
Book review

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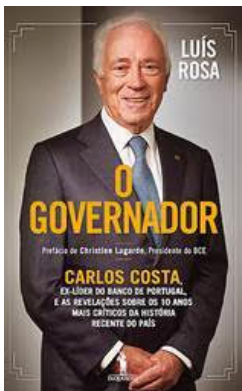
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[Book notes: O Governador, by Luis Rosa Documents Carlos Costa's clashes with Portugal's elite during the eurozone sovereign debt and banking crisis](#)

By Miguel Faria e Castro

Central Banking

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Luis Rosa, O Governador, D.Quixote, November 2022, 372 pages

After a tumultuous decade, the Portuguese economy finally entered a period of stable and rapid growth in 1985, with accession to the European Communities. As advanced economies were experiencing the post-Volcker 'great moderation', Portugal experienced a 'great convergence', making up for its chronic underdevelopment, the legacy of decades under authoritarian dictatorship.

Rapid convergence gave way to stagnant growth in the early to mid-2000s. Economists and policy-makers blamed this slowdown on the rise of unit labour costs, a structural shift towards non-tradable industries and inefficient public spending. These were the issues du jour on the eve of the global financial crisis, which would spread the turmoil in US real-estate markets to European sovereigns over subsequent years.

It is in this context that Carlos Costa became governor of the Central Bank of Portugal (BdP) in 2010, succeeding Vítor Constâncio, who became vice-president of the European Central Bank in Frankfurt. Costa's mandate would span a decade of macro-financial volatility for the Portuguese economy. Luis Rosa's biography, O Governador, offers a compelling narrative of Costa's 2010–20 tenure as governor, a period that spanned three different governments, an external intervention by a troika composed of the International Monetary Fund, the ECB and the European Commission, and two major bank failures that had broad political and economic consequences. The narration is complemented by excerpts of personal interviews conducted by the author with Costa.

The book begins with a description of Costa's pre-BdP years. He arrived at the Rua do Comércio (a metonym for the BdP) as an outsider, as he did not come from the traditional and politically connected Lisbon elite. Rather, he was a technocrat with extensive foreign experience navigating European institutions in Brussels, complemented by experience in the Portuguese banking sector, where his career had been hampered by clashes with the prevailing powers – a sign of things to come.

His political independence and Brussels experience made him a natural choice to succeed Constâncio. Then-prime minister José Sócrates had an ambitious public investment plan aimed at minimising the effects of the financial crisis in the Portuguese economy. The feasibility of such plans for an already fiscally constrained government was contingent on the goodwill of European institutions. Costa had a markedly different attitude to his predecessors: emphasising the BdP's role as a banking supervisor, and keen on creating institutional distance between the supervisor and supervisees. This attitude would ruffle feathers among powerful banking interests, used to a friendly stance from the regulator.

As the crisis spread to European sovereign markets, the Portuguese government effectively lost access to international funding in early 2011. Domestic banks were unable to maintain their purchases of domestic public debt. Costa had to deal with a prime minister in denial. Sócrates found himself unable to pursue his fiscally ambitious strategies, and he stopped communicating with his own finance minister. As a sovereign default becomes a real possibility, Costa helped negotiate external assistance from the troika. But the government's failure to approve a suitable fiscal plan led to new elections, and the ascension of a centre-right government led by prime minister Pedro Passos Coelho.

This new government, eager to fulfil the terms of the external adjustment programme, undertook a series of structural reforms that Costa supported for the most part. A noteworthy exception was the infamous internal devaluation episode, which consisted of raising social security taxes paid by workers and lowering the percentage paid by firms. Costa viewed this as a politically destabilising move that could jeopardise support for the government's adjustment plans and managed to convince then-finance minister Vítor Gaspar (now director of fiscal affairs at the IMF) to abandon the idea.

Rosa dedicates the second half of the book to a detailed account of the aftershocks of the financial crisis in Portugal: the failure of what was then the third-largest and oldest private bank in Portugal, Banco Espírito Santo. It did not take long until Costa's regulatory impetus bothered some of Portugal's most prominent bankers. Chief among these was Ricardo Salgado, head of BES and colloquially known as DDT – *Dono Disto Tudo* ('owner of all this'). A member of the traditional Portuguese elite, Salgado had a multitude of economic interests and was very well-connected politically: he did not hesitate to leverage his political connections to exert pressure over Costa's supervisory efforts.

Starting in 2012, the BdP slowly uncovered extensive fraud perpetrated by Salgado through GES, BES's holding company, and its non-financial affiliates. The main scheme involved covering losses at such affiliates by having BES repackage affiliate debt issuance into its mutual funds, to be sold to retail clients. Losses on these securities were guaranteed by BES in case of default. Increasing regulatory scrutiny at the European level eventually made the BES/GES situation unsustainable. Costa, worried about the financial stability repercussions of the failure of one of the country's largest banks, began a ring-fencing procedure that attempted to insulate BES from further GES contamination.

Finally able to terminate Salgado and his family's control over the bank in 2014, the question then became what to do with BES and how to minimise externalities to the rest of the financial system. There were initial hopes that the bank could be sold to investors, but this became impossible as soon as first-quarter results revealed the extent of the damage to the bank. Liquidation was out of question because of the bank's size. Nationalisation was also precluded by the government, as it would require the injection of public funds at a time when prime minister Coelho presented the conclusion of the adjustment programme as one of its main goals before the 2015 election. The only remaining option was resolution: this was announced at a press conference by Costa on August 3, 2014, and involved the splitting of BES into a 'good bank', to be sold, and a 'bad bank', to be liquidated.

In 2015, Passos Coelho confirmed Costa's appointment as head of the BdP for another five-year term. Later that year, the opposition Socialist party regained power. The incoming prime minister, António Costa (no known relation), resented having to spend his first term with a BdP governor who was chosen by the previous government.

The new prime minister was also not pleased with the internal treatment of Mário Centeno at the BdP. Centeno – the current governor of the BdP – had been passed over for the position of research director, and accused Carlos Costa of having personally vetoed the appointment. Centeno became António Costa's finance minister, which cooled institutional relations between the Treasury and the central bank.

Another episode that caused tension between the two Costas, controversially described in the book, concerns the board of Banco Internacional de Crédito (BIC), the Portuguese affiliate of an Angolan-controlled bank. Among BIC's board members was Isabel dos Santos, daughter of then-Angolan president José Eduardo dos Santos – a noted oligarch, who did not pass 'fit and proper' tests imposed by European banking regulations. Carlos Costa threatened to cease BIC operations in Portugal unless the unfit board members resigned. This triggered a phone call from António Costa himself, who argued that "we should not mistreat the daughter of the president of a friendly country". This communication, which was first revealed in this book, triggered political and media uproar in Portugal, with António Costa threatening to sue Carlos Costa.

For the rest of his mandate, Carlos Costa was subject to intense attacks from political agents. The book goes as far as implying that members of the government tried to trigger a process to fire Carlos Costa from his position as governor: this would have been the first such attempt in the brief history of the Eurosystem. He survived the war of attrition, and finally completed his second term in 2020, and later succeeded by Centeno.

The preface to the book, penned by the current president of the ECB, Christine Lagarde, is titled 'The right man for difficult times', and emphasises the difficulty of real-time economic decision-making. It is easy to evaluate decisions and policies ex-post (after the event), but most decisions have to be designed in real time, ex-ante (before the event). Carlos Costa had to make many such calls, most notably with regard to the BES case, and his actions made him a political target later in his second term. Would those who attack him have acted differently in the same circumstances?

The views expressed herein are those of the author, and do not reflect the views of the Federal Reserve Bank of St Louis or of the Federal Reserve System.