# *Portuguese economic growth at the crossroads of the euro and globalization*[1]

**Júlio Mota, Luís Lopes, Margarida Antunes**

## Abstract

Present situation in Portugal, more than revealing the fragility of the budgetary situation, reflects above all the weakness of its industry export potential. This weakness is related not only to the economic policy that has favored non-tradable goods but also to new international trade realities that undermine Portuguese industry. If there is a common idea in all this, it certainly is the global economy model. Portugal joined the EU when the Single Market program was beginning and therefore Portugal started orienting its economic policy into the same direction. What was undoubtedly identified as a major problem hampering the restructuration of the Portuguese industrial sector it was the adoption of policies directed to the reduction and to the stability of prices through currency appreciation, and also the belief that supply side policies would be sufficient for that purpose.

Therefore, the dynamics of the present crisis in Portugal has to be discussed not only in the light of the EU economic and institutional framework, but has also to take in account the impact of the global economy model on the Portuguese economy, an impact already perceived since the late 80s. We will not be able to get some perspective of future economic growth in Portugal without a broad debate about these issues. With this paper we are willing to contribute to that debate.

## Introduction

Along the last ten years Portugal reached relatively low growth rates of the GDP; between 2000 and 2007the average annual rate did not come to 1,5 %. One can explain this evolution as a result from the break in investment that can be evaluated by the reduction of its weight on the GDP and by the policy of budget constraint, statistically more evident from 2005 on. The domestic consumption, in spite of its weak increase, was also responsible for the above-mentioned growth and one has even seen an increase of the household consumption weight on the GDP. This evolution in consumption, associated

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[1] The Research Network Macroeconomics and Macroeconomic Policies
***From crisis to growth? The challenge of imbalances, debt, and limited resources***
Berlin, 28 - 29 October 2011
Júlio Mota (jmota@fe.uc.pt) Faculty of Economics, University of Coimbra, Portugal
Luís Lopes (perlopes@fe.uc.pt) Faculty of Economics and GEMF, University of Coimbra, Portugal
Margarida Antunes (mantunes@fe.uc.pt) Faculty of Economics, University of Coimbra, Portugal

with the home purchase, has had, as a counterpart, the reduction of savings and the increase of family indebtedness, that in 2008 corresponded to about 105 % of the GDP — a situation that also is a consequence of the fact that the labour income did not grow in a way that could make it possible to support this demand.

This uneasiness of the Portuguese economy since 2000 is associated with several reasons, some more distant in time, others more recent. The first one goes through the process of adaptation to the global economy model started in the middle of the 80s in parallel with Portugal´s adhesion to the former EEC in 1986. After this year, the preference was for policies of reduction and stability of prices, through the exchange rate appreciation and the increase of interest rates, as well as supply side policies, simultaneously with the liberalization of the financial sector —all this has generated a bias favourable to the production of non-tradable goods, what made vulnerable the Portuguese productive tissue, in special the export sector. The second reason lies in the political decision of Portugal entering the founding group of the European single currency, a process of monetary integration that led to a reinforcement of the guidelines of previous policies. And, finally, the reconfigurations of the international trade and productive processes at the global scale — intensified in the 90s, mainly after 2000 —which conditioned the international specialization followed by Portugal and confirmed the need for a renewal.

In face of this, in Portugal, the current days show the fragility of its budgetary situation, but also the fragility of the export capacity of its industry. This also shows that the dynamics of the present crisis in Portugal must be discussed not only in the light of economic and institutional framework of the EU, but also considering the effects of the global economy model on the Portuguese economy.

If so, any strategy of economic growth presupposes to identify, in a clear way, the blockades of the so-called real economy, that underlies the present crisis, but also to detect its causes and the respective effects. In this way, indeed there is no chance of glimpsing any growth in the horizon of Portuguese economy, without an enlarged debate on these issues. This paper tries to serve as a contribution towards it.

## 1. Portugal at the crossroads of the euro

### 1.1. The bridge to the euro

In the beginning of the 80s, Portugal presented certain specifics that made it different among the other European countries. Beyond its lower level of development, Portugal was leaving a period of political, economic and social consolidation — after the establishment of the democratic regime in 1974 —, that culminated in two programmes of economic stabilization signed with the IMF (1978 and 1983), what made possible the normalization of the external accounts but produced negative impacts in product, unemployment, real wages and the inflation rate.

In 1986 Portugal adhered to the EEC and started the adaptation process to the global economy model — today often referred as the neoliberal economic model —, since the EEC itself was launching the programme of the European Single Market, a programme that is its first big approach to this same model. It is difficult to make an analysis of the *anti-monde* type and evaluate how all this process would evolve if Portugal did not adhered to the Community. What really is important to point out is that then there was an option at the level of the economic policy towards the redefinition of the State functions — through privatizations that, at start, were concentrated in the financial sector basically but were extended to other areas in a more intensive way in the 90s[2] and commodification of services and the public sector (intensified already since 2000), also through the liberalization of the economy and the financial sector, the change of the labour legislation and the promotion of supply side policies. In this sequence, wages passed exclusively to be conceived and assumed as a production cost and, at the macroeconomic level, a reference instrument of the competitiveness and anti-inflationary policies. In this way, Portugal was taking, at the end of the 80s, the first big leap towards the neoliberal economic model.

To reinforce this process, in 1990, the Government decided that escudo should participate in the European Monetary System (EMS), being effective in 1992, and assumed, as a priority, an anti-inflationary policy through the escudo appreciation and the raise of interest rates, to which also contributed a policy of wage moderation. This political choice, and of economic policy too, meant a clear inversion of stimuli for the export sector, once it had existed (since 1977) a deliberate policy of exchange rate devaluation till that moment, thus generating contradictory signs in the incentives to the productive sector, since that was a period of reception of EU structural funds addressed to the renewal of the productive tissue and the export sector.

Today, for some authors (Silva Lopes, 1996, and Amaral, 2010), this decision indeed limited this renewal and, in a structural manner, created a sloping in the incentives for the sector of non-tradable goods. The results reached in the following years indicated that exactly: fall in the agricultural and industrial production (with a net reduction in the manufacturing industry), moderation in investment, reinforcement of the specialization in the traditional sectors (relatively more intensive in labour) and a relative favouring of the non-tradable goods production. In this period, one must also take into consideration the crisis of the EMS in 1992-93, that also shown the fragility with which the escudo adhered to this system, given the still high difference between the inflation rates — a difference that has not reflected itself sufficiently in the chosen exchange rate parity. Independently of the results attained, what matters to refer is that the Government chose a policy of competitive disinflation, seen as a way of modernizing the Portuguese economy, what by that time meant a change in the macroeconomic regulation. As Lordon says (1997, p. 33): «Instead of weighing on the making of the demand components, the competitive disinflation aims now to assure a general context of stability — of exchange rates, of prices — within a framework in which it is supposed that economic activity will find the best conditions for its spontaneous development… Where the Keynesian regime aimed the expansion, the competitive disinflation has *the stability* as a new imperative».

In the following years of the 90s, after being officially established by the Maastricht Treaty the creation of the single European currency to which Portugal decided to adhere since the beginning, no conditions were also generated for the industrial restructuring, on the contrary. The overvaluation of the escudo was going on, from which resulted a definitive exchange rate of the euro in terms of escudo considered too penalizing for the export sector. This, together with the establishment of the free circulation of capital, the follow-up of the liberalization of the financial sector, the tax incentives, the gradual reduction of the interest rates, the positive economic expectations generated by the single currency, all this created the conditions to go on with the relative favouring to the non-

[2] Among the developed economies, Portugal in the 90s is the country showing the highest income generated by privatizations in GDP percentage.

tradable goods, namely the housing and building sector, to the prejudice of the productive investment in the sector of the tradable goods. It was associated with all this the increasing indebtedness of families and enterprises, what to a great extent explain the degradation of the Portuguese current account, that reached to a deficit of 10,7% of the GDP in 2000, i.e. an increase of 7 p.p. in five years. The resulting demand rise, associated with the cycle of public investments in course by that time, justifies a large part of the economic growth in that period, what aided Portugal to comply with the budgetary criteria for its adhesion to the founding group of the euro zone (in parallel with the interest rate reduction made in the 90s and the privatizations that were intensified to this effect too).

### 1.2. Portugal as a Member state of the euro zone[3]

Portugal begins its integration in the European monetary union already with a macroeconomic imbalance and in full process of competitiveness loss, both situations being not detected by the adopted convergence criteria. Today Portugal belongs to a monetary union that, following the framework of macroeconomic policies designed in the 90s, has the price stability within the whole zone as the priority target and uses the exchange rate, through the euro overvaluation, as one of the instruments. This has been a real economic shock, negative and asymmetric, that has contributed to the follow-up of the relative preference given to the non-tradable goods in Portugal. From 1995 till 2005, the weight of the gross value added (GVA) concerning these goods raised from 62,8%to 65,9%, the housing and building sectors being among the main agents responsible for it; in the same period there was a fall in the level of tradability from 30,3% to 23,8% (Ferreira do Amaral, 2009). One estimates that the escudo/euro appreciation may be responsible for 60% of the competitiveness loss in the export sector — that reached 17,3% between 1991 and 2006 —, the remaining responsibility belonging to factors related to the cost structure (excluding wages), being the evolution of wages neutral in what concerns this aspect. The exchange rate appreciation may explain, according to this, the loss in the market share of the Portuguese industry — a loss that reached 17,7%, between 1998 and 2006, a period in which the dependence on imports of the export sector increased too (the import content reached 56% in 1999).

Beyond all this, since the common monetary policy is concerned about the price stability in the whole euro zone and countries have not their own instruments to manage the national specifics of the evolution in the general price level, there are still discrepancies between the national inflation rates, what has penalized the evolution of the Portuguese real exchange rate within this zone.

This excessive concentration in the price stability to draw macroeconomic policies of the euro zone, in parallel with the conditioning imposed to expansionist and discretionary fiscal policies, had the counterpart of using the labour markets as the way through which the adjustments of economies would be processed. The European Employment Strategy was created by the end of 1997 precisely close to the achievement of the monetary union. Its main target is to render the workers and the labour markets adaptable to the economic changes (article 145 of the Treaty on the Functioning of the European Union) established by the regional and global markets and the resulting guidelines for the employment policies appeal indeed to the flexibility of labour markets and the policies of wage moderation.

[3] In this point one will talk only about the period up to 2007, before the burst of the crisis in 2008.

In Portugal the contractual evolution in the labour market indeed reflects this new context of the labour markets in the economic policy. In fact the relative share of the temporary employment increased in a very intensive manner, passing from 12,4% in 1997 to 22,4% ten years later, the same happening with the share of the involuntary part-time employment in total part-time employment, that passed from 22% in 2000 to about 39% in 2007 — values much higher than the average of the EU 15. This change in the contractual structure reflected itself in the wage conditions in Portugal, since the remunerations of the temporary employment contracts and those in part-time have been respectively about 75% of the other contracts and about 80% of those in full time. This explains that, in many situations, the labour market has not been a safeguard against the poverty conditions. In Portugal (data of 2007), 9% of the workers are in risk of poverty, but this value is higher concerning the workers that, in a year, succeeded in working only a part of it (15%) and is significantly higher for those working in part-time and on self-employment (29%, data of 2006) — a value much higher than the poverty risk for the total population (18%).

In spite of this evolution of the wage conditions, the weight of wages on GDP has not been reduced in a significant way in ten years (1997-2007) — only about 1 p.p., what can be explained by the high increase of wages of the last quintile that caused the worsening of the wage inequalities. In 2006, Portugal presented the third highest value in the whole EU for the *ratio* between the top 10% wage income and the bottom 10%.

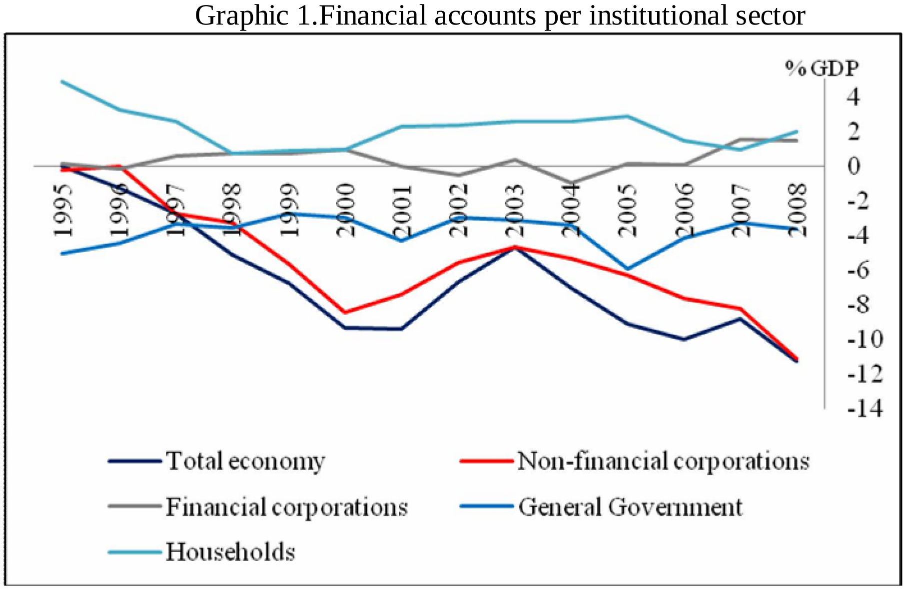
The rise of the contractual instability, the evolution of the wage conditions associated to it and the worsening of wage inequalities have conditioned the capabilities of growth for the domestic demand, all the more since there is not an extraordinary expansion of the family indebtedness in this period, to the contrary to what has happened in Spain and Italy, what is in accordance with the slow-down of the investment in the building sector. And public consumption also presents, since 2000, a rate of change with a decreasing trend, though its weight on GDP may have increased a bit.

Despite of the conditioning put to the external demand and the private and public consumption, the main issue stood at the level of productive investment. Between 2000 and 2007, the weight of this on GDP is reduced in 5 p.p. or 2 p.p., if one does not consider the building sector. Even the public investment itself did not keep away from this kind of movement, since its weight on GDP diminishes 1 p.p. This insufficiency in productive investment has been, according to the Portuguese central bank (Banco de Portugal, 2010, p. 103), one of the determining factors of the weak and decreasing growth of the potential product, detected after the last years of the 90s, what has justified such low growth rates of GDP.

Then the question is to know the main reasons of this blockade in the Portuguese productive investment. Given the leading role of the economic expectations put in the decision of investing and knowing that 77% of the Portuguese companies produce for the domestic market, and considering what has already been said, the evolution of the consumption must be a relevant explanation. It is towards this direction that the Portuguese Investment Survey (Banco de Portugal, 2009, p. 503) points out. In addition, the increase in competitiveness of third producers in domestic market, partly resulting from the euro appreciation, what generated the increase of the contents in imports by the domestic demand, may have also penalized the attractiveness of the domestic market to the investment. The same could have occurred in the export sector, and due to its loss of competitiveness as well as to the reconfiguration and uncertainty of international trade at the global scale (see point 2.). In Portugal, and as a difference from what was going on in most countries of the EU, there has been a reduction of rentability in the productive sector (the share of gross operating surplus in GVA decreased 1,2 p.p. between 2000 and 2007 and this decrease being of 2 p.p., if one considers the values since 1995), what probably is one more conditioning factor of the investment.

In macroeconomic terms, associated with the investment, there is the question of its financing, since this immediately refers to the situation of the external accounts and an eventual dependency on the external savings. In spite of the investment evolution already indicated, there has been a worsening of the financing needs of Portuguese economy, what means a deterioration of the saving rate in the country — something happening from the middle of the 90s on (see graphic 1.). Analysing this by institutional sector, the most impressive fact is the proximity between the evolution of the financing needs of Portugal and the needs of non-financial corporations — representing more than 85% of the total, in average and in that period — that are related to the considerable decline in their saving rate (in 2002 corresponded to 8,7% of GDP and, in 2008, to only 3,4%). It is also worthwhile to point out the situation of the General Government that, though negative along that period of time, presented some improvement in the latest times before the burst of the crisis in 2008. Concerning the households, in spite of the reduction of its saving rate, they can reach a surplus of the financial account, so without contributing, in a direct way, to the dependency on the external saving.

Graphic 1.Financial accounts per institutional sector




Source: Banco de Portugal.

The values here presented concerning the financial account of the country and the different institutional sectors refer to the essential issue of knowing the why of this evolution in the financing needs of the non-financial corporations. A possible justifications passes through their lesser capacity of *ex post* saving, resulting from the break of rentability in the productive sector — what may have been a result of the loss of competitiveness of the Portuguese products in the national and international market, either through the quantity effect or through the functioning of the negative margin effects. Being so, the situation of the non-financial corporations may be seen rather as an endogenous result as to the functioning or to some disfunctioning of the Portuguese economy.

## 2. Portugal at the crossroads of the global economy

### 2.1. China and the reconfiguration of the global economy

Today China is the second-largest economy after having surpassed Germany in 2008 and Japan in 2010, and also is the biggest exporter ahead of Germany. Nowadays it is consensual too that the Chinese currency is undervalued, what has served as one of several tools that explain its international trade rising share. Taking the risk of being completely short-sighted, we cannot ignore that we are looking at a very much open economy, not obeying to the same rules as Western societies do with their democratic roots and following an export-led growth model, based in the attractiveness of the foreign direct investment, much through the relocation of industries[4], and more and more in the acquisition and transference of technology[5], with the participation of the State in enterprises competing with Western companies at the internal and external level — with rules and principles of their own, covered by a large opacity —, in the low direct and indirect wages, in a strongly aggressive policy of internal and external prices, then also based in the exchange rate control[6]. There is another mechanism central to all this that reinforces the policy of low wages and harsh working conditions: the household registration system— the so-called Houkou regime that forces more than one hundred million Chinese workers to a clandestine situation, people coming from the rural regions but becoming clandestine within their own homeland. All these aspects as a whole justify the contradictory classification given to China: a country of low wages but with more and more technological capacity, what enables it to be competitive in the different markets, independently of the development level of the competitors. Indeed it is a model of State capitalism that Stiglitz (2010, pp. 228-29) sums up well, when he writes:

> Low wages ensure high profits, and there is little pressure to distribute the profits. The result is that enterprises (both public and private) retain a large fraction of their income, but changing the distribution of income in any country is difficult.
>
> Some of the apparent corporate profits arise from China's failure to charge appropriately for natural resources (including land). In effect, the corporations were given these assets, which

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[4] It is in this sense one understands the movements of senior executives towards China, the establishments of Western companies in the Hong Kong Stock-Exchange, the alliance between Chinese and European tourism groups (with Chinese elements at the managing direction), and the announcement that banks like HSBC decided to displace their head-offices to this same city, that Smith & Nephew (specialized in medical material) does the same, that Alstom may follow the same path (since they consider that it is in China that the technologies and norms for tomorrow are designed). Thus, directors are leaving today, tomorrow medium-qualified personnel will also leave, and then the unemployed will remain in Europe.

[5] In many cases the question is the transference of high technologies, mainly in the market of equipment goods. As an example, the disloyal contracts with Westinghouse, against AREVA, for the production of nuclear power plants, and with EADS, against Boeing, for the production of planes. In both cases, the winners were the competitors that accepted to transfer their technologies. At a minimum, we may say that several enterprises are competing among them in face of China market and against the organized competition of a whole State, of almost a whole continent.

[6] As Brunet and Guichard (2011, p. 114) refer, quoting Munro and Berstein: «No matter at what level they are applied, all the China's exports distort with China's largest customer, the United States. But even as it subsidizes certain industries, including some that operate at a loss, China is becoming increasingly sophisticated in focusing its subsidies on higher-value-added exports, which are then priced artificially low».

really belong to the people; if, for instance, they auctioned off those resources, the revenues would generate a hefty income. If China captured the return on these assets for all of its people, it would have more revenues to finance health, education, and retirement benefits, and this would reduce some of the need for high household savings.

While this new growth strategy may seem sensible, there are powerful political forces arrayed against it: the large enterprises and their officials, for instance, enjoy the current system, and they hope that it can somehow be made sustainable.

Considering the internal features of the Chinese model, Wang Hui (2003) refers to this as the model of «neo-liberalism with Chinese characteristics» and Rodrick (2011) — in a different manner, perhaps a bit compliant — only look at the external behaviour of China, seeing it as a model of economic and social policy from the times and patterns of Bretton Woods as a counterpoint to Europe and the remaining West that are living under the rules of the hiperglobalization. This means that, for the same markets, the rules are changing according to the countries that participate in them. It is in this context that the exchange rate reaches to a special acuity, but it cannot be seen as an isolated problem, as Americans do[7].

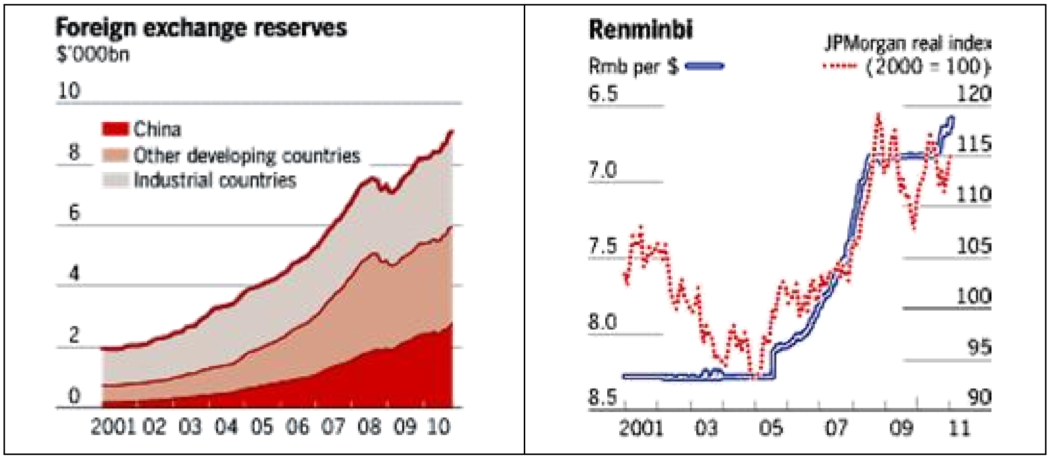
Specially as to the exchange rate policy, the exchange rate control is absolute, the nationals cannot keep foreign currencies, neither in China nor abroad, and the foreigners cannot keep the national currency (the yuan), i.e. the yuan is an inconvertible currency. One understands, therefore, that the exchange rate may represent a true instrument of commercial policy, since this also is a State policy.

The evolution of the foreign exchange reserves (see graphic 2.) of China, as well as the exchange rate of the yuan, either against the dollar or against the whole set of its main economic partners is explanatory. The exchange rate was constant against the dollar between 2001 and 2005, and between 2007 and 2010; and, against its main partners, in 2011 it is at the same level as it was in 2008. The evolution of the two exchange rates, its identical going, shows how the dollar is the fundamental currency in the exchange rate of the yuan[8].

Graphic 2. Evolution of the Chinese foreign exchange reserves and the exchange rate of the yuan (Renminbi)

[7] As Scott (2010, p. 3) points out concerning China, beyond the extremely aggressive exchange rate policy, «other policies by the Chinese government also encourage exports. China extensively suppresses labour rights, which lowers production costs within China. An AFL-CIO study estimated that repression of labor rights by the Chinese government has lowered manufacturing wages of Chinese workers by 47% to 86%. China has also been shown to provide massive direct subsidization of export production in many key industries. Finally, it maintains strict, non-tariff barriers to imports».

[8] The Chinese currency, during a long time, took as a reference the dollar and currently has, as a reference, a set of currencies where the dollar still is the main currency.



Source: Wolf (2011).

This behaviour of China within the sphere of action of the WTO shows that the role granted to this organization is not suitable in face of these trade practices that have had economic and social effects on other countries — known, identified and, in some cases, quantified. For example, Scott (2010, p.1) estimates that the entry of China in the WTO, in 2001, had devastating effects on the American economy: «Between 2001 and 2008, 2.4 million jobs were lost or delocalized, including 91 400 in 2008 alone, despite a dramatic decline in total and bilateral U.S.-China trade deficits that began in the second half of that year».

The yuan exchange rate policy is far from being the only important domain of China's presence in the global economy as we have seen but, in spite of that and in the American case — due to its high trade deficit in relation to China, as well as the effects on the unemployment —, in the end we understand the insistence on the Obama Administration in order to consider China as a manipulator of its exchange rate and to adopt protectionist measures in retaliation. In this sense, some recent declarations (end of September) by senators Harry Reid (according to Reuters) and Debbie Stabenow (according to Stock Market Today) are very clear and their purpose is to present this question to the Congress. «I don't think there's anything more important for a jobs measure than China trade…It hurts our economy. It costs American jobs», Reid calls the attention. «China's exchange rate manipulation directly affects the United States. Effective solution to this problem would be helpful the U.S. job market", Stabenow suggests.

2.2. The evolution of the Portuguese export market share

Portugal as a Member state of the present EU and within the scope of the international division of labour inherent to this global economy model has been caught at a crossfire characterized by the high euro value for its economy, the insertion of the East countries in the EU, the entry of China in the WTO and also by the appearance of other emerging countries — and now with the addition of the sovereign debt crisis, the collective incapacity or the lack of will, or both, of the EU to face it, the austerity policies that are being imposed, beyond the political choice made by the present Portuguese Government to reinforce, in the most dogmatic way, the neoliberal guidelines for the economy.

One of the clearest signs at this crossfire has been given by its process of deindustrialization in parallel with a quick process of tertiarisation, in which the GVA of the manufacturing industry passed from 18% of the total value added in 1995 to 14% in 2008, and there have been a similar evolution in terms of employment.

Another sign is on the loss of competitiveness of their products whose market share has been decreasing, either in the domestic market or in the foreign one. According to a research by Cabral and Esteves (2006), published by the central bank of Portugal, on the market losses share of the Portuguese exports, the total share of exports diminishes 16,2% since 1999 (see table 1.). By countries, it is worth pointing out that, in the case of Germany, this country is responsible for a break superior to 45% and a negative contribution of 11,7 p.p., followed by the United Kingdom, but with a much lesser contribution; on the contrary, there was a substantial share gain in the Spanish market (7,3%). In relation to the different sectors, one must point out the share loss in textiles and clothing (9,9%) and in electrical machinery (7,4%).

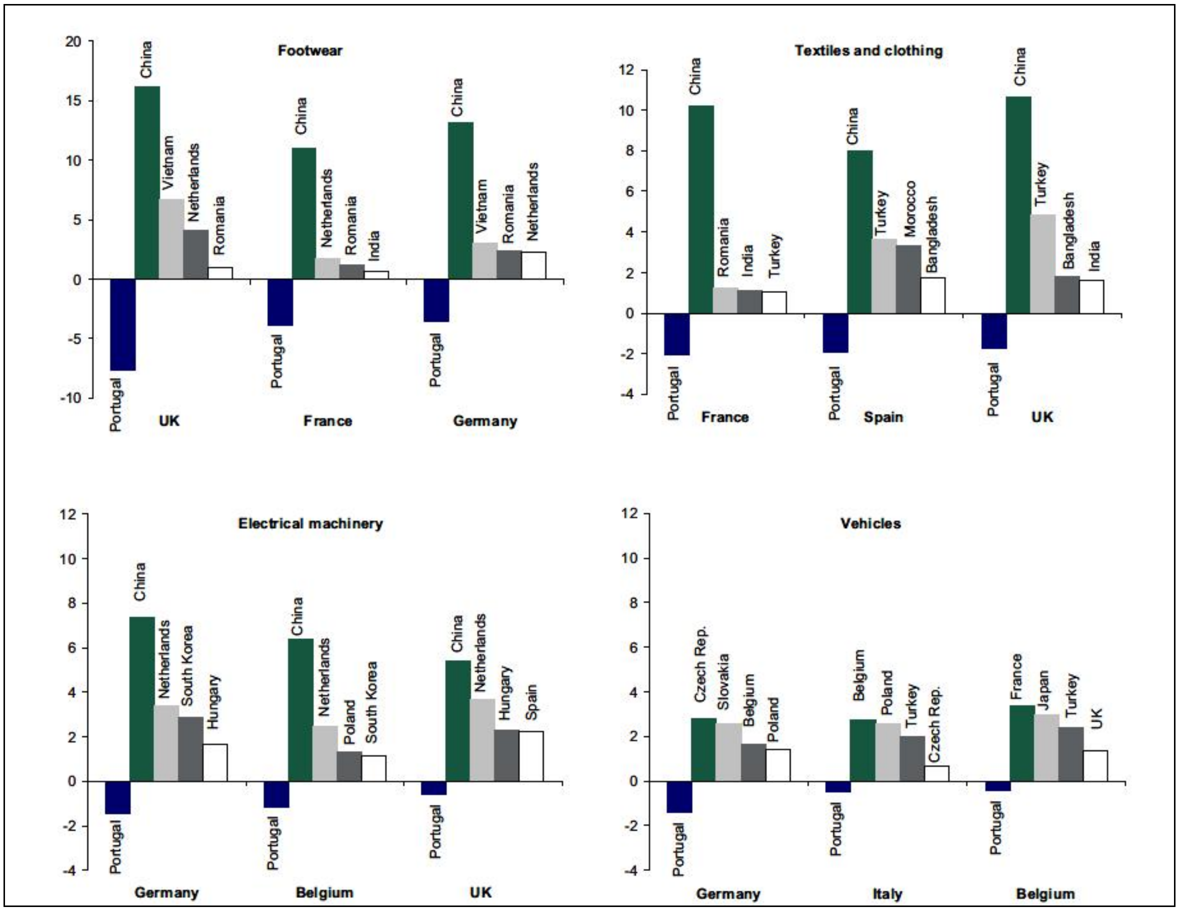
Table 1. Contributions to the total change of Portuguese market share, 2000-2005
(in percentage points)

| | Chemicals | Pharmaceuticals | Plastics | Wood and paper | Cork | Textiles and clothing | Footwear | Metal products | Non-electrical machinery | Electrical machinery | Vehicles | Furniture | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Spain | 0.53 | 0.05 | 1.55 | -0.02 | 0.06 | 0.60 | 0.22 | 2.70 | -0.03 | -0.11 | 1.02 | 0.73 | **7.3** |
| France | 0.03 | -0.01 | 0.13 | -0.06 | -0.19 | -2.65 | -0.52 | 0.04 | 0.34 | -1.04 | 1.77 | 0.67 | **-1.5** |
| Germany | 0.15 | -0.07 | 0.06 | 0.17 | -0.25 | -3.12 | -1.37 | -0.07 | 1.42 | -4.30 | -4.19 | -0.13 | **-11.7** |
| United Kingdom | 0.00 | 0.05 | -0.08 | -0.17 | -0.04 | -2.33 | -1.70 | 0.15 | -0.12 | -1.75 | -0.05 | -0.05 | **-6.1** |
| United States | -0.19 | 0.07 | -0.01 | 0.31 | -0.14 | -0.80 | -0.20 | 0.00 | 0.64 | 0.49 | 0.04 | 0.00 | **0.2** |
| Belgium | 0.29 | 0.10 | 0.00 | 0.03 | -0.02 | -0.13 | -0.03 | 0.00 | -0.26 | -0.97 | -0.49 | -0.01 | **-1.5** |
| Italy | -0.03 | 0.00 | -0.01 | 0.14 | 0.00 | -0.58 | -0.05 | 0.03 | 0.03 | 0.30 | -0.80 | 0.02 | **-1.0** |
| Netherlands | -0.35 | 0.02 | -0.02 | 0.06 | -0.04 | -0.90 | -0.22 | -0.04 | 0.01 | -0.04 | -0.48 | -0.03 | **-2.0** |
| Total | **0.4** | **0.2** | **1.6** | **0.5** | **-0.6** | **-9.9** | **-3.9** | **2.8** | **2.0** | **-7.4** | **-3.2** | **1.2** | **-16.2** |

Source: Cabral and Esteves (2006, p. 63).

This research also reveals that the «greatest winners» of share in the same markets where Portugal lost were some of the most important developing countries in Asia, Central and Eastern Europe. Regarding the Asian economies, the highest share gains in this period were obtained by China and, far away, Vietnam, Bangladesh and India — in three out of four analysed sectors (see graphic 3.) —, as well as Turkey, Romania and Slovakia, these last countries in the automobile industry sector.

Graphic 3. Portuguese export market share losses, 2000-2005
(in percentage points)




Source: Cabral and Esteves (2006, p. 67).

Nevertheless, these numbers hide some positive developments in the export sector. In its structure there has been a reduction in the weight of more traditional industries, an upgrading in the technological contents of the exported goods and a positive evolution in the weight of the intra-sector trade. Within this context, for instance, Portugal — since it has been loosing market share in the footwear industry for China's benefit — tries to go up in the value-added scale and, at the same time, looks for the specialization in machines used in the footwear sector, of which already is an exporter. Notwithstanding, these changes are inserted in a larger picture that shows the adaptation fragilities of Portugal to the framework of the global economy.

It is true that the reduction in the exporting share is not a specifically Portuguese fact. Italy registers a loss even superior to the Portuguese one (see table 2.), it is also worth pointing out the losses of Spain, United Kingdom and Germany, though this one with a lower value. This indicates that, in EU, there has been some anticipation and reaction incapacity as to all these reconfigurations of the international changes, what probably passes through the exchange rate policy, the absence of a selective and active industrial policy and also the acceptation of disloyal trade practices by countries where democracy is hardly present or even absent[9].

[9] In Portugal, the bicycles industry is protected by an anti-dumping tax, created by EU in 1998 — recently renewed, in August 2011, but in a curious manner, since it was by secret vote that it was decided to keep it, in a meeting held by the respective commission. This hints that some hesitation, among European decision-makers and even some external pressure may have occurred.

Table 2. Export market share losses in some countries, 2000-2005

| | 10 markets with higher share losses (average) | |
|---|---|---|
| Portugal´s loss of share (percentage points) | -2.8 | |
| Main economies losing shares in the same markets (percentage points) | Italy | -3.7 |
| | Hong Kong | -1.5 |
| | Japan | -1.2 |
| | United Kingdom | -1.2 |
| | Spain | -1.1 |
| | United States | -0.7 |
| | Thailand | -0.7 |
| | Taiwan | -0.7 |
| | Germany | -0.6 |
| | Indonesia | -0.5 |

Source: Cabral and Esteves (2006, p. 68).

In this context, it is still important to refer to the possible effect of the export market share losses in Portugal. In two among the sectors where more share was lost (textiles, clothing and footwear) there was a loss of 104,6 thousand jobs (in terms of equivalents to full-time employment) from 1995 till 2008, i.e. about one-third of the number of workers existing in those sectors, in the beginning of that period.

## 2.3. Portugal and China in a third market: Spain

In the previous point, we have seen that, according to the research done by Cabral and Esteves (2006), China probably is the country that has won more market share from Portugal between 2000 and 2005. Given the permanent dynamics of the international trade, as a feature of the subsequent period — and this independently of the effects of the economic and financial crisis that burst in 2008 — it is worth still looking at evolution of trade relations that involves these two countries. In this area, it is a timely thing to analyze the Spanish market, here considered as a third market, where the two countries are and can be potential competitors. Let us remind that Spain has been the main trade partner of Portugal, representing 27% of its exports and 31% of its imports in 2010.

Trade between Portugal and China represents a small weight in the whole Portuguese external trade, not surpassing 0,64% of all the Portuguese exports (becoming the 21st biggest customer) and 2,76% of imports in 2010, but already being the eighth biggest supplier. Nevertheless, there has been a significant evolution in the latest years. Between 2006 and 2010, the value of the imports coming from China reached to more than the double (it passed from 0,7 thousand millions of euros to 1,6 thousand millions), giving prominence to the machinery and equipment group, to which belongs the largest part, increasing its weight from 33% to 35% in the same period. It is also important to point out the progress in the textile, clothing and footwear group, which registered a rise from 15,4% to 19,7% in the total of imports[10].

[10] According to Banco de Portugal (2011, p. 17), in 2010, China became the main extra-community supplier of Portugal.

Concerning Portuguese exports to China, these increased only about 10% in the whole period under analysis (its value passed from 213 millions of euros to 235 millions), again with the prominence for the machinery and equipment group (but here because it suffered a considerable loss of weight, passing from 61% to 23%).

In global terms, the trade deficit of Portugal became worse in more than 100% (from 0,6 thousand millions of euros in 2006 passed to 1,3 thousand millions of euros in 2010), the machinery and equipment group (the trade deficit of which almost quadruplicated) being the main responsible for that, in absolute and relative terms.

As to the Spanish market, seen as a third market for Portugal and China, along the period under analysis, the global value of Portuguese exports to Spain went down in 3% (it passed from 10 thousand millions of euros to 9,7 thousand millions), while the value of the Chinese exports to the same country registered a rise of about 11% (from 14,4 thousand millions of euros it went up to 16 thousand millions of euros), and this in spite of the fact that a large part of the same period encompasses the crisis situation affecting Spanish economy and unemployment rate in an intensive manner.

Regarding product groups, it is in the electrical machinery, equipment and material group that the development is more evident — in opposite direction as to the exports of both countries to Spain (China has increased in 669 millions of euros, while Portugal has decreased in 288 millions), what seems to be in accordance to what happened in the previous period. One must also point out the textile and clothing group — in which China increased its share in 10 p.p. (in global terms) between 2000 and 2005, a period of time when Portugal slightly reinforced its share in the Spanish market in that same group. The values nowadays seem to suggest a different situation in relation to the previous period, since Portuguese exports diminished in 59 million of euros and those of China increased in 472 millions. The same happened in the footwear group (Portuguese exports were reduced in 10 million of euros, while China increased its exports in 34 millions).

The values already shown seem to suggest that there has been a change in the position of Portugal and China in the Spanish market (here considered as a third market) concerning certain product groups, though we cannot, in a rigorous way, take the research done by Cabral and Esteves (2006) as a reference since it employs a methodology of their own. This is the case for textiles and footwear, where the rise of the Chinese exports was going together with a decline in the Portuguese exports. And also the values concerning the trade between Portugal and China indicate a quick development of the entry of Chinese products in Portugal, even in considerably low values, and this for machinery and equipment as well as for textiles, clothing and footwear — products already distinguished in the Spanish market. On their side, Portuguese exports to China, even rising, increased twenty times less (in percentage points) than the Chinese exports to Portugal.

In this way, the values here shown suggest that Portugal may have been, and still is, penalized on account of China's presence, either in the case of the Spanish market and probably other third markets, where Portuguese exports compete against Chinese exports, as well as in its own domestic market — where Chinese imports compete against domestic producers directly. If one considers too that those sectors are relatively intensive in labour, one understands we are in presence of a real and potential focus for the job destruction in Portugal. And all this is happening because Portugal has a productive structure with goods that are sensitive to price changes, sensitive to the values of the price elasticity of demand. Therefore it is possible to understand that Portuguese economy may be liable to a strong competition from China, either at the internal level or at the external one, on account of low prices.

To this competition it will not be irrelevant the policy of a weak yuan decided by China, to which the euro zone connivance is contributing on allowing that the euro may keep high levels, either against the yuan or the dollar. These policy decisions reinforce the fragility of the Portuguese productive structure in the face of the external competition based on the minimization of prices.

This exchange rate and trade policy of China, like the similar policies of the euro zone, has asymmetric effects on the zone. As long as, in some countries (as it happens in Portugal), the euro-yuan exchange rate harms its export sector but also the producers who sell to the domestic market, the situation is different in other countries (Germany is the more emblematic case): the same exchange rate does not penalize the final product of the export sector, and even benefits this one by the cost reduction of imported components (coming from German relocation of enterprises or from enterprises under German outsourcing) but benefits also the domestic producers that have the internal market as a target. To confirm this, the German minister of Economy, Rainer Brüderle, who publicly sustained (according to AFP, 2010) that the issue of a cheap yuan and an expensive euro is not very relevant for Germany, because its products are less sensitive to prices than products of other countries. Beyond this, a strong euro has been fundamental in order to enable Germany to implement a policy of competitive disinflation and to create a space for the Hartz IV laws of deregulation in the labour markets and the policy of wage moderation, even some times accompanied by margin effects as a way of improving profits. With this, Germany today becomes the nation of Colbert not the nation of List, becomes also the China of Europe, as Chevènement and many others put it.

In conclusion, in the trade nets connecting Portugal and China, mainly in the European market, the policies concerning the euro-yuan exchange rate and the trade liberalization are the fundamental elements in the competitiveness of the Portuguese products. To this, one can add the fact that China has been taking a good position as a country with high technological capacity, beyond being a country of low wages too.

## 3. Portugal at the crossroads of these days [11]

### 3.1. From the 2008 crisis to the financial assistance programme

Portugal reached the moment when the economic and financial crisis burst in 2008 in a certain situation that was revealing the fragilities of the productive sector that have conditioned the Portuguese economic growth. Despite this, in 2009, Portugal was one of the euro zone countries with a lesser fall in GDP (2,7%), probably due to the anti-cyclical policies launched by the Government — actions corresponding to 1,25% of GDP and 0,8% of GDP in terms of public expenditure in 2009.

As a result from the GDP reduction in 2009, the functioning of the automatic stabilisers, the anticrisis and support measures for the financial sector, the public deficit-to-GDP *ratio*raised to 9,4% (afterwards corrected to 10,1%, due to subsequent methodological changes) — with a deterioration of 6,5 p.p. of the GDP (including 4,5 p.p., an oscillation

[11] In this paper, the problematic related to financial markets is out of our scope.

justified by the economic contracting effects and the anticrisis measures). The public debt-to-GDP *ratio*also raised in 11,4 p.p., from 71,6% to 83%.

In March 2010, the Government presented, to the European Commission, the *Stability and Growth Program 2010-2013*, where expressed its purpose of reducing the *ratio* under 3%, establishing a *ratio* of 8,3% for 2010. According to the suggested measures, the main contributions for the reduction of public expenditure were focused on the public sector wages, social protection and also on the postponement of a few huge public investments. On the side of tax revenues, one has reduced certain tax allowances connected with family expenditure in the health and education areas and has created anadditional tax bracket for personal income tax with a marginal rate of 45% that reaches to a tiny slice of family income.

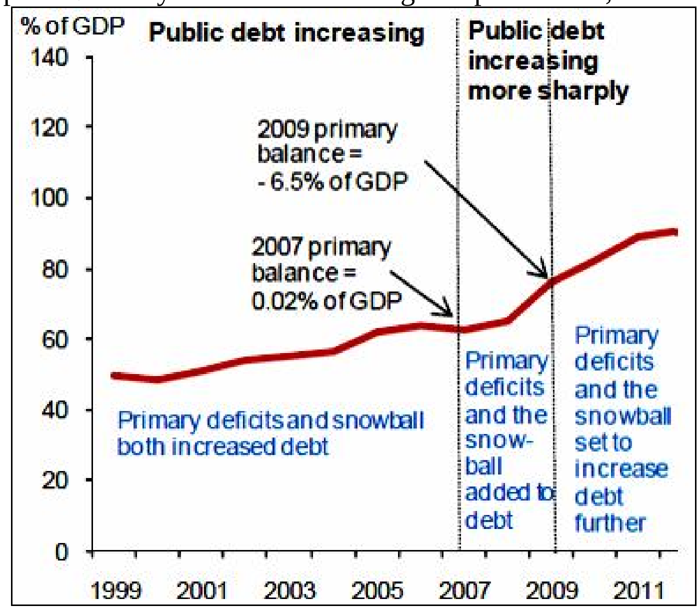
In the middle of the following April, this *Program* was approved by the European Commission, though they had warned to the possibility of those measures being not sufficient, due to the relatively optimistic economic foresights, and only for this reason. Following the meeting at the European Union Economic and Financial Affairs Council (9/10 May, 2010), the *Program* was revised and, as a target, established a *ratio* of 7,3% for the same year, 1 p.p. less than in the original version. This implied a series of measures: regarding to the public revenues, one decided to increase the VAT, to create an additional taxation of 1% or 1,5% on the personal income, according to the income levels, and a surtax on the enterprise income to be applied to the highest profits. Concerning expenditure, among others it is to be pointed out a 5% reduction on the remunerations of managerial and political positions, as well as forestalling of the elimination of stimulus measures to the economy and to job creation as a reaction to the crisis, whose continuation until the end of 2010 had been announced by the Government in November 2009. And then the argument was the same one coming from other European capitals: technically, the recession was over.

As this kind of pressure was going on, the continuous rise of the interest rate of government bonds in the secondary market was leading to additional measures in the same direction at the end of September, when the guidelines for the State Budget for 2011 became known, and this meaning once again more constraint in public expenditure and reinforcement of the tax revenue. As to the first, concerning Public Administration, it must be pointed out the 5% reduction in remunerations and freezing of new hires and promotions and career upgrades. It also worth to refer the freezing in retirement pension and the expenditure reduction with certain social benefits and health care. As to the second, one must call the attention to the revision of tax benefits for families and enterprises, a new rise of the normal VAT (more 2 p.p.) and an increase of 1 p.p. in the contributions to the pension systemof Public Administration.

In the following months, the Eurogroup was supporting the austerity measures already launched and, at the same time, appealing to reforms in the product and labour markets, without explaining the reasons for this connection. Despite all these measures, the public deficit was 9,1% of the GDP at the end of 2010, a value to which there also was the contribution of some methodological changes enlarging it, and the public debt-to-GDP *ratio*continued to increase—at the end of the year was at 92,9%.

In this manner, if till 2007 Portugal was suffering an increase of the public debt-to-GDP *ratio*, partly justified by the low rates of growth, staying just a bit above 60% and within the euro zone average in that same year, it is true that the budgetary situation became worse in a clear way, with the crisis explosion in 2008, and even worse with the irruption of the sovereign debt crisis, what caused the rise of interest rates and the snowball effect (see graphic 4.).

Graphic 4. The dynamics of the Portuguese public debt, 1999-2011




Source: Llewellyn and Westaway (2011, p. 49).

In March 2011, within the scope of the new European semester, the Portuguese government presents, to the European institutions, its *Stability and Growth Program 2011-2014*with new austerity measures, without having previously made it known to the national leading political authorities and parties represented at the Parliament. This fact launched a political crisis resulting from the rejection of the same document by the Portuguese Republic Assembly and the Prime Minister's subsequent resignation. Still on duty, in the beginning of April, José Sócrates addresses to the European Commission a request for international financial assistance that culminated in the writing of a «*Memorandum of understanding on specific economic policy conditionality*». As it was referred to at once in a statement by the Eurogroup and ECOFIN, the rejected *Stability and Growth Program* would be the starting point and the essential pillars expressed there show that, beyond a financial assistance programme, what is also at stake is a reinforcement of the neoliberal guidelines in the economic policy in Portugal. As a matter of fact, beyond the «fiscal sustainability», one appeals to reforms that «can remove the rigidity» in product and labour markets and to an «ambitious privatisation programme».

This is the clear guidance of the final document, what in this field makes it different from the *Stability and Growth Program* presented in March. Beyond the measures for the strong constraint of public expenditures directly aiming to the family incomes and pensions, the social benefits, the health and education sectors, and the policies of increasing government revenue by means of increasing taxation (on consumption and incomes), moderating fees in health and public transport prices, the political guidance and the guidelines for the economic policies are identified in a clear way. Thus, it is established: 1) the reduction of the weight of the State in the economy, by accelerating the privatization programme, the reduction and extinction of public services, the decrease of employment in

Public Administration, the permanent cutting in public investments and the minimization and recycling[12] of the «welfare state» presence at the level of social benefits, health care and education; 2) within the scope of labour market, the reinforcement of the activation principle in the unemployment insurance system to the detriment of the conception of this one as the right to a replacement income for someone that lost a job, the reformulation of the concept of individual dismissal aiming to make it easier and the reduction of severance payments concerning labour contracts in force, according to what has already been decided for new hires; 3) in the markets of goods and services, the total liberalization of the electricity and natural gas markets and the competition increase in postal services, telecommunication and transportation services; 4) a generalized decrease of employer's social security contribution, understood as a «fiscal devaluation» and a means of improving competitiveness[13].

The current Government — invested in June and supported by a coalition of two parties that had rejected the *Stability and Growth Program* in March — has adopted austerity measures that are more exigent than those prescribed in the «*Memorandum of understanding*». In this way, they have already created an extraordinary personal income tax surcharge of 3,5% on taxable income (mainly labour and pension incomes) of 2011, what is equivalent to 50% of the Christmas bonus beyond the minimum wage, in practice without affecting the capital gains or profits, even those got by big companies, and increased VAT for electricity and natural gas in 17 p.p., to be applied already this year. *Fiscal Strategy Document 2011-2015*, recently published (August) takes a step forward with the creation of an additional and temporary «solidarity tax» on the corporate income tax of companies with the highest taxable profits (3%) and on the personal income tax of individuals who are in the highest income tax categories (2,5%). This Government also wants «to go beyond» the «*Memorandum*» as to the State role and is betting on a «structural transformation of the State», i.e. on a «reduction of the weight of the State to the limit of the country's financial possibilities and with a view to generating a better State» (Ministry of Finance, 2011, pp.7 and 36). This intention goes through a programme of privatizations more intensive than that designed by the European institutions and the IMF with the purpose of decreasing the weight of the State in the economy, not only (as it will be shown here ahead) by a more substantial reduction of central government services and managerial positions but also by structural changes in the conception of the unemployment insurance system (that may even be subject to the means-testing procedures), on account of a more and more assistentialist vision about social benefits and also due to the fragilization of the National Health Service.

With the measures that have been taken, one sees an intention to devalue the State presence being already visible also the quality decreasing of certain public services included in the area of social support (an increase in the number of babies per room at nursery), in education (an increase in the number of pupils per each classroom at schools), in health care (cuts in the funds granted to public hospitals and reduction in the

[12]Donzelot (2008), author of this kind of analysis, sustains that this change in the causes of the social problems is inscribed in the assumption that globalization generates vulnerabilities in populations and thus there is a need for inclusion policies addressed to the excluded either to preserve the social cohesion that may assure the competition — since this becomes as stronger as less are the excluded — or to attract its own victims to this logic.

[13]According to State Budget for 2012, known last week (October 13), this measure has already been abandoned. Instead, the Government allows the working time per day to increase in half an hour without extra pay in private sector. This is a clearly example of the inconsistency of some proposals of the «*Memorandum*».

medicaments co-payment). The effects will be probably more visible in future, since an important slice of the public expenditure reduction foreseen for 2011-2015 falls upon health, education and social security.

Now looking at the macroeconomic picture already designed, what immediately catches our attention is the downward revision of GDP growth rate. From the *Stability and Growth Program* made public in March to the *Document* presented now (basically encompassing the policies already inscribed in the «*Memorandum*») that same rate changed from (–0,9%) to (–2,2%) in 2011, becoming worse in 2012 (decreasing from 0,3% to (–1,8%)) and (strangely) staying in higher values in the following years (till 2014). The unemployment rate has also been subjected to a correction, with a foresight of higher values every year, all of them reaching around 13%. Another aspect to be pointed out is the results from a reading of the evolution in the main macroeconomic indicators in the period under exam (2011-2015). Beyond the permanent reduction in public consumption at an annual average rate of 3,4%, what seems to be evident is the intention of promoting growth through exports. The weight of these on GDP will pass from 31% in 2010 to 40,1% in 2015, reaching an annual average growth of about 6,8% along this period.

These values are quite questionable, not only due to conjuncture issues as the economic situation of the main trade partner and the prospects for the world economy as a whole, to the impossibility for Portugal to use the exchange rate instrument, but also to the domestic economic conditions that have been favourable to the sector of non-tradable goods, along two decades, to the difficulties that Portugal has made visible or has been forced to suffer to be inserted into this global economy. And even the investment foresights, presenting negative rates of change of 10,6% in 2011 and 5,6% in 2012— and this following a decade with negative rate of change in many years too — are not in accordance with the foreseen evolution of exports. It seems also questionable the evolution of imports that show negative rate of change till 2012 and positive but relatively low in the following years — this though one knows that the contents of imports per exported unit is considerably high (about 55%). In front of all this, and also knowing that the rates of change in private consumption are negative or, though positive, around zero (the weight of private consumption on GDP passes from 64,7% in 2010 to 59,18% in 2015), above all one must question the GDP foresighted growth rates for 2013 (1,3%) and in the following years (2,5% and 2,2% respectively).

As a counterpoint to this picture, João Ferreira do Amaral — one of the leading Portuguese economists — rather speaks about a dangerous scenario close to the collapse of Portuguese economy[14].

[14] After "finishing" this paper, the State Budget for 2012 was known. There is something to be firstly remarked: the reduction of the remunerations in the Public Administration and State Entrepreneurial Sector in 2,7 thousand million of euros, i.e. four times superior to what is imposed by the «*Memorandum of understanding*».The Government to achieve this established a new heavy package of additional austerity measures: 1) a suspension, in 2012 and 2013, of two month wages of each civil servant and of each worker of the State Entrepreneurial Sector earning per month more than 1000 euros and one month wage for whom is earning between 485 euros and 1000 euros. The same is applied to the equivalent retirement pensions; 2) the continuity of the 5% reduction in remunerations to the same workers; 3) a compulsory reduction of 2% in the total number of people working in the civil service and the forbidding of new work contracts.

There are other things that have to be remarked: the public expenditure reduction in health in 8,2%, implying a strong reduction in the National Health Service (6%), what must be considered as emblematic; a reduction of 9,2% in education, being 6% in expenditure with teachers contracts; a reduction of 8,7% in Justice; and a reduction of 13,2% in capital expenditure. Beyond this, we should stress the VAT increase from 6% to 23% in the cultural services and the VAT increase from 13% to 23% in the catering sector.

In Portugal the crossfire, at the present moment, may also be understood if we examine the necessary conditions for the sustainability of public debt within the scope of the economic policy options already chosen and the possible cumulative effects due to the interdependence of all the macroeconomic variables in cause and the fact of the budget variables being not determined exogenously.

As one knows from any handbook, the evolution dynamics of the public debt per GDP unit is given by db = dp+b(i–g), where **db** is the evolution of the public debt per GDP unit, **dp** is the primary public deficit per GDP unit, **b** is the public debt-to-GDP *ratio*, **i** is the interest rate of public debt and **g** is the nominal GDP growth rate. In a logic way, one reaches to the public debt stability when **db** is equal to zero. But, according to the European Commission proposal of September 2010[15], within the scope of «strengthening economic governance», the countries having a public debt-to-GDP *ratio* that exceeds 60% of the GDP may be liable to a proceeding of excessive deficit if the debt *ratio* does not decrease, in average for the last three years, at least at one twentieth per year in relation to the 60%. Thus, in the Portuguese case, considering a public debt-to-GDP *ratio* of 100,8% for 2011 — according to the *Fiscal Strategy Document* —, the difference in relation to the reference value is 40,8% and 1/20 of this is about 2%, what means that **db** must then decrease (in annual average) in 2%, according to this logic.

Taking into account the previous expression and considering that economic growth is not a way to reduce the value of any *ratio* of public finance indicators — an idea generalized and sustained by the European institutions and the Portuguese Government (about which one will talk ahead) —, the government has two direct ways to reach the value established on the left of equality (–2%). One is the decrease of the public debt-to-GDP *ratio* (**b**) and the other is the decrease the primary deficit or the creation of primary surpluses per GDP unit (**dp**), obtained by means of an increase in public revenues, a reduction of public expenditure or the conjugation of these two kinds of variations.

The going down of **b** may be reached through privatization. This is the option inscribed in the «*Memorandum of understanding*» and reinforced by the Portuguese Government in the *Fiscal Strategy Document 2011-2015* (Ministry of Finance, 2011, p. 21), where it is explicitly written that «in a context of financing difficulties, the privatisation operations tend to be more successful than operations to issue debt, while they also permit the reduction of debt stock». This programme of privatizations includes transport, energy, communications (comprising public television), insurance and water and it is more encompassing and of higher value that what was determined by the European institutions and the IMF. Goods produced by some of these sectors clearly are public goods or public services, a part of them belonging to a set of goods that satisfy the minimum life conditions or have been furnished so far at relatively lower prices. After reading this *Document*, one thinks that someone is taking advantage of this moment of need to reduce **db**— and privatizations are useful for this purpose — in order to reinforce the guidelines of the neoliberal model in the Portuguese economy. As one may read in the *Document*

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At last but not the least, we should remark the increase of the invoice for public debt interests from 6 thousand millions of euros in 2011 to 8 thousand millions, an increase that is a result of the additional costs with financing, in spite of the external aid.

The State Budget for 2012 shows that the austerity plan of the last August failed, but shows one more thing: when an austerity plan failed the answer is more stronger austerity according to the EU economic model.

[15]This proposal of the European Commission was now approved by the Ecofin Council on last October 4.

(Ministry of Finance, 2011, p. 21), in this way the State weight on the economy is reduced and foreign direct investment will be attracted to Portugal:

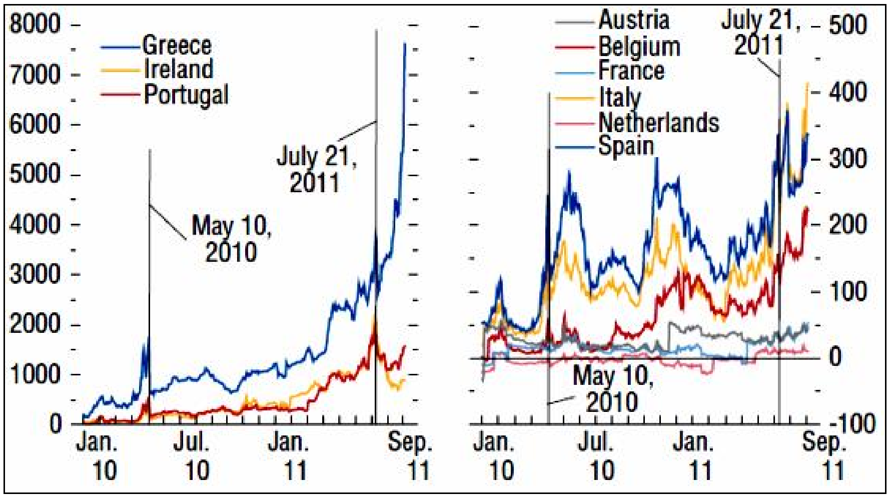
> The privatization programme is, therefore, a fundamental pillar that fits in with the goals of reducing the weight of the State in the economy and deepening European integration, primarily by opening up corporate capital to foreign investment. Foreign direct investment and the acquisition of capital shares in Portuguese companies by non-residents are vehicles that provide access to external financing without incurring additional debt and that in the medium to longer term lead to increased competition and efficiency.

The second way to a **db** reduction, the going down of the primary deficit or the creation of primary surpluses is also followed by the Portuguese government, once again «going beyond» the text of the «*Memorandum*». Aiming to a decrease in the primary deficit, the government has decided to place most of the adjustment (two thirds) on the side of public expenditure, including the reduction of public investment, though the main measures taken so far may belong to the revenue side, in accordance with what has been referred to previously.

All these measures, already taken or to be taken yet, directly or indirectly lead to a reduction in the domestic demand, that necessarily generates the corresponding supply on the side of the production of goods and services. Its reduction, as such, represents the blockade of a strong dose of sap feeding the channels of the economic life, thus stopping to irrigate the system: the incomes already created are no longer answering to the level of tax revenues necessary to assure a better primary deficit or the appearance of primary surpluses.

The contractionary effects, considering the **i** interest rate as constant — given what became established with European institutions and the IMF — worsen the (i–g), positive and very high at the start, due to either the level of interest rates of government bonds in the secondary market (see graphic 5.) or the growth rates close to zero or negative. In this way, there is a worsening of the snowball effect and with this the expected decrease of **b**, the public debt-to-GDP *ratio*, resulting from the privatizations is totally or in part neutralized by the reinforcement of this effect, to say no more about the consequences resulting from the fall of the product.

Graphic 5. Government Bond Spreads (two-year yield spreads over German bonds/basis points)



Source: IMF (2011, p. 4).

These are not the expected results according to the *Fiscal Strategy Document 2011-2015*and this comes from the idea, included in it, that the fiscal consolidation policies may have expansionary effects on the economic activity — a characteristic idea belonging to the present economic model, very much spread by the international and European institutions, nowadays reinforced in the sequence of the sovereign debt crisis and accepted as a dogma by the Portuguese Government too.

3.2. Fiscal consolidation policies: a discussion around the Portuguese case

The defenders of the idea above-mentioned, at the theoretical level, have as one of their roots the Ricardian equivalence model. According to this, within the framework of the perfect foresight and the perfect credit markets, a representative individual with rational expectations, immortal or altruistic, in the sense that he/she stops consuming in the present to avoid passing his/her tax burden to pay the debt to future generations, able to draw an optimal inter-temporal plan of consumption and saving, in the moment of a fiscal expansion, leading to the increase of public debt, anticipates a future tax increase necessary to pay it. In this way, he/she will answer in the present with a saving increase that will serve, as an exact measure, to future generations or to him/her, to bear a bigger tax charge to pay the debt. Being so, in the present moment, the fiscal expansion will not have any effect on the aggregate expenditure, and therefore on growth and employment. In this case, an opposite fiscal policy will generate effects also opposite to the described and, therefore, a reduction of public expenditure can lead the individual to create expectations of tax cuts in the future, leading to an increase in private consumption in the present, which will compensate the contractionary impact coming from public expenditure. On this kind of argument, Stiglitz (2010, pp. 71-72) writes:

> Ricardian equivalence, as it's known to economists, is taught in every graduate school in the country. It is also sheer nonsense. When President Bush cut taxes in the early years of the decade, savings rates actually fell. Of course, in the world of economics, things are never as they seem. The defenders of Ricardian equivalence would argue that perhaps they would have fallen even more without the tax cut. That would mean that America's savings rates before the crisis would have been solidly negative, by several percentage points.

Beyond this channel, a «sheer nonsense» according to Stiglitz, the same defenders also argue using the crowding-out effects associated with the expansionary fiscal policies. According to this, an increase of public expenditure can imply a rise of the interest rate due to the higher supply of government bonds in capital markets, what will penalize private consumption and investment. Once again, *a contrario,* a fiscal consolidation policy may lead to a reduction in that rate and therefore imply a rise in the domestic private demand. But the crowding-out effect, to occur, implies that the amount of government bonds at stake may be, in marginal terms, high enough to influence the market conditions, what usually does not happen and much less in small countries. Furthermore this interpretation neglects or devalue the positive multiplier effect on the economic activity of an expansionary fiscal policy and, as we are seeing it our times, does not catch the complexity in the determination of the interest rates, remaining this one far from corresponding to the simplicity of the reasoning expressed here.

Whatever the line of analysis, the basic line is that contractionary fiscal policies can generate crowding-in effects in the economic activity. If, at the theoretical level, this idea can be questionable enough, as we have seen, the empirical studies on this issue do also not forward convincing arguments. Most estimates using the VAR models and the simulation of macroeconometric modelssuggests a contractionary effect of a decrease in public expenditure or of an increase in public taxes at short-term, and its size depends on many different factors (duration of the shock, fiscal instrument, size and openness of the economy, reaction of the monetary policy, international coordination, etc.). On the other hand, the estimates of fiscal multipliers indicating to positive effects on the economic activity at short-term that are resulting from contractionary fiscal policies are scarce. Adding to this, the positive effects of studies on contractionary fiscal policies of specific cases are uncertain.

To corroborate all this, it is worthwhile to refer that even the IMF (2010, pp. 98-99 and 101) recognized it after a recent research:

> A key result is that fiscal consolidation is typically contractionary. A fiscal consolidation equal to 1 percent of GDP typically reduces real GDP by about 0.5 percent after two years [0.7 percent after one year]. The effect on the unemployment rate is an increase of about 0.3 percentage point after two years. The results are statistically significant at conventional levels. Overall, the idea that fiscal austerity stimulates economic activity in the short-term finds little. [And in addition:] In particular, a consolidation of 1 percent of GDP reduces the contribution of domestic demand to GDP by about 1 percentage point after two years. This result is broadly consistent with textbook (Keynesian) effects on demand of spending cuts and tax hikes.

Nevertheless, these calculations presented by the IMF do not evaluate the fiscal policy impact only; they also consider that this one is accompanied by a monetary expansion and a rise of exports, by means of a real devaluation of the domestic currency. Without the effects resulting from the interest rate reduction, the contractionary effect on the GDP is much higher: 1,1% in the first year and 1% in the second. If the other countries are additionally going to take the same kind of fiscal policy, the GDP contraction will be of 2% in the first year and will drag on, for more two years, with negative rates of around 1%-2% (IMF, 2010, p. 110).

Concerning countries presenting high default risks, the research done by the IMF (2010, p. 113) also concluded: «Fiscal retrenchment in countries that face a higher perceived sovereign default risk tends to be less contractionary. But expansionary effects of consolidation are unusual even for this group».

In presence of these effects at short-term, the counterargument passes through possible positive impacts at long-term. These would come from an increase of public savings due to lower financial burden associated with a lower public debt. This — together with the reduction of present and future interest rates at short-term and the decrease of the risk premium — may lead to a reduction in real interest rates and the occurrence of crowding-in effects. The empirical study presented by the IMF reaches to results close to these, but they are doubtful when we analyze, from the statistical data, the relation between the public debt (in percentage of the GDP) and the real interest rates at long-term (UNCTAD, 2011, p. 61). Furthermore, in the present context, even if the interest rates decrease, it is not to be expected the crowding-in effects already referred to, since in many countries the private sector (corporations and households) is undergoing a deleveraging process and banks are suffering strong restrictions to the access and granting of credit.

And the Portuguese central bank (Banco de Portugal, 2011, pp. 69-70), about the subject now under discussion, advises:

> Not only the evidence put forward but also the current economic environment recommend prudence in the arguments on behalf of positive short-term effects of fiscal consolidation on economic activity. The current economic circumstances are such as to clearly reduce the probability of an expansionary fiscal consolidation in comparison to the circumstances prevailing during the historical episodes examined. Firstly, the extent of the potential crowding-in of private investment and consumption in most advanced economies is limited by the need of private agents to repair their balance sheets. Secondly, the current situation remains characterised by a high level of uncertainty regarding the sustainability and vigour of the world economic recovery. The need for fiscal retrenchment is generalized to most advanced economies, which implies that the behaviour of exports should not be expected to offset to the adverse effects of the fiscal contraction on growth. In the euro area there is also no scope for currency devaluations. Thus, while external demand and large devaluations may have been important factors behind past episodes of expansionary fiscal consolidations, their relevance in the current circumstances has diminished. In current conditions, there is also a reduced probability of an expansionary monetary policy.

In the present context, even an expansionary monetary policy does not reach to the expected results. Japan shows it, the United States shows it, England shows it, but a part of the euro zone too, on account of the low level of the reference interest rates.

Recently, Bernanke (2011, pp. 10-11) has suggested, in a covered manner, a policy mix of expansionary monetary and fiscal policies. In this same context, he calls our attention to something left behind usually but has to do with the costs at long term of high unemployment rates at short-term:

> Normally, monetary or fiscal policies aimed primarily at promoting a faster pace of economic recovery in the near term would not be expected to significantly affect the longer-term performance of the economy. However, current circumstances may be an exception to that standard view — the exception to which I alluded earlier. Our economy is suffering today from an extraordinarily high level of long-term unemployment, with nearly half of the unemployed having been out of work for more than six months. Under these unusual circumstances, policies that promote a stronger recovery in the near term may serve longer-term objectives as well. In the short term, putting people back to work reduces the hardships inflicted by difficult economic times and helps ensure that our economy is producing at its full potential rather than leaving productive

resources fallow. In the longer term, minimizing the duration of unemployment supports a healthy economy by avoiding some of the erosion of skills and loss of attachment to the labor force that is often associated with long-term unemployment.

For all that we have been exposing about the possible effects of fiscal policies on economic activity, it might be concluded, contrary to what is being done, that a way to reduce the weight of public deficits in GDP is to conduct expansionary fiscal policies that increase the GDP and also put the automatic stabilisers to operate. As an expansionary fiscal policy by itself might not ensure the economic growth, Bernanke proposes a policy mix. This way, it is possible to see a double effect of a double policy that can reduce the weight of public deficits and simultaneously start the road to economic recovery becoming increasingly urgent in the euro zone[16].

## 4. Portugal at the crossroads of the trilemmas

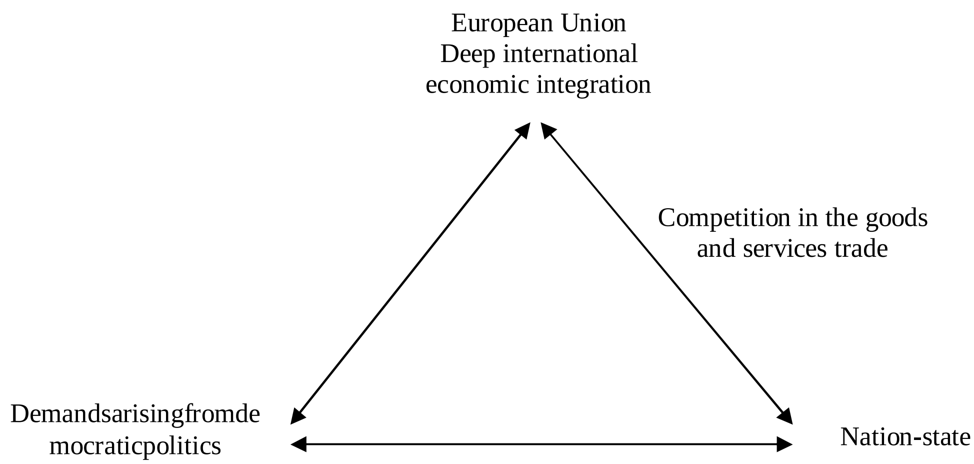
### 4.1. Trilemmas and economic policy in Portugal

The fragile picture of the Portugal economy insertion into the current global economy, recently worsened by the so-called sovereign debt crisis and the respective financial assistance programme, has put Portugal in front of two trilemmas of politics and economic policy overlapped partially. One corresponds to the trilemma presented by Rodrik (2011, p. 200), called by himself «the fundamental political trilemma of the world economy», that results from Portugal's difficulty to adapt itself to the global economy. As we have seen, the explanation of this lies in the fundamentals that have woven the international trade nets and the continuous preference given by the domestic economic policy to the sector of non-tradable goods, a fact that may be a reflection of the first. There is another trilemma, due to the fact of Portugal being inserted in a monetary area such as the euro zone is, with its own features.

The first trilemma (see figure 1.) shows that Portugal cannot simultaneously try to be in a situation of respect for democracy demands[17], the Nation-state as a sovereign State in its political decision and a deep international economic integration, but it can reach to only two of the three possible situations.

[16] For an overview of the discussion around the effects of contractionary fiscal policies, see Banco de Portugal (2011, pp. 67-70) and UNCTAD (2011, pp. 57-88).
[17] Concerning this situation, we prefer to use O'Rourke's term (O´Rourke, 2011).

Figure 1. The political trilemma of Portugal



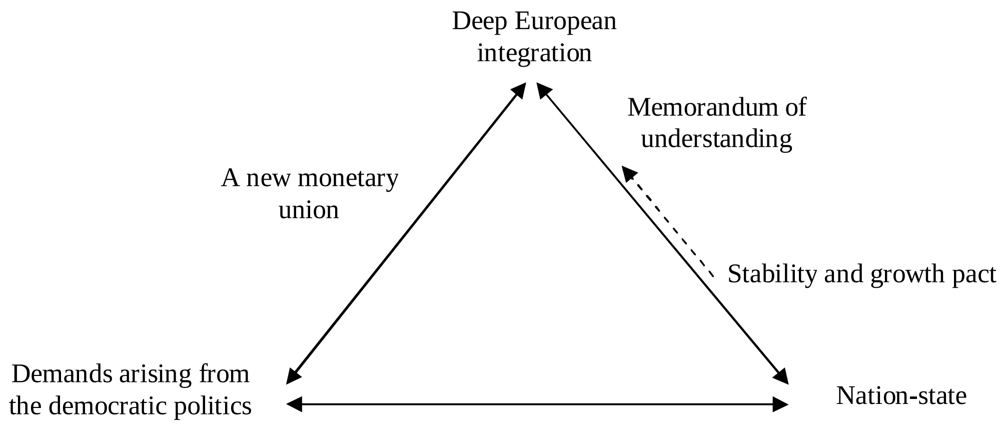

After what we have already referred to regarding the feature of international trade, Portugal as a member of the WTO and a Member state of EU has been placed on the right side of the triangle, leaving the internal practice of democracy behind, since the competition space already established at the global level has led to policy choices by national governments that have called into question the collective choices of the citizens who elected them — because those governments were *a priori* embodying common interests. In this sense, this external determination does not collide with national sovereignty, since national governments agree with its fundamentals, in this way becoming participating players/makers of this global process.

Portugal, as we have already remarked, has been vulnerable and has been hit by this global reconfiguration of international trade. As participators in this process and in the logical framework of it, as well as in the set of EU guidelines, one of the choices of the national governments on politics and policies has been the «restructuring» of the labour market, in order to assure its participation in the wage and labour conditions competition, and the «recycling» of social benefits and social supports, passing from the valorization of the objective causes, with their roots in the economic system, to an individualized perspective on the social problems. This movement has become more visible since 2000 and definitively inscribed in the neoliberal logic with the measures taken by the new Portuguese Government, in a large extent as a sequence to the financial assistance programme. Changing the concept of dismissal and its conditions, some of them already defined, others at the decision phase, with the reinforcement of the activation principle in the unemployment insurance system to the detriment of the conception of it as a right to a replacement revenue to somebody who lost a job, and with the assistentialist view as to the social benefits: what is at stake is the passage from a conception of the labour and the social benefits as a right to a logic where every individual, every citizen, is viewed as a mere instrumental variable or as a debtor to the society itself. At the end, what is at stake is the right of being a citizen, a concept inherent to any democracy.

The second trilemma results as we have already said it, from the insertion of Portugal into the euro zone and, in this case, our country cannot aspire to a situation of respect for the demands of democracy and, at the same time, to be a Nation-state as a sovereign country in its political decisions and to belong to the European monetary zone.

Also here one has left some aspects of democracy behind, to the profit of the other two situations: once again Portugal took a position on the right side of the triangle (see figure 2.).

Figure 2. Portugal's trilemma in the euro zone context




Any monetary zone, considering Mundell's triangle of incompatibilities, presupposes a loss of economic sovereignty at the level of monetary and exchange rate policies. Necessarily the euro zone did not avoid these circumstances, what means that, with its construction, some instruments of macroeconomic management were taken from the hands of democratically elected governments, that is, some capacity has been withdrawn from the citizen's hands of the different Member states. Nevertheless, the decision of joining the euro zone at the moment of its foundation was a sovereign decision of the different national governments, like in the case of Portugal.

The level at which one must discuss these issues is not, in this manner, that one resulting from the creation of any monetary union, but rather that one with the features of the global architecture of the macroeconomic policies inherent to the euro zone and, in special, to the framework of the domestic fiscal policies. Since it was not adopted a fiscal union, apparently it was kept the sovereignty of domestic fiscal policies, but it was established a set of common rules and proceedings. These limit the national macroeconomic management and thus reduce the possibility for national governments to answer to the citizen's demands concerning the creation and delivery public services and public goods, the formation and redistribution of incomes, as well as the economic stabilization. This has created, among citizens, some movements against a larger integration, due to a phenomenon to which Monti (2010, p. 12) called «integration fatigue», and to which added the «market fatigue» after 2008.

In the present Portuguese situation, the demand of financial assistance to the European Commission, from which resulted the «*Memorandum of understanding*», as such is a sovereign decision of the Portuguese Government, but its causes reveal, more than so far, the functioning of what Gill (2000, p. 4) calls the «disciplinary neo-liberalism», in which governments try to show their *credibility* and the *consistency* of their policies, in accordance with the *confidence* they want to inspire among the financial markets that are determining the macroeconomic management of the country to the benefit of their own interests, with same influence on the European institutions too. In this sense, one may say that Portugal is keeping its position on the right side of the triangle, but walking away from the Nation-state (see figure 2.). As Scharpf (2011, p. 26) refers about the «memorandum of understanding» of Greece and Ireland that can also be applied to Portugal:

> Once an EMU member state has applied for the protection of European rescue funds, its government will be operating under a form of 'receivership'. European and IMF authorities will define the criteria to be treated as 'conditionality'; the Commission will analyze financial and economic problems, define the policy choices that are required, monitor compliance and evaluate progress or failure. Of course it will prefer to do so in consultation with national authorities and expertise. But in cases of disagreement, the bargaining power of the national government will be minimal.

But this way along the right side of the triangle also means that there is more distance from the demands of democracy, in first for reasons already mentioned on talking about the other trilemma. But in this case, one may raise the question about the democratic legitimacy of this external interference, that is, to what point citizens see it as something that can be representative of their own interests. As Scharpf says (2011, p. 35), democracy is compatible with the necessity of respecting the external constraints, if justified as much as adequate and efficacious to deal with the common problems or to reach to collective aims, but it is not compatible with a situation where choices are pre-empted by external domination.

Nowadays, the democratic legitimacy of the external interference is still far from being assured, owing to the kind of policies involved, of deep austerity, because citizens are feeling that their disposable income is hit and some collective guarantees are under attack, and also due to the economic and social insecurity already generated. Probably, it is not by chance that the Portuguese minister of Finance talked about the need of reaching to an understanding with the population, that is, after deciding in accordance with the external appeals «to appease the markets», the minister now feels the need «to appease the population».

In a report of last March (by the BNP), about this subject but concerning the whole EU, Longueville and Faure (2011, p. 12) warned: «'Social patience' is also being stretched to the limits, reducing governability». In the same direction, the eurodeputy Goulard (2011) warns:

> No-one can still believe, in 2011, that our society with its eagerness for interaction would accept that the European Council makes important economic and social decisions behind closed doors. Unity must not be born out of diktat. It must be a product of public debate. Furthermore, it is dangerous to call meetings of the European Council a 'government', because as it stands today, the European Council does not have to answer to anyone.

As in other moments of the past, this feeling, this unease can create the claim to a national option instead of European monetary integration, considered unachieved or underconceived, and this option as a replacement of a large debate to which it must be submitted, in order to make it also possible to deconstruct the idea that this is the only way leading to a monetary union. Some signals indicating the desire of leaving the euro zone are becoming more and more visible among citizens of several countries, like in Portugal.

4.2. The other side of the triangle, another solution for the trilemma

The way previously traced will be a wrong way and the triangle shows us the way to be followed: it will be a movement from the right to the left of the triangle, where one demands that, to the deepening of democracy, it may correspond a new monetary union (see figure 2.), in which the European institutions can, in a democratic manner, ensure continuity to the aspirations that were at the origin of the European integration process.

Thus what must now be brought into question is not the existence of a European monetary union, as we have already mentioned, but rather this monetary union with the neoliberal matrix that is used as its support. It is necessary to recreate the present monetary union, to give it other fundamentals, other targets, to replace the economic stability principle by the economic expansion principle, and also to value the employment and the conditions in the labour market in detriment of price stability as a first priority. In this manner, it is the common monetary policy, as a whole, that must be reconsidered, what implies that the same happen with the exchange rate policy itself, passing to be also used as an instrument of trade policy within the international framework of loyal practices.

Concerning the national fiscal policies, the existent rules must be reconsidered regarding either their fundamentals, also with the valuating of the positive spillover effects of the expansionary fiscal policies launched in each country on the whole economy of the euro zone, or as to the reference values of the stability and growth pact, given the conceptual void associated with them and the outdated context in which they were defined. The «new» reference values must be established according to the expected economic growth for the euro zone and specific for each Member state, i.e. in this manner one intends to resume the fiscal policy as the instrumental way for economic growth, without any more taking values of public finance indicators as an end in itself.

Within this scope it is important to ensure that the public financing becomes less dependent of the financial markets, what implies two aspects. One is the possibility of monetary financing, within the limits defined as a whole and according to circumstances. The other is to create mechanisms that can assure that the emission conditions of public debt of the different Member states be identical in the markets. Still in this point and concerning the financing of public expenditure, it must be ensured that there is no chance for tax competition inside the euro zone and even inside the EU.

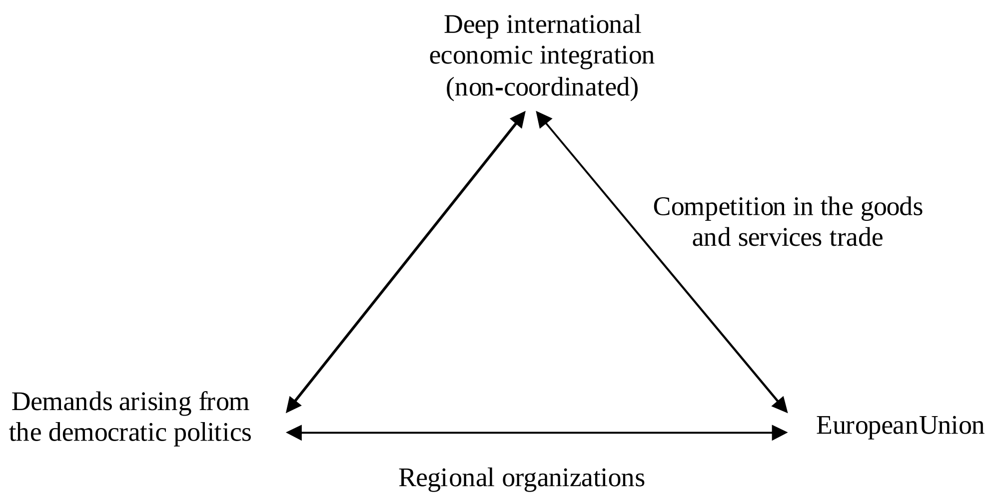
The labour market policies — a central piece, non-recognized by the present monetary union — must be revised. This market cannot to be the replacement channel for exchange rate devaluations among Member states, i.e. wages must be seen not so much as cost-variable and an adjustment variable, to be considered, once again and mainly, as a fundamental income component and, as such, a key element of the aggregate demand. In this sense, the wage formation will have to ensure that there is a total (or almost) indexation to either the inflation rate or the evolution of the labour productivity. Again in this area of labour incomes, there is a need for the creation of mechanisms able to correct the present wage dispersion.

This new monetary union would necessarily imply a new conception of the European Single Market not supported in the present context of the EU in the global economy, because on implying certain changes in the production conditions and pricing process it would leave European products, at the internal and external market, more vulnerable to the present conditions of the international trade. A new reconfiguration in international trade must exist then — and there is a proposition, already formulated by Allais (2009) but not yet discussed, as far as we know, something that may be a new step in that direction:

> Ten years ago, I suggested the recreation of more homogeneous regional groups, uniting several countries, as they are presenting the same income conditions and the same social conditions. Each one of these 'regional organizations' would have permission to take a reasonable self-protection against the differences in production costs that confer some advantages not granted to certain competing countries, but keeping — at the same time, at the internal level of its zone — the conditions of a healthy and real competition among its associated members.

From this proposition, and considering the EU as a whole, would also result a movement in the triangle, but now towards its base (see figure 3.), establishing a parallelism, in this manner, with the Bretton Woods compromise referred to by Rodrik (2011).

Figure 3. The EU trilemma in the global context




In this picture, we should keep some distance in relation to the superior vertex, which identifies the current global economy, what means that Allais's proposition is not compatible with the global institutional picture of today. The protection of regional frontiers against goods and services produced in countries with which they have wage differences that not correspond to the differences of labour productivity and inflation rates and where the environmental norms are not respected implies a new ILO, with a statute placed at the same level of the statute of WTO, as well as it implies a new WTO — in which the principles of more open and more competitive may be strongly conditioned by the fulfilment of the other principles, also already established by this organization.

Nevertheless, this also implies, at the international level, a political dimension and vision still missing and a long maturation time. The current situation at the EU is not in accordance with this waiting, owing to the immediate need to reconfigure itself and in this way to find other solutions for the time being. By these reasons and under perspective of short and medium term, the EU must go on alone towards the creation of a regional organization including a monetary union and a new single market, without wage and tax competition, as already suggested. This way would force the EU to take a new position in the global economy context, to limit its international insertion to its own economic growth.

## Conclusion

In Portugal the present circumstances, more than to show the fiscal consolidation fragility, rather make evident the fragility of the Portuguese productive tissue. The macroeconomic picture of the country till 2007 was not very far from the macroeconomic picture of the euro zone average. Nevertheless, there was an exception: the current account timbalance that had the negative financial account of the non-financial corporations as the main interest counterpart, in degradation since the middle of the 90s until then. The financial account of General Government, though negative, was improving since 2005.

This situation of the current account deficit also is a signal of the difficult insertion of Portugal into the framework of international trade, not only in the external markets — where the share loss in Portuguese exports occurred — but also in the domestic market itself with the competition of imported goods. In association with this, there have been some economic policies that, from the latest 90s on, have favoured the production of non-tradable goods, a path that was trodden in parallel with the adaptation of Portuguese economy to the global economy model.

It is difficult to evaluate what is the causality sense between this redefinition of the productive structure and the reconfiguration of international trade at the global level. Was this the last process to render difficult another international insertion of the Portuguese economy or rather the sloping position of investment and the imbalance of incentives in Portugal that have fragilized this same insertion? In any case, there is a common background: the European Single Market according to the patterns with which it was created and the absence of clear aims and coherent policies concerning the insertion of European economy itself into the global economy, taking the Lisbon Strategy as an example of it, and this independently of the economic policy mistakes made by the different Portuguese governments.

In the meanwhile, the financial crisis burst, in 2008, quickly becoming a sovereign debt crisis in the euro zone, with a very curious development in phases. The existence of excessive government deficits, in accordance with the reference values of the stability and growth pact was a pretext for the first speculative attacks to the government bonds of some countries, including Portugal. The EU and national governments, like the Portuguese one, reacted establishing austerity measures, but the speculative attacks went on, with the argument that the issue was then focused in the imbalanced external accounts and new austerity measures were taken, the speculation was going on and the problem passed to a different point staying at the public debt levels, considered excessive, once again according to the pact. The turbulence in the secondary markets of government bonds of some countries did not stop and the more recent explanation is that there is not economic growth enough to sustain the respective public debt, a result that seems obvious owing to the austerity policies that were adopted.

The European institutions showed and still show great difficulty in seizing the meaning of this crisis and they have taken and still take the «messages» from the financial markets as a reference for their activity. Austerity plans have been generalized within the euro zone and the effects of the resulting fiscal policies led to negative cumulative effects on the economic growth and on the employment, and generated a strong uncertainty in the economy of the euro zone, as well as in the process of European monetary integration.

Nevertheless, this difficulty in interpreting the crisis makes a contrast with the certainty that the European institutions use to adopt when they are forwarding solutions, some of them more explicit than others, for their resolution. The Portuguese case shows that someone is taking profit of the moment for a reposition of the State into the economy, reducing and weakening its capacity and room for manoeuvre. It is this same ideological bias that was present when, in the European institutions, the situation of Portuguese public accounts was identified as a main problem.

A bad diagnosis in the Portuguese case, but coherent concerning the model that supports it, and confusing and hasty diagnoses on the euro zone emitted by the European institutions generated inadequate solutions necessarily. All this creating a strong desire of another diagnosis, with another model, other policies, all this reminding us of something that Keynes (1973, p. 383) wrote in 1936, something that appears with a premonitory resonance:

«At the present moment people are unusually expectant of a more fundamental diagnosis; more particularly ready to receive it; eager to try it out, if it should be even plausible».

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