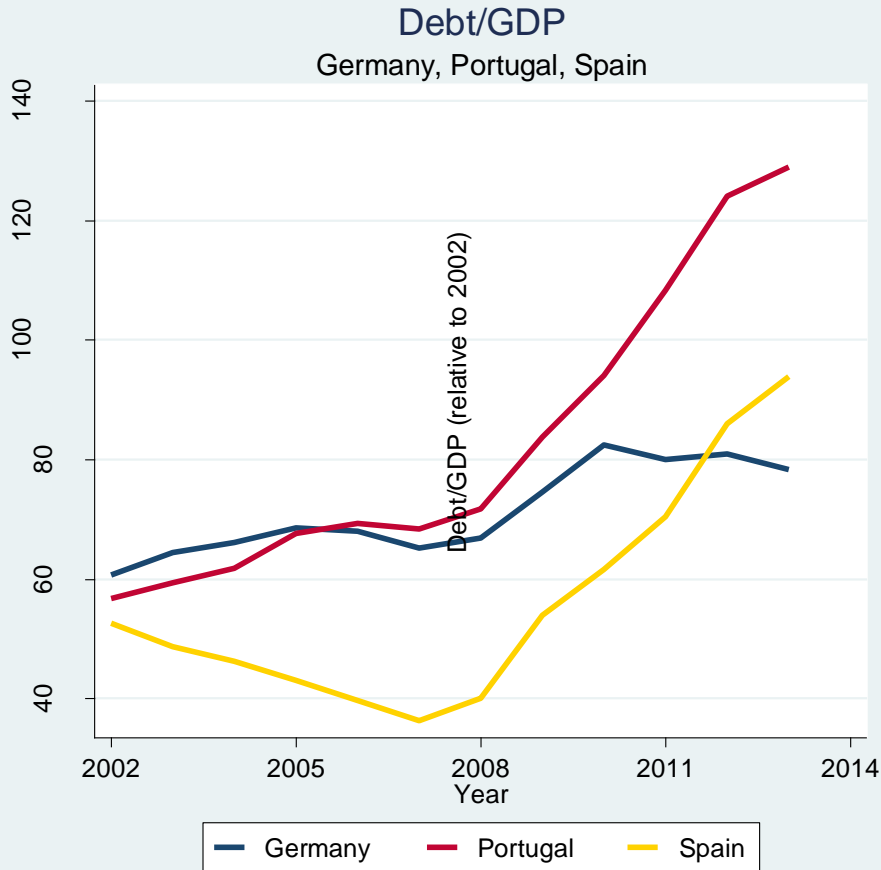
Portugal vs Germany and Spain: Employment

Total Employment: Germany, Portugal, Spain
Base Year = 2002

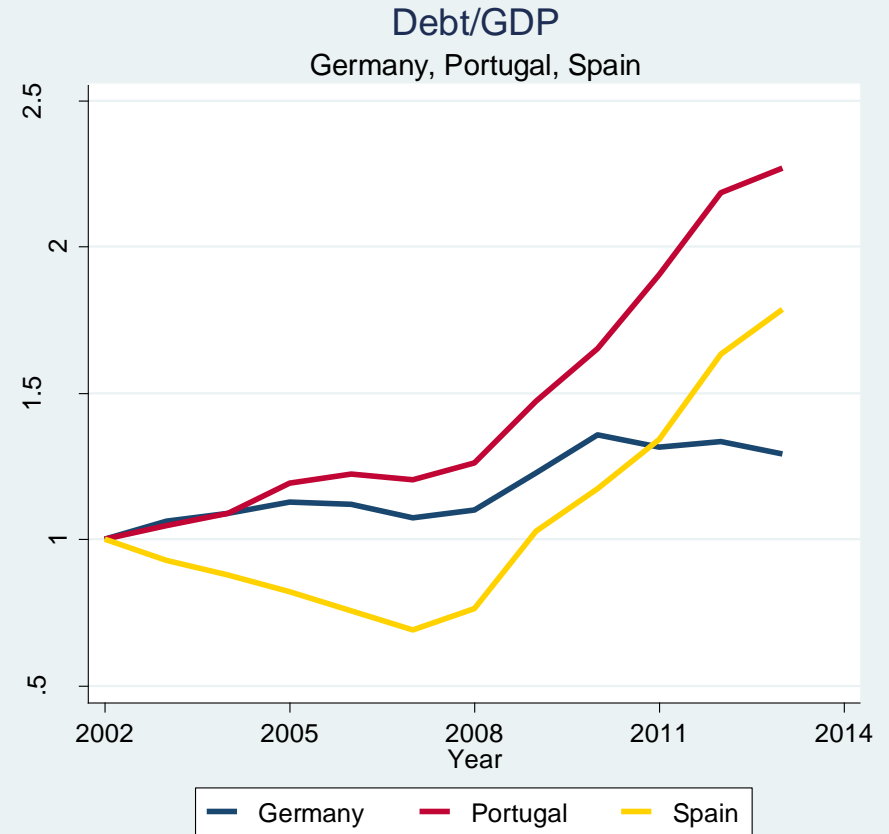


Source: Eurostat

Portugal vs Germany and Spain: Public debt/GDP



Source: Eurostat

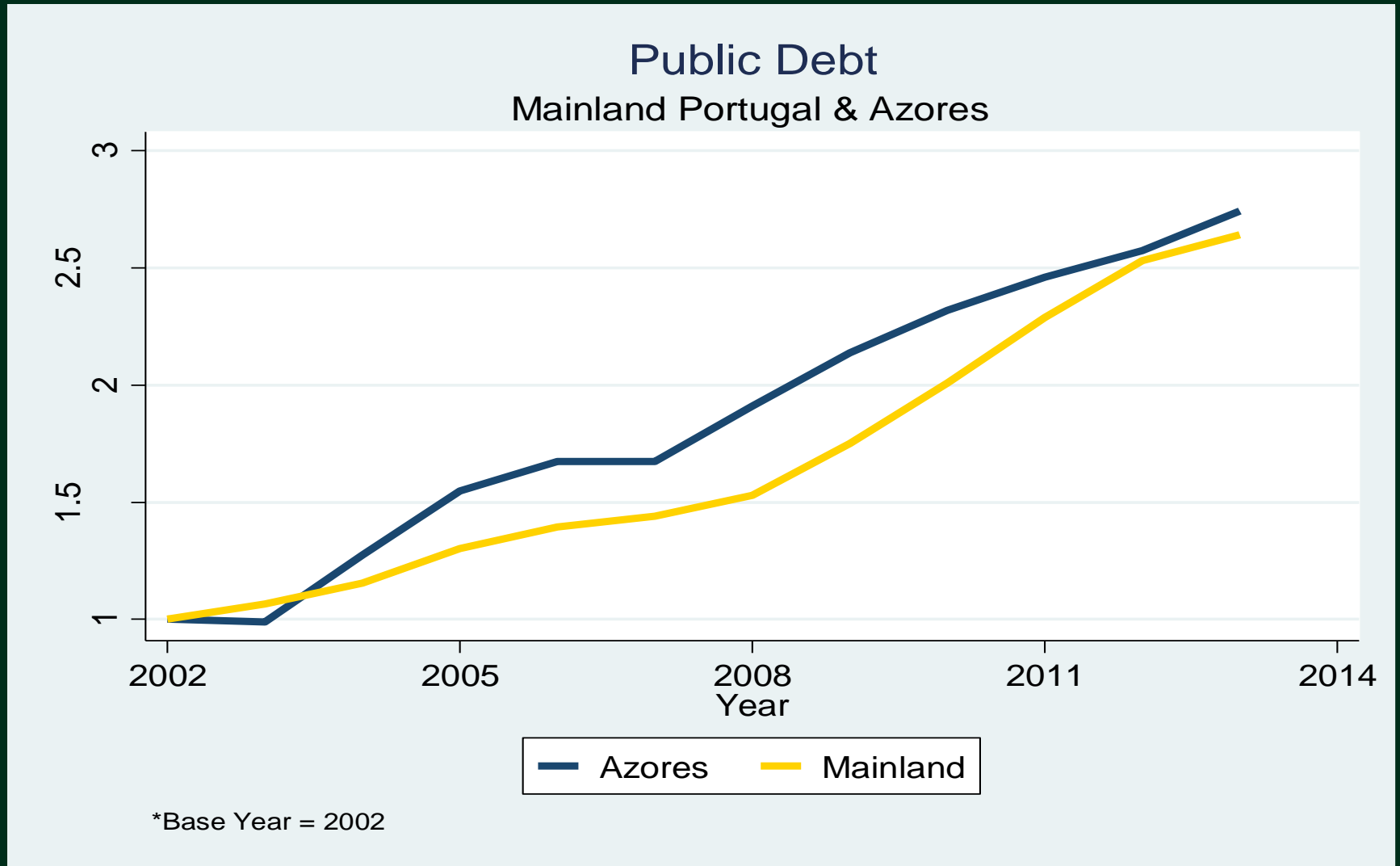


Source: Eurostat

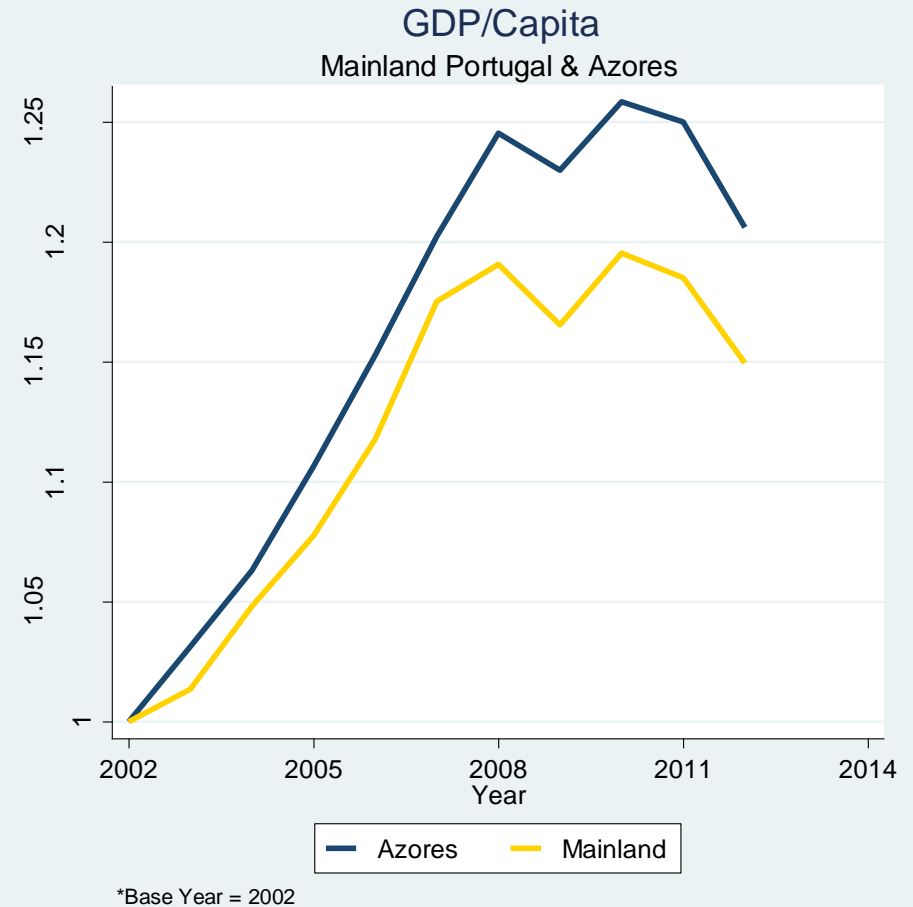
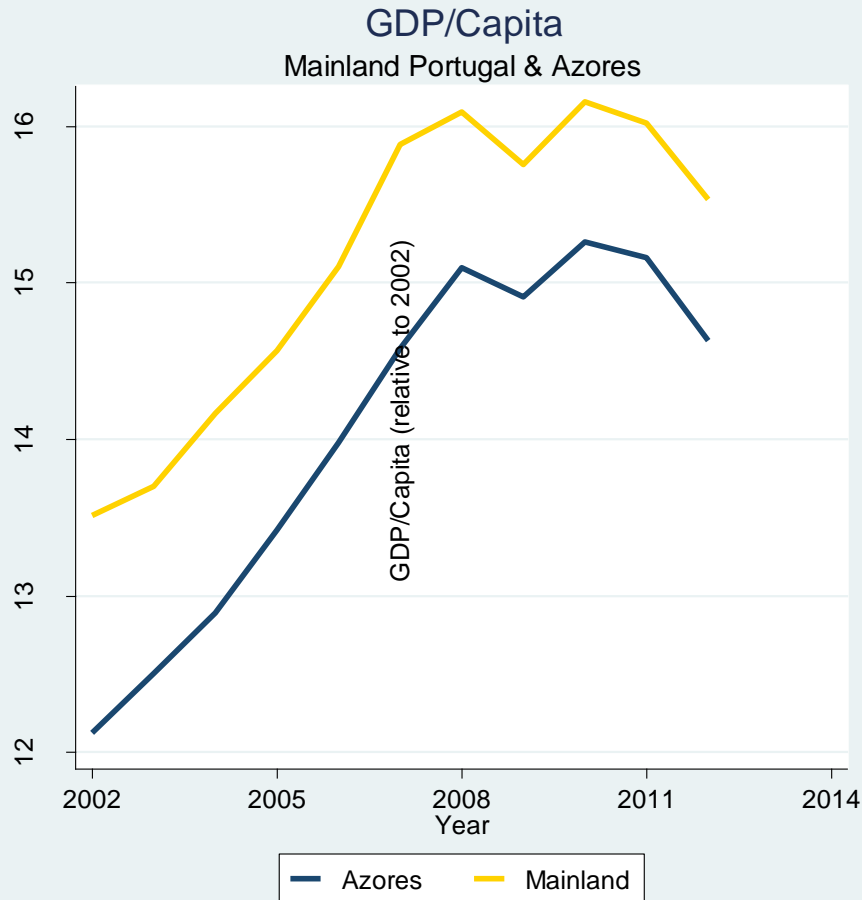
*Base Year = 2002

**WHAT DOES THE EXPERIENCE OF
AZORES TELL US?**

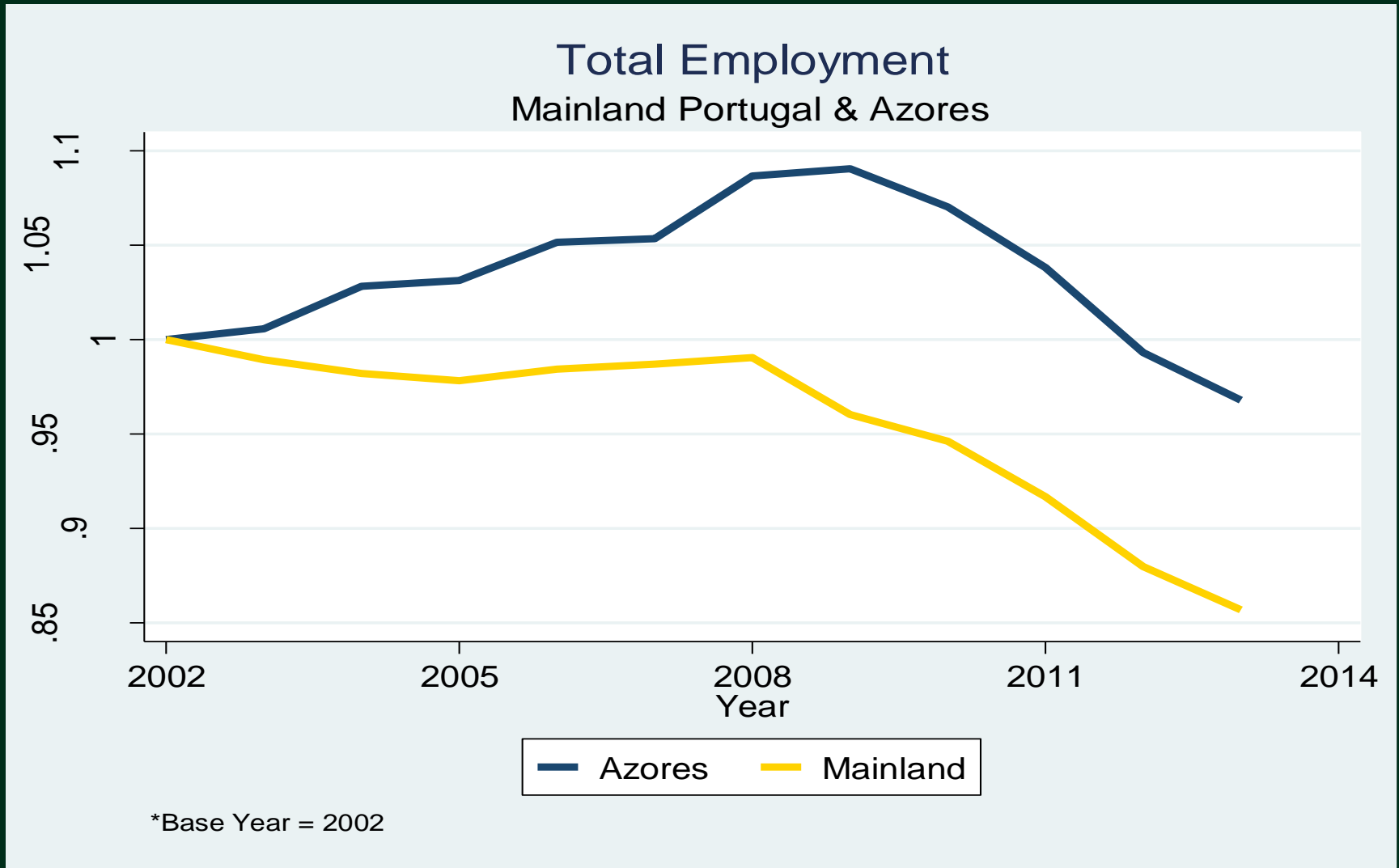
Azores vs. the Mainland: Public debt



Azores vs. the Mainland: GDP per capita

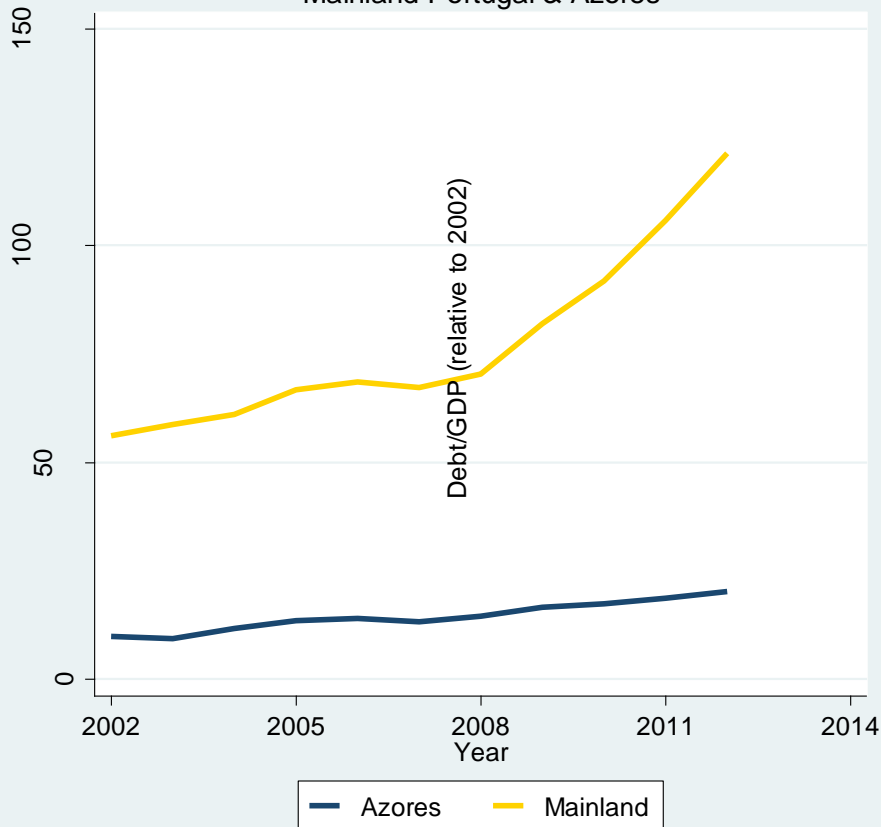


Azores vs. the Mainland: Employment

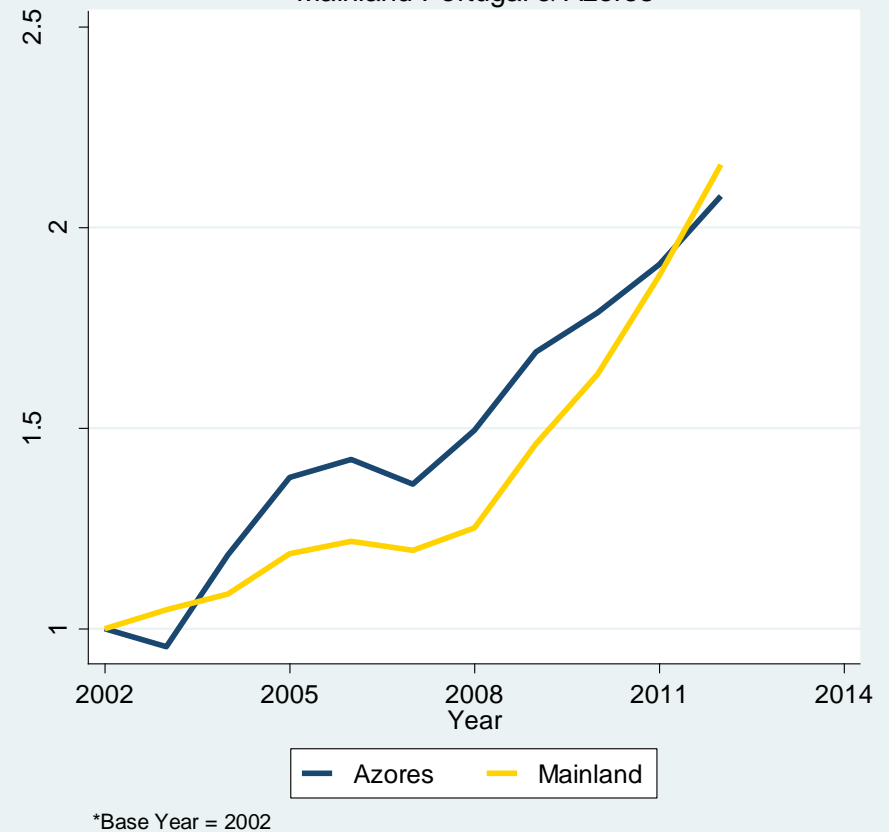


Azores vs. the Mainland : Debt to GDP

Debt/GDP Ratios
Mainland Portugal & Azores

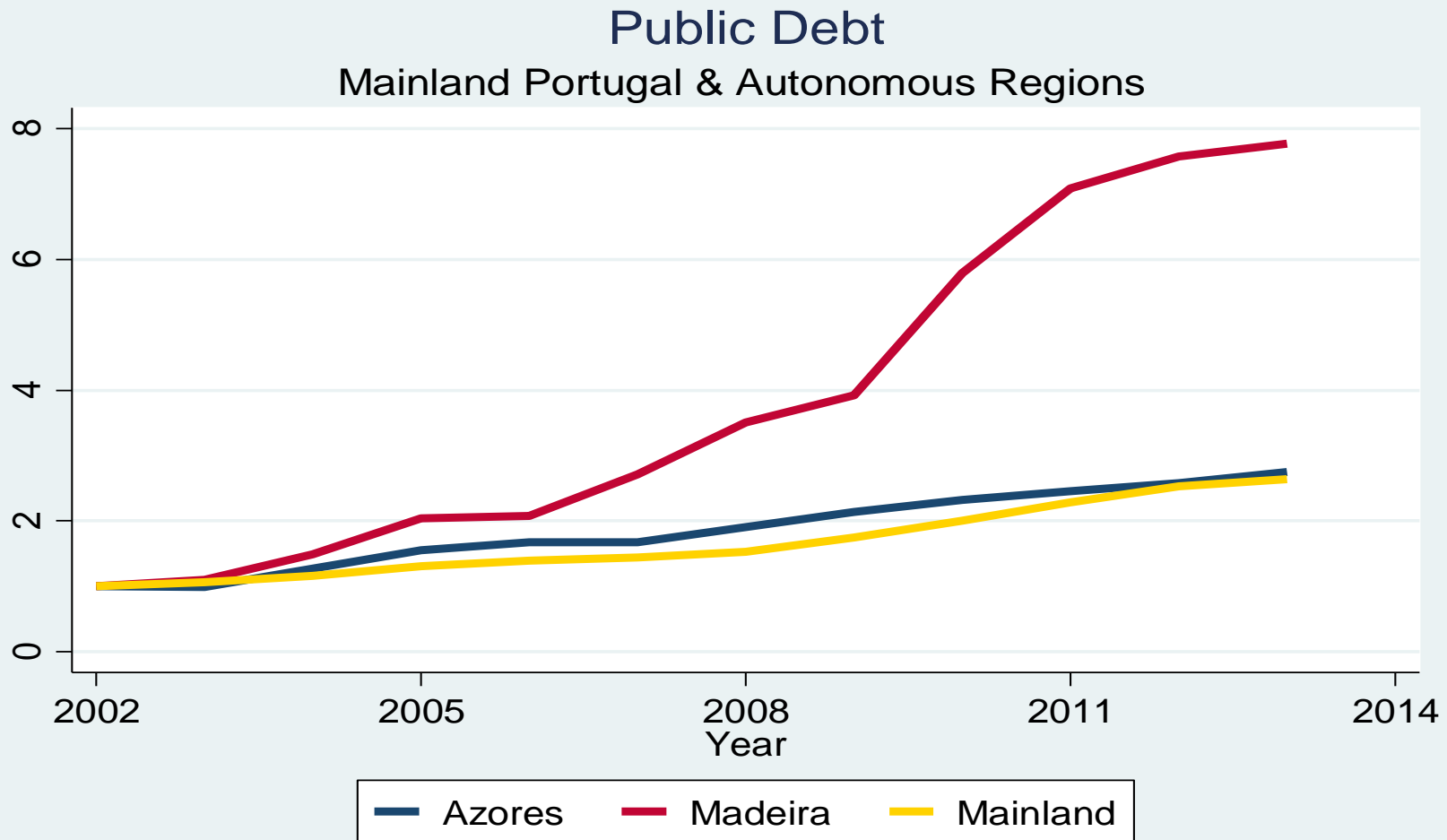


Debt/GDP Ratios
Mainland Portugal & Azores



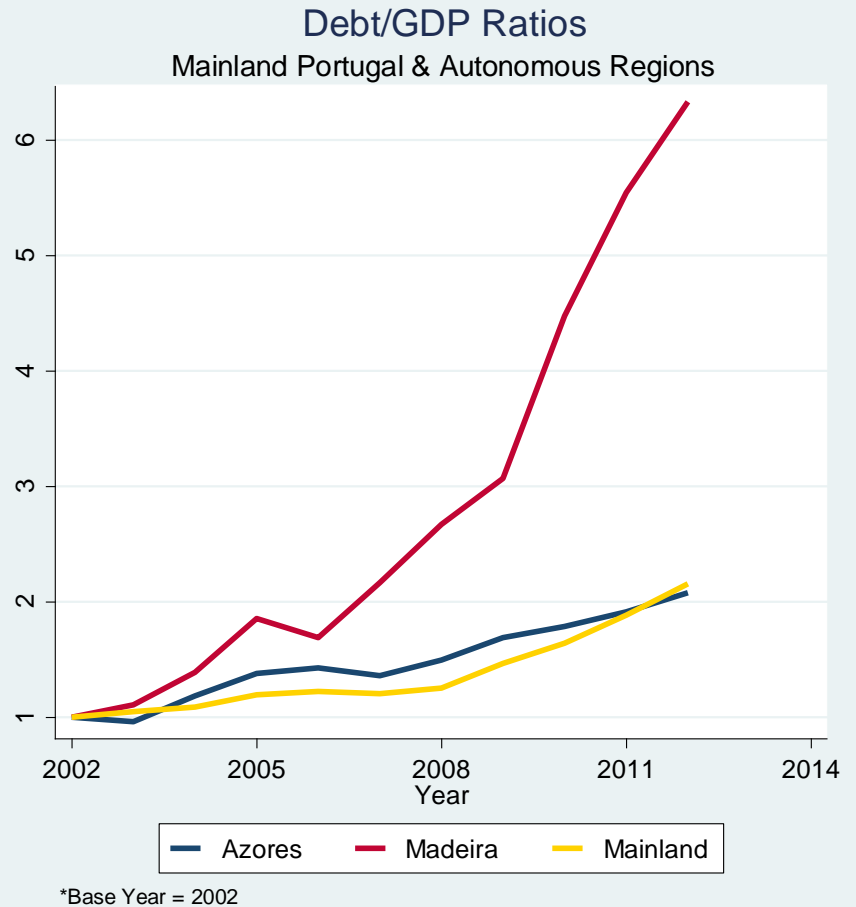
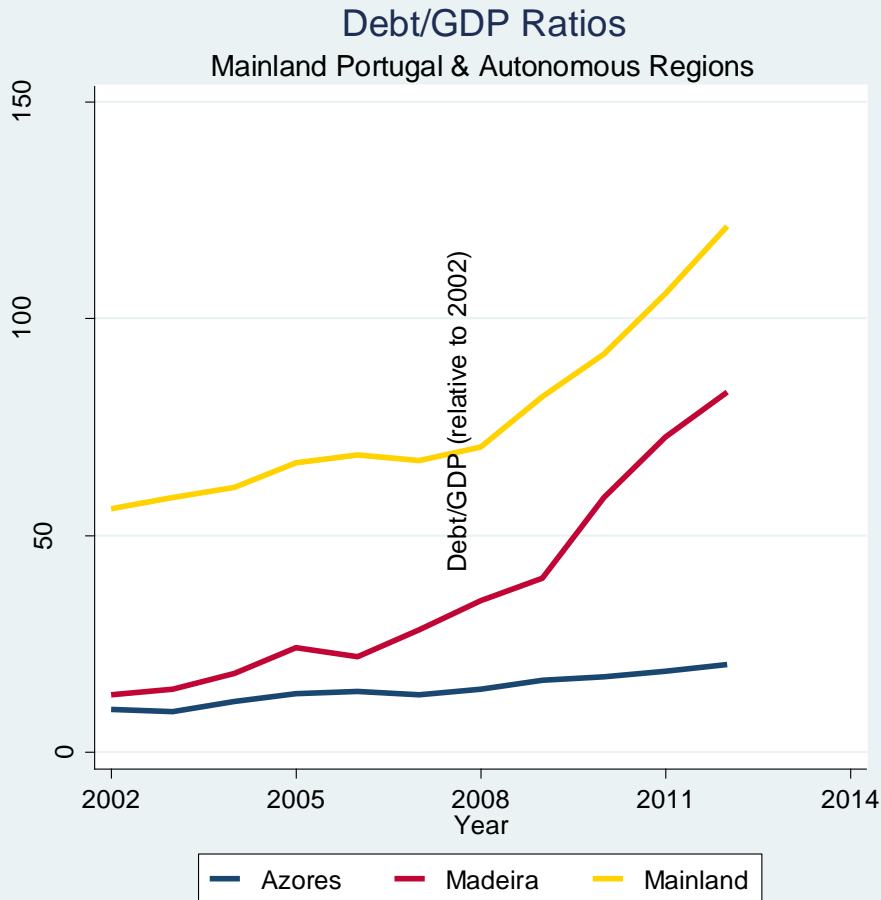
WHAT ABOUT MADEIRA?

Mainland vs. Azores, Madeira: Public debt



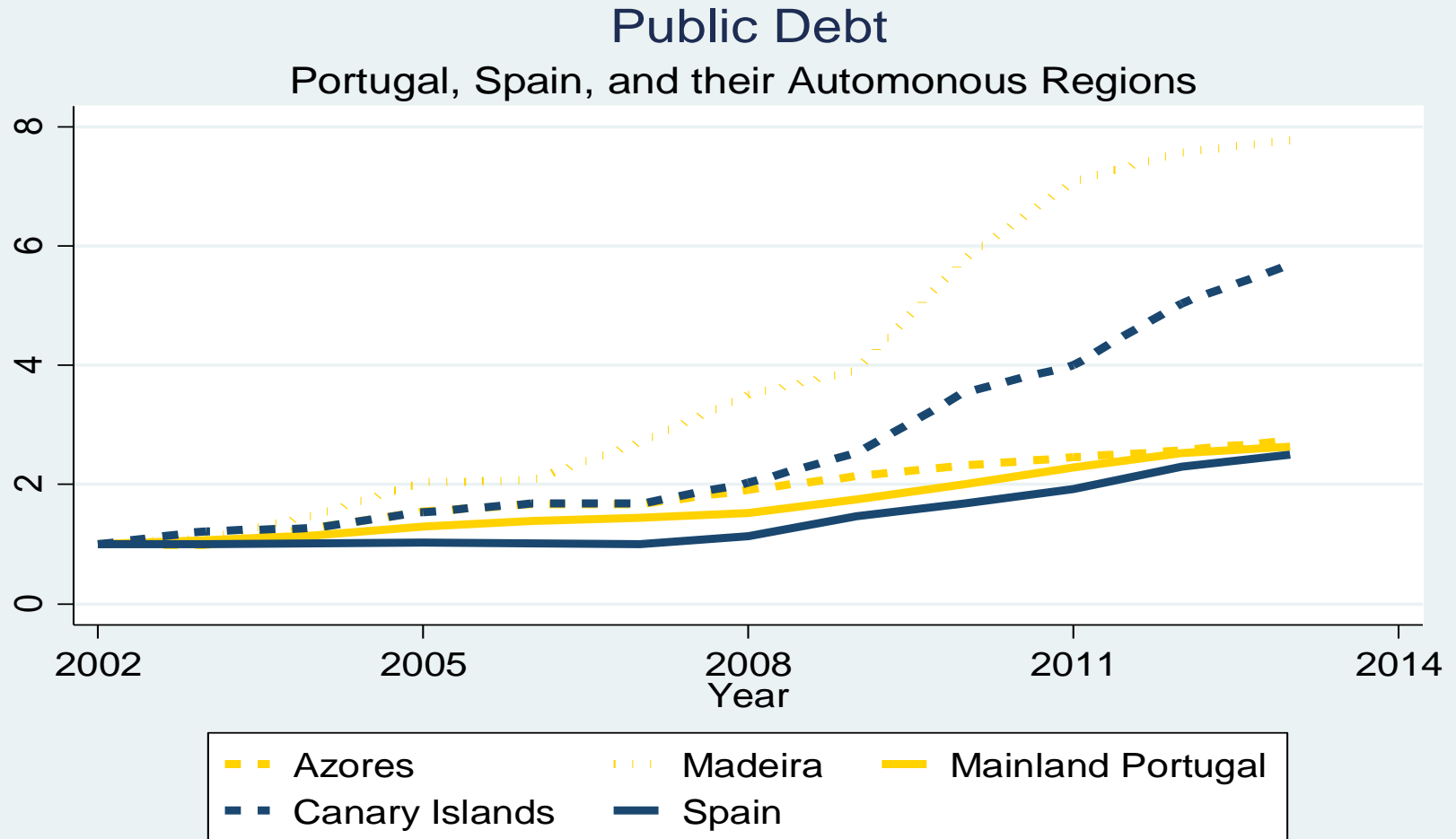
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Mainland vs. Azores, Madeira: Public debt/GDP



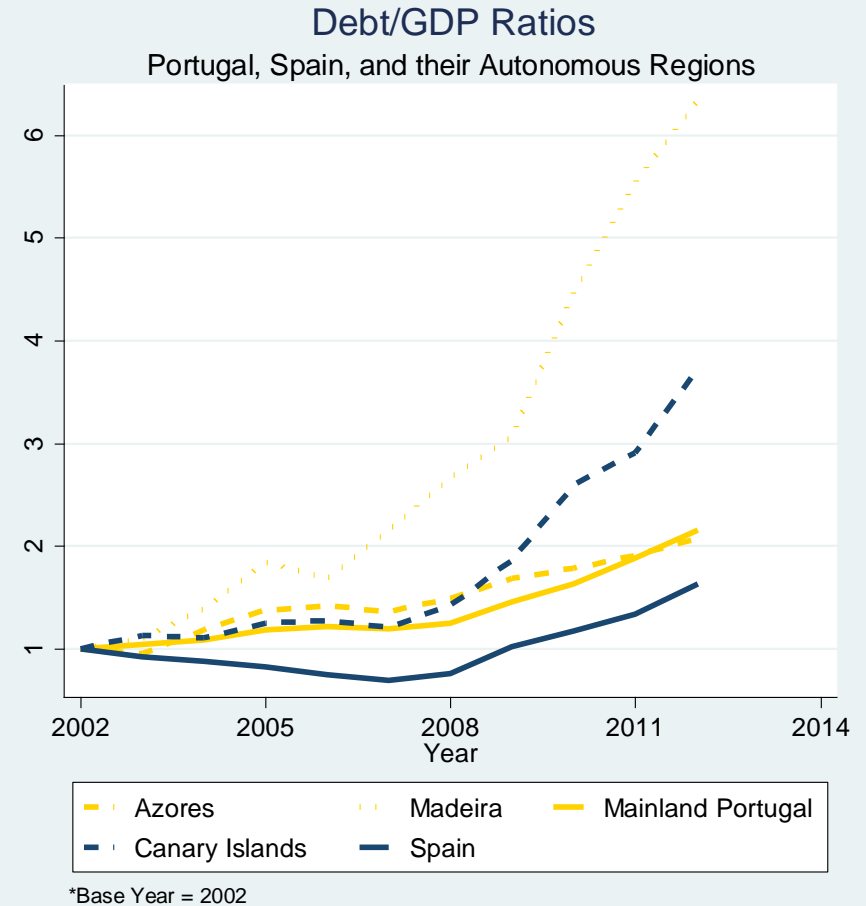
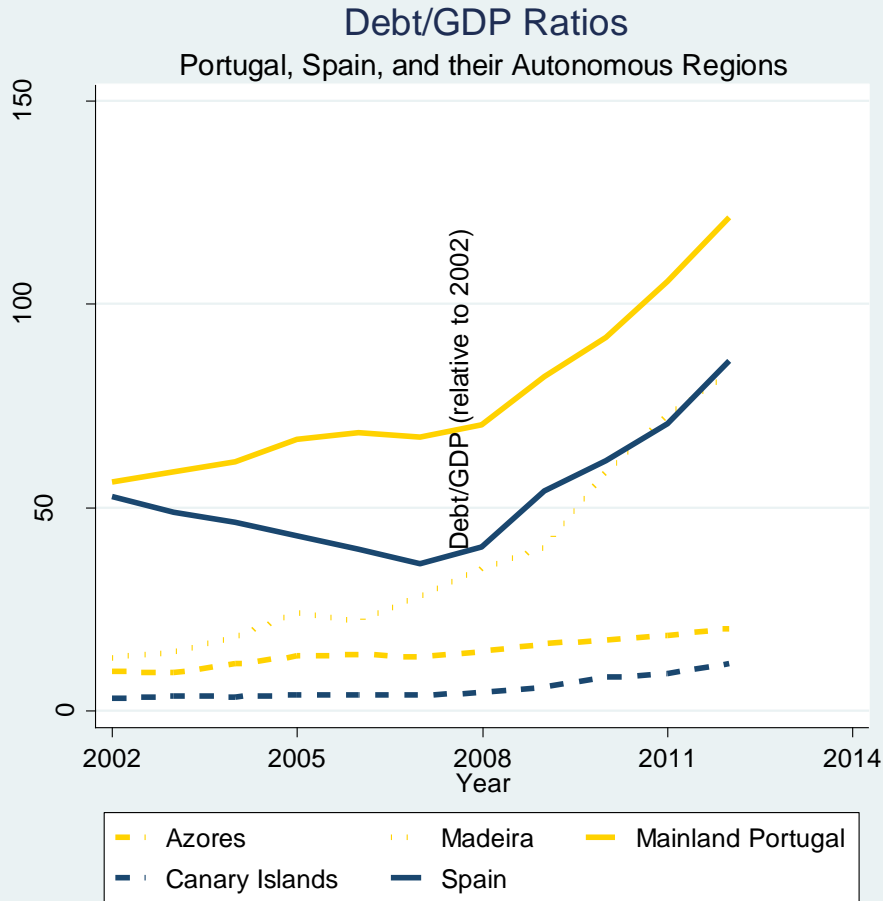
**IS THE PROBLEM UNIQUE TO
PORTUGAL?**

Portugal, Spain and Autonomous regions: Public debt



*Base Year = 2002

Portugal, Spain and Autonomous regions: Debt to GDP



Final remarks

- The history of Portugal in the euro era is a good example of
 - excessive government intervention/presence in the economy
 - interventions that are ill designed
 - how excessive interventions can distract the government from its core mission
- It is also a good example of the costs of excessive government intervention in the economy
- Between 2002 and 2013:
 - Public debt increased by more than 150%
 - GDP increased by less than 20%
 - Employment declined and by 2013 it was 14% lower than the 2002 level
- Portugal was unable to get closer to its euro area peers

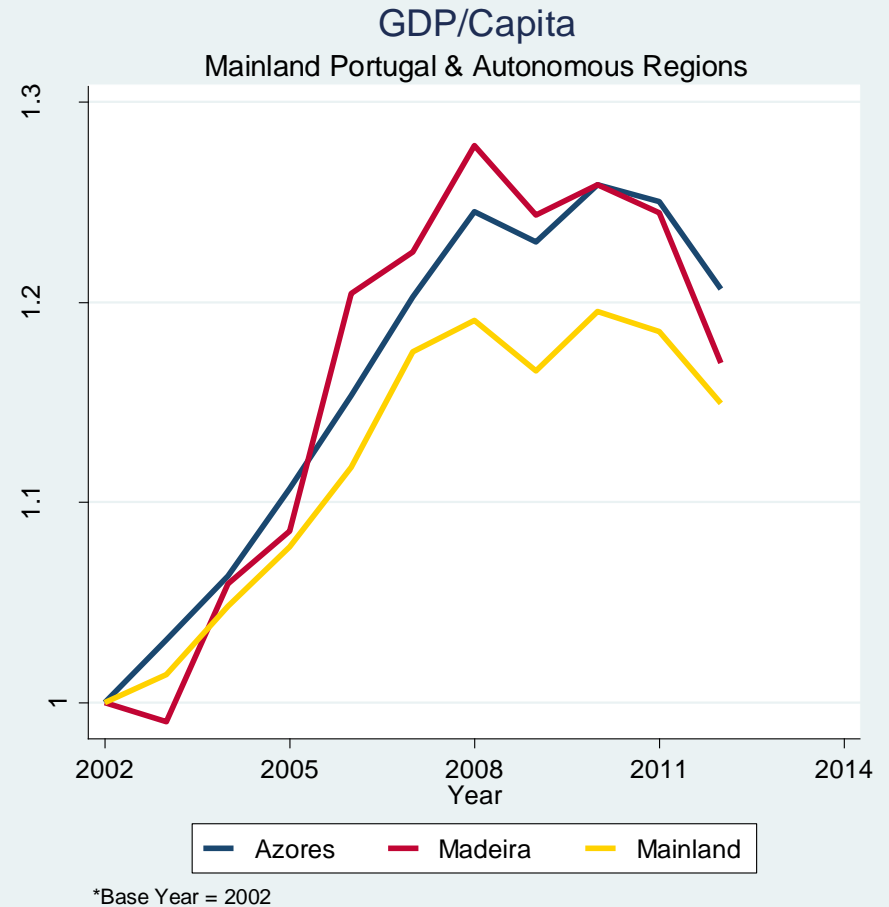
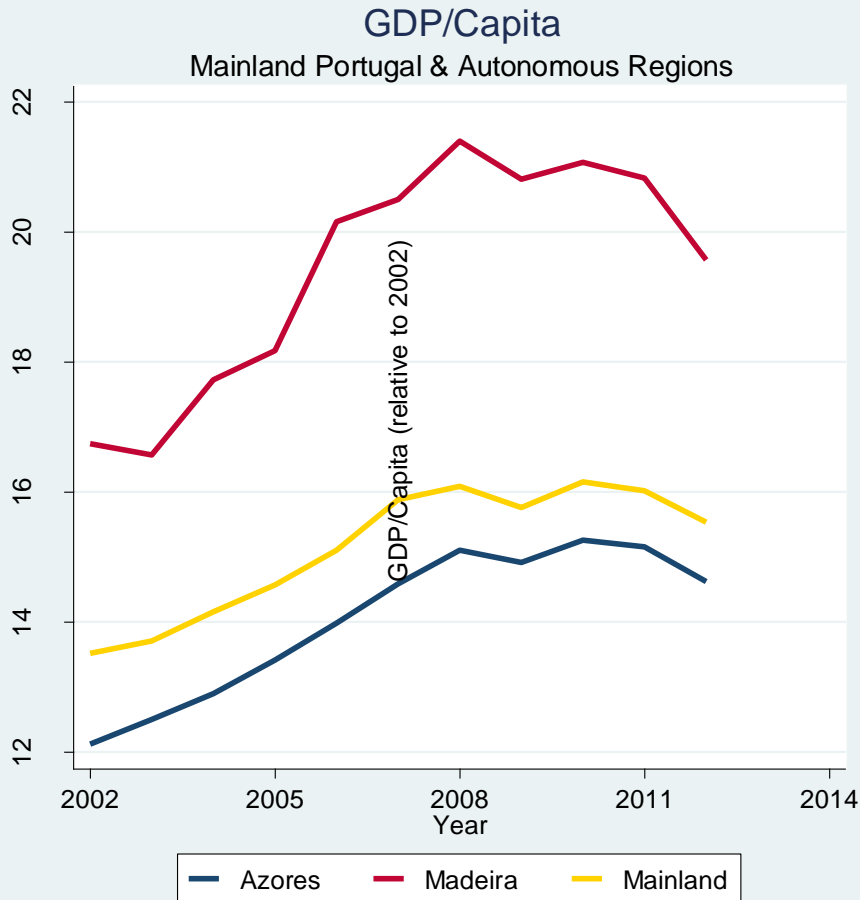
Final remarks, cont.

- Portugal developed a set of problems, of which the high level of public debt, and the associated funding burden, is only the most apparent
- High levels of public debt also lead to
 - Exposure to interest rate risk
 - Exposure to the financial conditions in the sovereign debt market
 - Debt overhang problem
 - Increase in the cost of funding for banks and nonfinancials
 - Pressure to finance the public debt leads to a crowding out effect
- Introduced an endless number of distortions, and dependencies on the government/public sector that will be difficult to revert

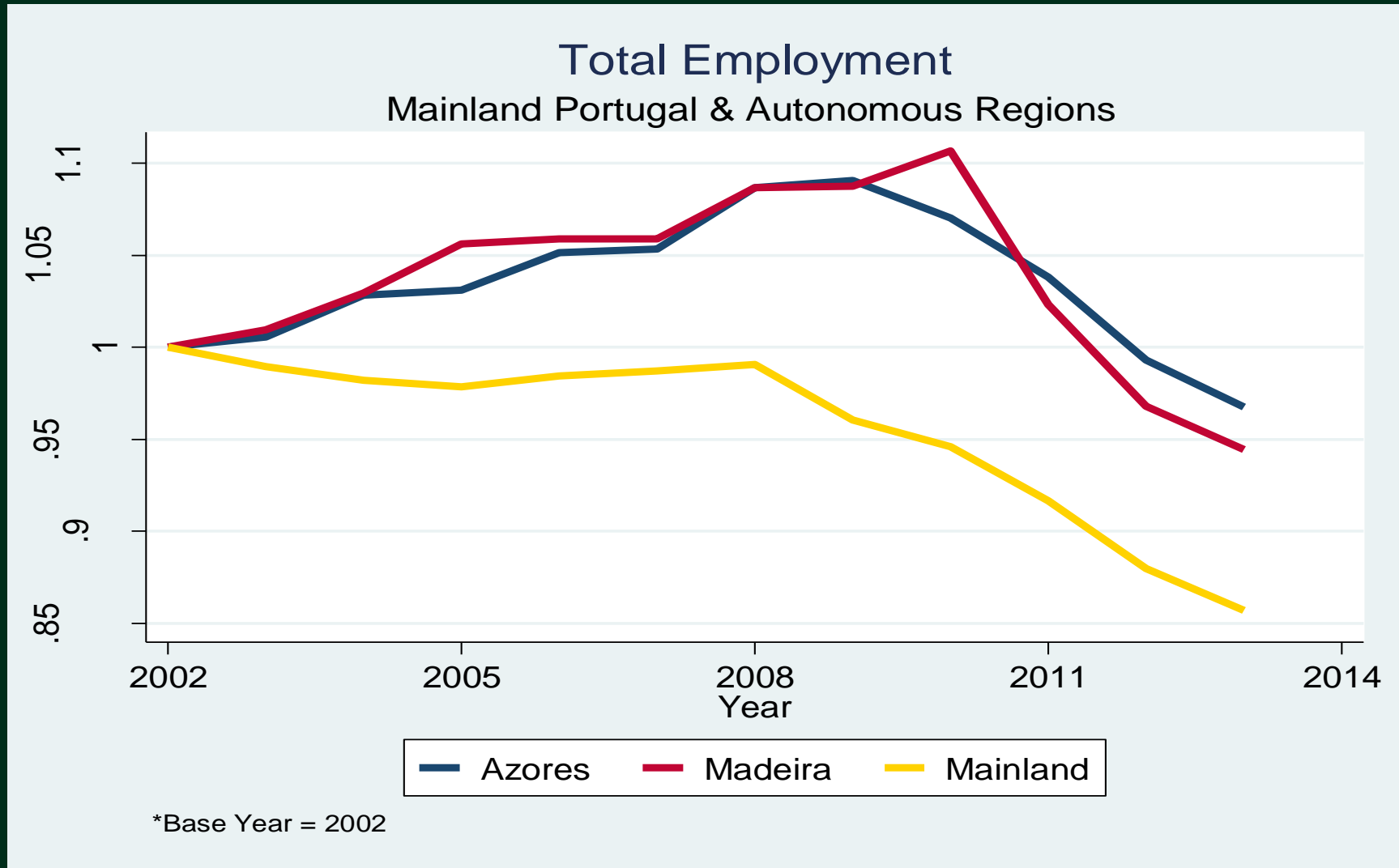
Final remarks, cont.

- Are there limits to the government's role on economic growth?
- Yes, and the recent history of Portugal proves it
- There is room for a role by the government, but
 - The threshold for interventions is far higher than what we have had in Portugal
 - The design/architecture of interventions needs to be of higher “quality”.

Mainland vs. Azores, Madeira GDP per capita



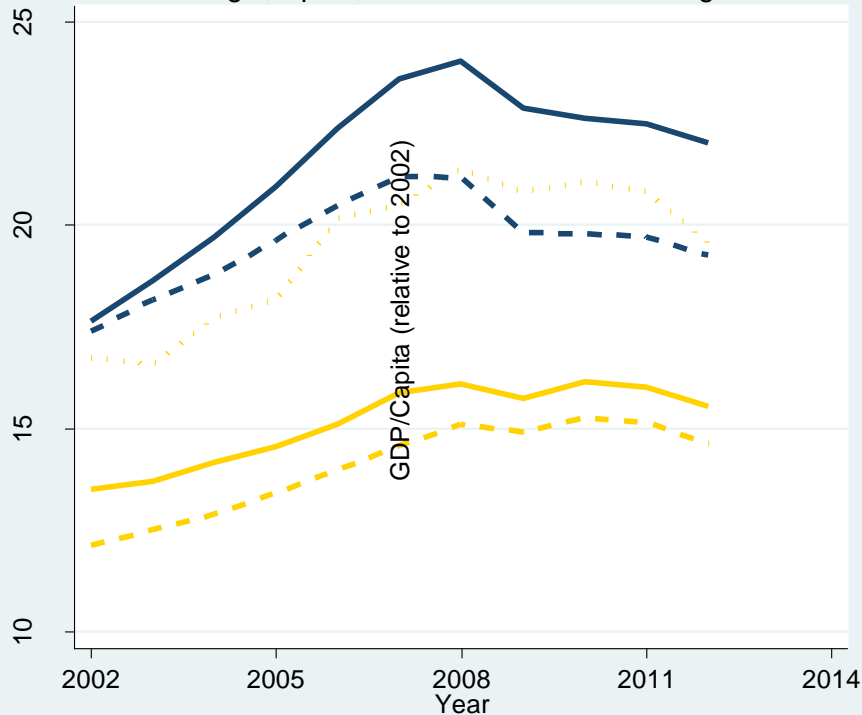
Mainland vs. Azores, Madeira: Employment



Portugal, Spain and Autonomous regions: GDP

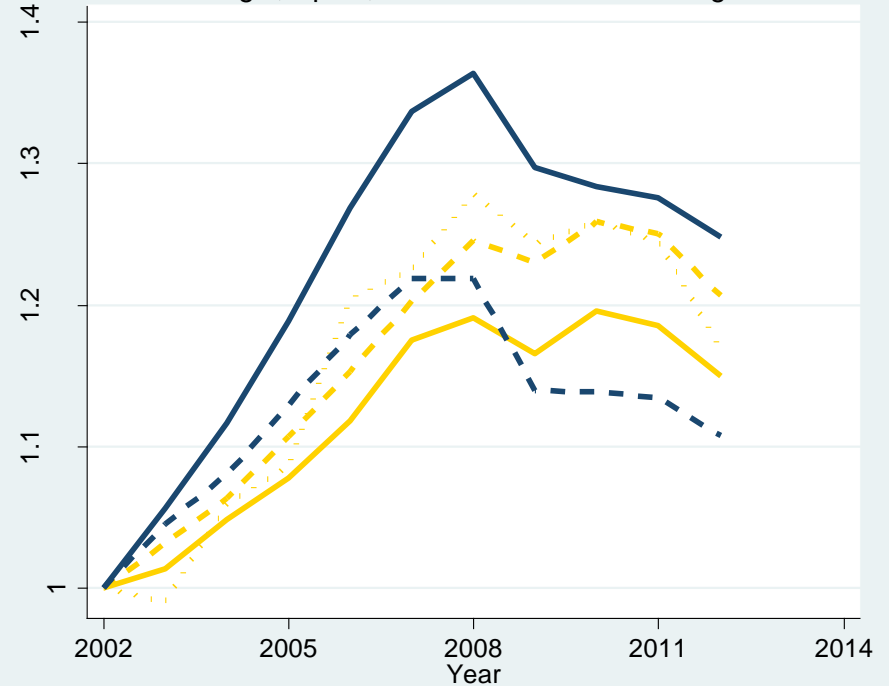
GDP/Capita

Portugal, Spain, and their Autonomous Regions



GDP/Capita

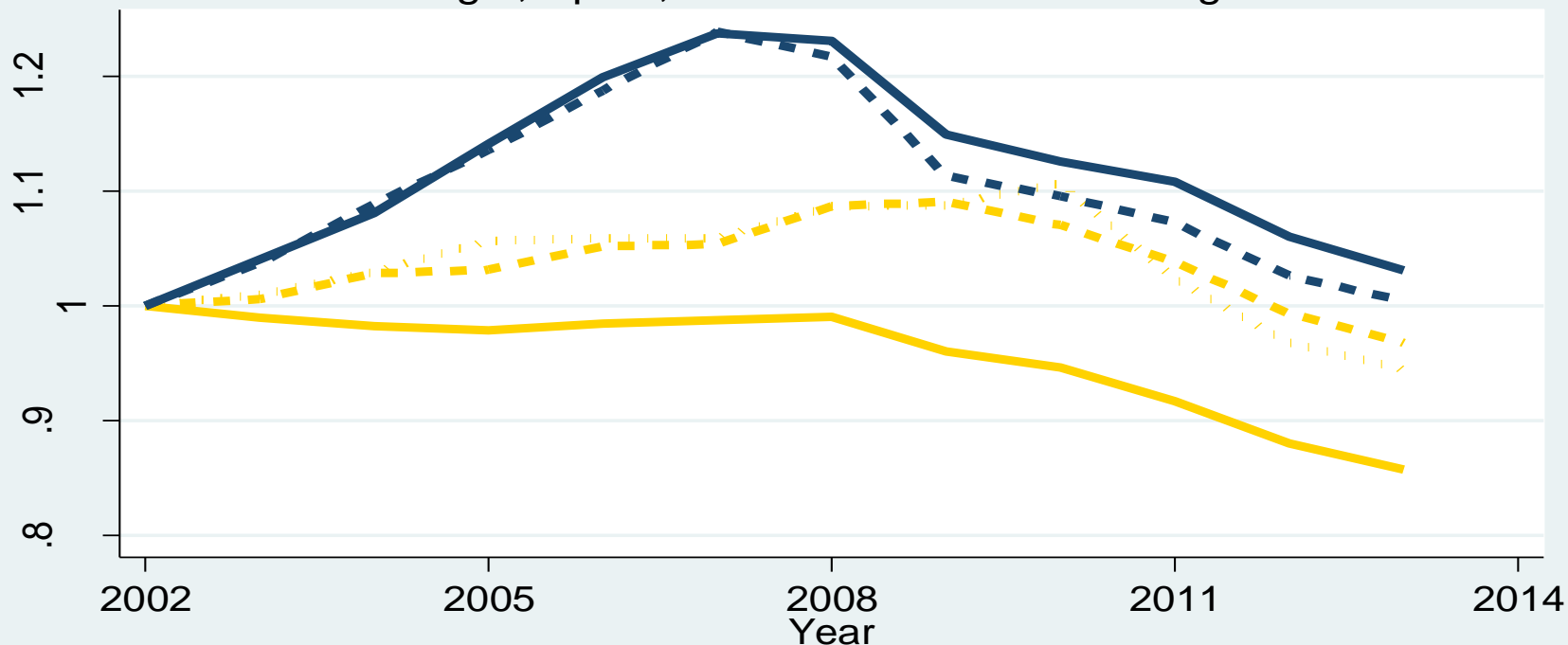
Portugal, Spain, and their Autonomous Regions



*Base Year = 2002

Portugal, Spain and Autonomous regions: Employment

Total Employment
Portugal, Spain, and their Autonomous Regions



*Base Year = 2002