The Consequences of Austerity Policies in Portugal

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- The main characteristics of the Portuguese economy since 2000 are low growth, a rising current account deficit and indebtedness. In the period 2000–2007 Portuguese GDP increased at an annual average rate of 1.4 per cent. The current account deficit, which was 3.5 per cent of GDP in 1995, quickly deteriorated under the EMU to reach 12.5 per cent in 2008

- The shift from fiscal stimulus to austerity took place in March 2010. In April 2011, assistance was requested from the EU and in the same month a Memorandum of Understanding was negotiated with the troika. Austerity and structural adjustment policies were geared towards reducing the government deficit and debt and rebalancing the current account by cutting wages (»internal devaluation«).

- The austerity measures adopted since March 2010 are having a strong recessionary impact. Unemployment rates have climbed to unprecedented heights, reaching 15.6 per cent in the first quarter of 2012. Youth unemployment (15–24) has reached 36.2 per cent. Nominal wages contracted by 3.9 per cent between the third quarter of 2010 and the first quarter of 2012.

- As it is becoming clear that austerity will fail to deliver its promises – the deficit is out of control and the public debt keeps growing – clear signs of what the IMF call »reform fatigue« are discernible. However, this discontent tends to take the form, not of the emergence of a political alternative, but rather of the increasing alienation of the public from what it perceives as a corrupt and dishonest political class.

Implementing Austerity Policies

The shift from fiscal stimulus to austerity, in line with European Council resolutions, took place in Portugal in March 2010 when the so-called Stability and Growth Programme (PEC I) was adopted by the minority government led by the Socialist Party. As yields in the sovereign bond market kept increasing and the financial conditions of banks kept deteriorating, two additional austerity packages followed in May (PEC II) and October 2010 (Budget 2012).

In March 2011, under increasing pressure from national bankers, the financial markets, the ECB and other EU institutions and governments, the Socialist cabinet submitted to the parliament a new package (PEC IV). This programme was rejected by all opposition parties and the government resigned. On 6 April, assistance was requested from the EU by the interim government, and in the same month the Memorandum of Understanding was negotiated with the troika and agreed to by three parties – Socialist (PS), Social-Democrat (PSD) and Popular (CDS-PP) – and announced on 3 May.

On 5 June, elections took place resulting in a new centre-right coalition government (PSD and PP). Having negotiated the Memorandum of Understanding, the Socialist Party still claims (August 2012) to be committed to it while opposing its implementation by the centre-right coalition.

Economic Conditions

The main characteristics of the Portuguese economy since 2000 are low growth, a rising current account deficit and indebtedness.

In the period 2000–2007 Portuguese GDP increased at an annual average rate of 1.4 per cent (0.7 per cent in 2000–2011) (source: Eurostat).

The current account deficit, which was 3.5 per cent of GDP in 1995, quickly deteriorated under the EMU to reach 12.5 per cent in 2008 (source: AMECO). The Net International Investment Position evolved from a comparatively balanced negative position in the mid-1990s (7.7 per cent of GDP in the first quarter of 1996) to 107.5 per cent of GDP by the end of 2010 (source: Bank of Portugal). The private debt which amounted to 88 per cent of GDP in 1996, increased to 249.1 per cent in 2011 (source: Eurostat). The public debt (general government gross debt) increased from 50.4 per cent of GDP in 2000, to 68.3 per cent in 2007, and 107.8 per cent in 2011 (source: Eurostat). Government deficits, which averaged 4.1 per cent of GDP in 2000–2008, increased under the impact of recession to 10.2 per cent in 2009, 9.8 per cent in 2010 and 4.2 per cent in 2011 (7.5 per cent without the transfer of bank pension funds to social security) (source: Eurostat).

The unemployment rate – 4.5 per cent in 2000 – kept increasing throughout the decade to reach 8.5 per cent in 2008 and 15.6 per cent in the first quarter of 2012 (source: Eurostat). The employment rate, one of the highest in Europe (68.4 per cent in 2000), remained stable until 2008 and decreased thereafter to reach 64.2 per cent in 2011 (source: Eurostat).

Income inequalities remained high with regard to the EU average. The share of total income received by the 20 per cent of the population with the highest income was 5.6 in Portugal in 2010, as against 4.9 in the Eurozone (source: Eurostat).

The combined impact of the euro, EU enlargement, cheap manufactured and agricultural goods from non-EU sources and abundant credit led the Portuguese economy to stagnation and indebtedness, making it more vulnerable to external shocks. In the decade of the euro the Portuguese economy diverged from the EU average: GDP per capita (PPP(which amounted to 81 per cent of the EU27 average, decreased to 77 per cent in 2011 (source: Eurostat).

Austerity and »Structural Adjustment«

Austerity and structural adjustment policies inscribed in the Memorandum of Understanding and the austerity packages that preceded it were geared towards reducing the government deficit and debt and rebalancing the current account by cutting wages (»internal devaluation«).

The goal of reducing the government deficit has been pursued since March 2010 with across-the-board tax increases and spending cuts. The main tax increases include: the reduction of tax allowances, increasing all VAT rates (maximum currently 23 per cent), increasing employee contributions to public pension funds and increasing income tax rates. In parallel with this, forms of co-payment were introduced in the National Health Service and the prices of other public services (transport) were increased.

The main spending cuts include: wage cuts in the public administration, cuts in higher pensions, spending cuts in the National Health Service and the Public Education System, the freezing of public investment and the reduction of transfers to public sector firms.

The Memorandum of Understanding included the reduction of rents and transfers to the private sector and the renegotiation of Public-Private Partnerships. However, the results have been meagre so far. Meanwhile an unknown sum, probably 5 billion euros, has been lost in rescuing a small bank and an as yet undetermined amount of the troika loan will be mobilised to recapitalise other ailing banks.

Following an agreement with some social partners – including one minority trade union – unemployment benefits have been curtailed and the labour code has undergone a thorough overhaul, aimed at facilitating dismissals, making the use of labour time flexible, reducing overtime payments and decentralising wage bargaining. The number of national holidays and paid leave days was reduced.

Social security systems have also been reconfigured with obligatory means-testing for the granting of social benefits, benefit cuts and, in some cases, the obligation of beneficiaries to provide unpaid working time for non-profit organisations.

Public investment was heavily cut and EU funds have been channelled to finance part of current expenditure. Gross fixed capital formation (public and private) in 2011 was 30 per cent lower in real terms compared to 2000.

The privatisation programme included in the socialist government's Stability and Growth Programme has been incorporated in the Memorandum of Understanding and extended, and is now being implemented. It includes: the energy sector (Galp Energia, EDP, REN, Hidroeléctrica Cahora Bassa), naval and defence construction (Estaleiros Navais de Viana de Castelo, Edisoft, Eid, Empordef IT), air transport (ANA e TAP), rail (CP Carga e EMEF), finance (BPN e Caixa Seguros), communications (CTT), paper distribution (INAPA), mining (Sociedade Portuguesa de Empreendimentos), media (one of two public channels, LUSA) and water distribution (Águas de Portugal). The concession of part of the Portuguese railway company is also foreseen.

Home rentals have been deregulated. New regulations on land use, with less licensing requirements, have been enacted. Numerous mining concessions are being negotiated with transnational firms.

Justifying the Austerity Policies

The austerity and »structural adjustment« policies were presented to the public by the ruling coalition that came to power in June 2011 as the outcome of »five years of undue public spending« or as the unavoidable consequence of the country »having spent above its means«. The moralistic tone of the government's justifications was reinforced by a legion of TV opinion makers, very often economists who did their best to argue that »there is no alternative«.

The ruling coalition that was elected on promises of »sacrifices for the state, not for citizens«, embarked at the outset with enthusiastic proclamations of its intention to »surpass the troika« in the pace and depth of austerity. Their enthusiasm was clearly motivated by the perception that the Memorandum of Understanding would provide the ideal opportunity for implementing polices that cannot be openly stated and submitted to the voters, namely labour law and privatisation of the National Health Service and the education and pension systems, as well as other public assets.

No ideology was openly evoked in public. Instead, the notion was advanced of austerity as a technical healing process that would have to hurt in order to be effective, and of a social welfare system that had to be rescaled since the present one would no longer be viable due to fiscal constraints and demographic trends.

Specific to the Portuguese case is the notion that Portugal should behave during the adjustment process as the »good pupil« of the troika. Government officials and the legion of TV opinion makers keep insisting that the best strategy is to implement the Memorandum of Understanding with great zeal, avoid voices in the EU critical of the prevailing EU strategy and always to the dominant position in EU debates. It is argued that such a strategy will grant the complacency of the troika in case anything goes wrong during the implementation of the Memorandum of Understanding.

Hitherto, the pro-austerity rhetoric has been aimed at producing public consent and has proved fairly effective. The fact that the Socialist Party insists on supporting the Memorandum of Understanding reinforces this, or at least quiet despair. Recently, however, as the devastating social consequences of austerity are becoming manifest, and as it is becoming clear that austerity will fail to deliver its promises – the deficit is out of control and the public debt keeps growing – clear signs of what the IMF call »reform fatigue« are clearly discernible.

Significant strikes and demonstrations by professionals (doctors, teachers) in defence of public services and professional dignity, and local demonstrations against the closure of public facilities have been gaining momentum all over the country. The discontent of managers, entrepreneurs and especially small businesses dependent on the domestic market is becoming manifest. Tensions within the ruling coalition, together with attempts by the Socialist Party to step up its criticism of the implementation of the Memorandum of Understanding, are cropping up, signalling an increasing loss of legitimacy on the part of austerity policy and structural adjustment policies. While a consensus is emerging that these policies simply do not work, the lack of a clear perspective on what the alternative might be within the Euro area, or of what the consequences of a euro exit might be for Portugal, is precluding a policy shift.

The Driving Forces of Austerity Policy

The austerity turn on the indebted periphery of the Eurozone may be interpreted as a strategy by creditors – banks and other financial institutions – to secure their financial and political positions, combined with the right-wing political intention of precipitating an institutional restructuring of welfare regimes in Southern Europe which could not be obtained by democratic means.

For the internal financial elites the austerity turn came as a »threat and an opportunity«. On the one hand, the presence of the troika may indeed pose a threat to the financial elites, in that the foreign institutions may tend to disregard the entrenched privileges of domestic economic and financial elites and their ties with political elites. A tension between the troika and these elites does exist in respect to the rents of sectors shielded from international competition, public–private partnerships, the preservation of ownership rights during the recapitalisation of banks and the privatisation process. The fact that Chinese, Angolan and Brazilian capital is being mobilised in the privatisation of public assets to the detriment of internal capital is a clear sign of a shift of power within the Portuguese political economy.

On the other hand, the intervention of the troika is perceived both by the financial elites and their political parties as an opportunity to restructure labour relations and the welfare system under extraordinary circumstances.
In sum, the financial elites and the centre-right political forces are trying to make the most of a challenging situation. Most of all they have striven and so far succeeded in shifting the social costs of the adjustment process to workers and small entrepreneurs.

The financial elites, now including Angolan capital, are investing heavily in controlling the media. As a result, the public space is quasi-monopolized by the advocacy of the TINA (there is no alternative) perspective. Opinion-makers, as already mentioned, mostly academic economists, use and abuse prime-time TV.

However, due to the efforts of some academics and open-minded journalists, a slow transformation has recently been taking place involving the appearance of dissenting views in the public space. Formal and informal networks of academic researchers are taking shape expressing alternative perspectives on the economic and political situation, and the media is offering some space for their expression.

The Main Consequences of These Policies So Far

The austerity measures adopted since March 2010 are having a strong recessionary impact. The second quarter of 2012 is now the seventh quarter of GDP contraction. The reduction of real GDP from its peak in 2008 till the end 2012 is estimated by Eurostat to reach 6.5 percentage points. Meanwhile, unemployment rates have climbed to unprecedented heights, reaching 15.6 per cent in the first quarter of 2012. Youth unemployment (15–24) has reached 36.2 per cent (Eurostat). Nominal wages contracted by 3.9 per cent between the third quarter of 2010 and the first quarter of 2012 (Eurostat).

Unsurprisingly, with the retrenchment of domestic demand, the balance of trade has improved. Imports are estimated to decrease 16.6 per cent in 2012 from their level in 2008 and exports to increase by 6.7 per cent (source: Ameco). Export growth (due to growth in non-EU destinations) has, however, been declining recently and is to decline further with the deterioration of the economic situation in Portugal's main trade partner, Spain.

However, the most paradoxical result of austerity is its impact on the government deficit. Since the beginning of 2012 government revenue has been declining (3.6 per cent in the first quarter of 2012 relative to the same quarter in 2011) and government expenditure has also decreased, although less than expected due to the increasing costs of unemployment benefits (2.33 per cent in the first quarter of 2012 relative to the same quarter in 2011) (source: Eurostat). According to most analysts the government deficit target for 2012, stipulated in the Memorandum of Understanding, will not be achieved without further austerity measures.

Traditional public investment in infrastructure has been frozen. The investment and provision of public services in health, education and the judiciary is declining. Health services, schools and courts are being closed, university and science budgets reduced.

Robust updated data on income distribution for Portugal are unavailable. However, it seems clear that the burden of austerity has been falling predominantly on the unemployed (with an increasing number lacking any protection), in particular young people, public sector workers and pensioners.

Good updated data on migration are also not available. However, it is clear that not only immigrant workers are currently leaving Portugal in large numbers, but Portuguese natives, especially better qualified young people, are leaving the country in droves.

The Political Consequences of Austerity

Overall austerity and structural adjustment have not raised the level of resistance and public protest, as most analysts anticipated. However, increasing awareness of the consequences of austerity – unemployment has reached unsustainable levels, the public deficit is out of control and the public debt keeps increasing – is leading to a rapid shift in perceptions. Austerity policies are increasingly seen as futile and useless, besides being cruel.

Despite the fact that the polls reveal declining but still sustained majority support for the ruling coalition parties, combined with a slight recuperation of the Socialist Party and of the political parties on its left, a growing discontent is clearly discernible. However, this discontent tends to take the form, not of the emergence of a political alternative, but rather of the increasing alienation of the public from what it perceives as a corrupt and dishonest political class. The fact that the Socialist Party, the historical political rival of the ruling coalition, remains committed to the Memorandum of Understanding is precluding the political mobilisation of existing discontent and undermining trust in democratic politics.

Although populist or nationalist political forces have been weak in Portugal it is indeed to be feared that austerity is paving the way for an authoritarian turn, as talk of the failure of the democratic constitutional regime is gaining ground in the public sphere.

As alternative strategies to austerity that might boost growth are regarded as dependent on a shift in EU policies, and as such a shift seems increasingly unlikely, other scenarios are starting to be seriously considered, not only by the left wing forces that advanced them, but by broader sections of society. Repudiating the Memorandum of Understanding and suspending debt servicing while the restructuring of the debt is being negotiated is one option. The other is euro exit.

As a »return to the markets« in 2013 will prove to be impossible, the servicing of the public and banking debt will require a second bailout. In this event, hard choices will have to made by democratic forces, including the Socialist Party. Is Portugal in this event to accept the extension of austerity and therefore of recession into an indeterminate future? Is Portugal to accept economic exhaustion and permanent decay, or is it to venture out along an alternative route?

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