

The Asymmetries of European Integration and the Crisis of Capitalism in Portugal

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This article analyses the crisis of Portuguese capitalism within the wider crisis of the Eurozone. Portugal's prolonged economic stagnation, associated with an increasingly dependent and fragile insertion in the Eurozone, can now be seen as an early manifestation of the asymmetries and fractures between the Eurozone's core and its periphery that are now wider and more visible. By focusing on the manifestations of 'embedded neoliberalism' in a country of the periphery, the article sheds light on how neoliberal restructuring has made the economic structure increasingly incompatible with the social developments that had previously helped to guarantee its legitimacy. The troika's structural adjustment reveals that this incompatibility is now fully assumed and that, in the absence of social resistance, the brunt of adjustment will be felt by the majority of workers.

KEYWORDS Austerity, crisis, Euro, neoliberalism, Portugal

Introduction

The signing, at the end of 2007, of the Lisbon Treaty, an elite-driven recovery of the socioeconomic content of the democratically defeated project of the European Constitution, indicated that history had a habit of repeating itself in Lisbon. The Lisbon Agenda, initiated in 2000, had already failed to turn Europe into the most competitive region of the global economy through supply-side policies of deregulation and an emphasis on investments in 'human capital' or research and development (R&D) (van Apeldoorn, 2002: 29). Partially the intellectual product of Portuguese social democracy and thus confirming the Socialist Party as the pro-European underpinning of the Portuguese political system (Soares, 2007), the Lisbon Agenda

expressed the extent to which it had accepted the socioeconomic order instituted at the European level. Van Apeldoorn's (2002) concept of 'embedded neoliberalism' captures well the nature of this order and the social forces and discourses that underpin it. Neoliberal hegemony in the European context is the ideological expression of the power of the dominant transnational fraction of capital which has been pushing for an integration process based upon the expansion of market forces. But in order to achieve this, elements of social protection and the deliberate promotion by the state of a favourable insertion into the international economy, coming respectively from the social democratic and neomercantilist traditions, needed to be accepted (van Apeldoorn, 2008). Nevertheless, this incorporation diluted these traditions, subsuming them within the neoliberal project which had already been inscribed in the institutional arrangements of Economic and Monetary Union (EMU).

The financial and economic crises from 2008 onwards, which turned into the so-called sovereign debt crises, exposed and intensified the fractures that had been opening within the Eurozone (see also Becker & Jäger in this special issue). The Euro is a currency without a sovereign state on the same scale, meaning there is little capacity for managing the tensions in a way that avoids turning labour and social conditions into the main variables of adjustment to crises. These events and biases are also at the root of the trajectory of uneven development, expressed in the new salience of a core-periphery divide, and are part of a contradictory process whereby the transnational integration of various national fractions of capital is said to coexist with entrenched 'varieties in capitalism' at the national level (Georgiou, 2010; Bruff, 2011; see also Bruff & Horn and Ebenau in this special issue). These varieties are being unevenly reconfigured in the context of the politics of permanent austerity (competitive or otherwise), imposed from the outside and pushed from the inside of each peripheral country, transforming this region into one, in economic policy terms, with very few vestiges of sovereignty (Cafruny, 2010; de Grauwe, 2011).

An analysis of the crisis of Portuguese capitalism in the context of a heterogeneous Eurozone, which, with the benefit of hindsight, can be interpreted as a leading indicator of the wider crisis that would befall the European periphery and eventually the entire European project, will reveal how van Apeldoorn's concept of European 'embedded neoliberalism' (2002; 2008), a necessarily contradictory and ultimately fragile order, manifested itself in a specific country of the periphery. Despite some progressive transformations associated with the institution of social protection and an uneven modernization of collective capabilities, Portugal is marked by the persistence of high levels of inequality and increased levels of unemployment and precarious work, within the context of a prolonged economic stagnation and an increasingly dependent and fragile insertion in the Eurozone (Lapavistas *et al.*, 2010: 321). Nationally, this insertion has favoured, and was favoured by, an alliance of capitalist forces led by the privatized banking sector and increasingly extraverted corporate groups. The austerity policies now being pursued with savage intensity in Portugal are seen as an opportunity to restructure the national political economy so as to decisively erode those social protections that were inherited from the revolutionary period of 1974–75 and from the enduring social mobilizations that followed (Fishman, 2010).

The analysis carried out here is rooted in a critical political economy of European integration that recognizes and accounts for the institutional arrangements and social

forces shaping the variegated forms of capitalism in Europe and the global political economy, and relates market forces with different forms of state power (Cafruny & Ryner, 2007; Drahokoupil *et al.*, 2008). Importance also must be given to the ‘transnationally constituted local action’ axis of an intellectual project aiming at the dissolution of the transnational-national dichotomy (Drahokoupil *et al.*, 2008: 12). The paper will mostly focus on the institutional arrangements that were shaped by European integration and the macroeconomic patterns thus generated.¹ Recourse will then also be made to post-Keynesian analyses of the main economic patterns at the national and European levels, and the most plausible underlying causal mechanisms. Post-Keynesianism is an approach rooted in the most radical aspects of Keynes’ work, from the role of uncertainty to the critique of the instability and imbalances created by the unfettered operation of financial speculators. It can complement a critical political economy approach: the latter explaining the emergence, through social conflict and cooperation, of the rules responsible for the regularities that can be accounted for by the former, as in the case of the macroeconomic imbalances within a financialized Eurozone (van Treeck, 2009; Stockhammer, 2011). This theoretical articulation can help with understanding how Portuguese capitalism was shaped by the project of European integration, whose general contours we will first systematize before moving to the analysis of some of its concrete expressions in Portugal, and to some indications about the nature of the austerity policies.

The asymmetries of European integration

In the book *The Strange Non-death of Neoliberalism*, Colin Crouch argues that, given the intellectual failure of the ideology that inspired the prevailing policy regime, one would expect the systemic crisis facing the capitalist North Atlantic area to prompt the abandonment of its presuppositions and prescriptions (Crouch, 2011). Instead, the ‘Keynesian’ interlude after the collapse of Lehman Brothers was essentially the continuation, by unconventional means, of the political support for what Crouch labels ‘privatised Keynesianism’ — i.e. the prompting of demand by private debt in a fractured socioeconomic landscape. Neoliberals were then able to capitalize on a conjuncture marked by the increase of public debt in order to impose the harsh medicine of austerity. Crouch further argues that the political resilience of neoliberalism shows how powerful large transnational corporations have become, and this is especially so in the financial sector. While pointing to some important culprits in the political response to the crisis, Crouch’s perplexity might be somewhat diminished, one could argue, by an institutionally-rooted analysis of European integration. A more satisfactory approach would include a critique of the intellectual underpinnings of European integration, such as ordoliberalism, an influential component of ‘the neoliberal thought collective’ in the European Union (EU) (Mirowski, 2009), and of the social forces that have gained from its hegemony throughout Europe.

Indeed, the European treaties and the institutions constructed seem to have strongly contributed to a kind of neoliberal policy lock-in, and the EU is structurally biased against market-correcting social protections (van Apeldoorn, 2008). On the one hand, market-enhancing integration is safely instituted at the European level, through the rulings of the European Court of Justice against social protections at the national

level, the commitment of the European Commission to new rounds of liberalization, and the statutes of the European Central Bank (ECB) which prohibit it from directly financing states, instead exerting pressure on them to introduce deflationary supply-side policies. On the other hand, political initiatives capable of introducing market-correcting policies at the European level, thus mitigating its neoliberal bias, have become more difficult to achieve. To understand why this is so, it is important to consider some of the mechanisms that further reveal the nature of the European political economy.

With each European enlargement, the unevenness of both development and the institutional underpinnings of capitalism at the national level has increased. This has made positive convergence and social coordination at the European level more difficult to achieve politically (Cafruny & Ryner, 2007). This growing heterogeneity, in a context where the mobility of capital is safely instituted at the European level, is responsible, among other factors, for the downward trends in the taxation of capital and for the difficulty in reaching unanimous agreements among governments. This, of course, aggravates, and is aggravated by, the polarizing tendencies within an area that is already more unequal than the USA (Galbraith, 2006).

In part due to the disappearance of several national mechanisms to promote development and sustainable catch-up, from industrial to exchange rate policies, the Euro consolidated a division between the core 'Northern' countries, led by (for example) Germany and the Netherlands, which registered important surpluses in their current accounts and therefore capital outflows, and the peripheral 'Southern' countries, registering, given the balanced relations of the Eurozone with the rest of the world, deficits in their current accounts and inflows of financial capital. Actually, the financial surpluses of the European periphery may well be responsible for its current account deficits, another manifestation of the price paid by less developed countries for their reliance on international markets to finance investment and/or consumption activities. These were generally biased towards non-industrial activities, as the multiplication of bubbles followed by financial crises attests (Bresser-Pereira, 2009; Milios & Sotiropoulos, 2010). In their wake, a 'debtor-creditor pattern' was thus generated (Dyson, 2010). The coexistence of credit-led and export-led models of growth in Europe ultimately led to creditors gaining the upper hand against divided debtors, imposing deflationary policies that increase unemployment, the probability of defaults, and the possibility of ever greater political tensions (see also Becker & Jäger in this special issue).

The debate about whether there are races to the bottom or to the top in terms of fiscal, social, or environmental standards is in this context better framed by Crouch's (2011: 127) formulation, used in the context of globalization: the power of large corporations to set the rules of the race has undeniably increased. Paradoxically, as Cafruny (2003) has argued, the long-term interests of capital may not be well served by an arrangement whereby the labour movement is permanently put on the defensive and compelled to abandon the demand-led policies that it has traditionally favoured. These policies were replaced by pacts that, particularly in countries retaining important mechanisms for coordination and a neomercantilist tradition (such as Germany), resulted in the acceptance of many years of wage stagnation by important segments of the working class, plus increased inequalities and levels of poverty. The prevalence

of this model in countries with higher economic capabilities has contributed to the generation and entrenchment of external imbalances (Cesaratto & Stirati, 2011).

The paradox of the European political economy mentioned by Cafruny has its macroeconomic expression in a fallacy of composition: while the model of growth is mostly profit-led at the national level, it is wage-led at the level of the Eurozone (Stockhammer, 2011). This means that the national policies of wage repression, which are now being generalized, can further intensify the contraction of the ‘internal market’. In this vein, the European obsession with unit labour costs, relating the growth of nominal wages to the growth of productivity in real terms (considered the most prominent indicator of the competitiveness of national economies), generates a policy bias that favours their permanent compression, thus deteriorating the position of labour and favouring the relative growth of the weight of capital incomes. This aggravates the demand problems and does not deal with the asymmetries in competitiveness generated by different patterns of industrial specialization (Felipe & Kumar, 2011).

The overall picture is well summarized by Bellofiore *et al.* (2011: 140): ‘Overcapacity and the stagnation of working class incomes compelled countries to find other markets for their outputs, to choose between neomercantilism and an economy based on debt. This, in turn, has created enormous room for financial capital’. Two further notes must be added. First, as Bellofiore *et al.* (2011) acknowledge, choice, even if constrained, is not an apt expression for countries locked into different trajectories. These are responsible, for example, for the fact that the peripheral countries had much less room to follow Germany in a strategy of permanent wage repression, given the relatively low base of their welfare states and their wage structures (Lapavistas *et al.*, 2010: 323). Second, and relatedly, the room created for financial capital generated imbalances and forms of dependency that now promise to create new mechanisms for uneven development. Previously, imbalances had fed the illusion of catching-up in most of the periphery, where economic performance in the first years of the Euro was responsible for two-thirds of the employment created (Grahl, 2012).

These asymmetries are exacerbated by the Stability and Growth Pact (SGP), which also illustrates the pervasive neoliberal orthodoxy of the EU. It is an example of how to institutionally favour a bias in economic policy so as to generate a ‘necessitarian’ neoliberal discourse, while the normative elements about the need to selectively tame the state are not abandoned (Hay, 2004). Within this frame, the present crisis is reinterpreted as not being caused by the way in which financial capital used the ‘enormous room for manoeuvre’ or the neomercantilist policies of the core countries of the Eurozone, but by the irresponsibility of peripheral governments. These are said to have deliberately failed to comply with the strictures of an SGP still lacking in enforcement mechanisms. However, a more realistic account is available in post-Keynesian circles. This focuses on the role of the macroeconomic imbalances generated by the Euro and the operation of financial capital, as well as the irredeemable interdependencies between public, private, and foreign debts.

As Hein *et al.* (2011: 9) indicate, on the basis of an analysis of the financial balances of the Eurozone countries, ‘the current Euro crisis can better be interpreted as the consequence of preceding private debt and current account imbalances and not

as a result of excessive public deficits'. The public deficits, for the most part, are more or less unavoidable consequences of the uncoordinated effort, on behalf of the over-indebted private sectors of each peripheral country, to try to rebalance their financial position, thus generating a demand-led crisis. Nevertheless, the way in which fiscal deficits are still given priority at the European level implies the institution of a strengthened deflationary pressure, which is particularly intense in peripheral economies under conditions of so-called financial assistance.

In consequence, a prolonged recession is one of the mechanisms deemed capable of correcting, together with the continuing neoliberal restructuring of the economies, the external imbalances that have been generated. The compression of internal demand through an effort to diminish real wages, for example, via a prolonged period of high unemployment, is projected to lead to a decrease in imports and an increase in exports. As discussed below, focusing on the case of Portugal, what is crucially missing from conventional accounts is the recognition of the perverse consequences of the Eurozone's institutional arrangements for the majority of the population in the peripheral economies.

The impasses of the Portuguese political economy

A difficult story

As Paul Krugman wrote in his influential blog: 'the Portuguese macro story is harder to tell than those of Greece, Spain, and Ireland' (Krugman, 2011). Indeed, Portugal did not have, in the previous years, an intense housing bubble fuelled by credit (like Spain or Ireland), despite the boost given to construction by its integration in international financial circuits from the mid-1990s onwards. Nor did it have a structural fiscal problem, like Greece, despite the fact that Portugal has endured stagnation since the institution of the Euro and thus persistent budget deficits. This caused a vicious circle of breaches of the SGP rules to be followed by efforts at fiscal retrenchment through the rise of indirect taxation and important cuts in public investment, with obvious negative effects on economic growth. The crisis replaced the continuing rise of private debt with a boost in public debt; the latter's weight in Gross Domestic Product (GDP) being aligned, before 2009, with Germany. The thesis that Portugal's 'fiscal indiscipline', when compared with Spain — 'one of the most disciplined in Europe' — was behind its economic problems, as in Royo's (2010) account, simply forgets that deficits or surpluses in the public sector for the most part are dependent upon the trajectory of economic growth and interconnected with the financial positions of the private and external sectors, as the Eurozone crisis would clearly reveal.

Milios & Sotiropoulos (2010: 229), on the other hand, identify the puzzle of an economy incapable of growing and converging: 'the paradoxical situation of displaying all the signs of overheating without enjoying any acceleration of GDP'. The most important sign was the permanent current account deficit nearing 10 per cent of GDP that Portugal registered since the late 1990s, accounting for the doubling of its negative net investment position since 2001 — from 46.9 per cent to 107.5 per cent of GDP. The deepening of external dependence went hand in hand with a decade of

stagnation — marked by alternating periods of low growth and two recessions — with an average annual growth rate of 0.7 per cent between 2001 and 2010 compared with growth rates averaging more than 3 per cent between 1987 and 2000 (Royo, 2010). This pattern was responsible for a tripling of the unemployment rate — from 4 per cent to 12 per cent — in a country used to registering very low rates, which still has levels of labour market participation above the European average. Interestingly, the latter had long puzzled neoliberals, challenged by the combination of a diagnosed ‘labour market rigidity’ with such an employment performance (Silva Lopes, 2003; Fishman, 2010). However, the steep rise in unemployment through the 2000s made it possible for this to be ignored, as we will now discuss.

The Portuguese economic trajectory was responsible for what was until 2008 the only case, among the so-called cohesion countries, of failure to catch up with the Euro average from 1999 onwards (the Portuguese GDP per capita stood at 68 per cent of the Euro average in 1999 and decreased to 64 per cent in 2008). This led to a consensus rooted in comparisons with what were considered, before the crisis hit, the successful adaptations of Ireland or Spain to the single currency (Royo, 2010). This is well summarized by a recent International Monetary Fund (IMF) Staff Report which pointed to the usual culprits (2010: 5): ‘Rigidities in the labor market and strict regulation discourage investment and growth, while nontradable sectors also suffer from a lack of competition’. Moreover, within the ranks of the European Commission, the ‘disappointing experience in the first EMU decade’ became a lesson for those wanting to join the Euro club (Martinez-Mongay, 2008: 34).

The ‘lesson for Euro newcomers’, as seen from Brussels, was clear and very influential in shaping the Portuguese debate: financial liberalization and competition were deemed insufficient without a ‘liberalization of the real side of the economy’ capable of blocking the rise of unit labour costs, said to be one of the main causes of Portugal’s loss of competitiveness and corresponding stagnation (Abreu, 2006: 2). In addition, one could add the notion that Portugal’s troubles were the result of a relaxation of the ‘disciplinary devices’ that exerted pressure on public policies: after 1999, there was nothing comparable to the EU accession, in 1986, or to the decision, made in the early 1990s, to join the Euro from its inception (European Commission, 2004: 6). According to an optimistic account of the relation between Portugal and the EMU, it was indeed ‘the pressure and promise of European integration’ that created the political conditions for ‘structural reforms and the liberalization of the economy’ (Torres, 1998: 171).

These assessments reveal more about the ideological commitments of the neoliberal consensus, both in Portugal and the EU, than about Portugal’s difficult macro story. An alternative economic history, embedded in a critical political economy account, ought to articulate the trends in Portuguese capitalism with changes in the European and global political economies that contributed to its vulnerabilities. In reality, an uneven process of social modernization took place: this was visible in both a certain development of Portugal’s welfare state and in the investments that were made in public infrastructures (albeit with increasing use of opaque public-private partnerships), plus in important parts of the economy which were being restructured along neoliberal lines and thus with specificities and rhythms that need to be accounted for. This restructuring made the economic structure increasingly incompatible with further social developments, which had previously helped to guarantee its

legitimacy. The troika's programme of structural adjustment follows previous reforms already in a spirit of retrenchment in the public provision of social goods, particularly visible in social security or in the efforts to decrease the number of public servants and their wage bill. This indicates that the incompatibility is now fully assumed and that, in the absence of social resistance, the brunt of adjustment will be felt by the great majority of workers, both in the public and private sectors. This is a manifestation in the periphery of the evolving 'embedded neoliberal' order mentioned above and its entrenched biases. In order to understand the permanent austerity that is the unavoidable new mark of the Europeanization of public policies within the country, we will now assess the most important moments in the institutionalization of embedded neoliberalism in Portugal.

Restructuring the economy

The restructuring of the economy was accelerated by the decision, jointly made by the two main political parties, to be part of the Euro from the start. This created a neoliberal bias in economic policies during the 1990s, the crucial period for explaining the current economic troubles. Indeed, it was mostly in the 1990s that the policies of 'nominal convergence' to satisfy the Maastricht criteria exerted a continuous pressure for the appreciation of the Portuguese currency — the Escudo — in a country which had previously relied on a deliberate policy of devaluation to boost its exports and solve its balance of payments problems (Ferreira do Amaral, 2006). This process was well summarized by an analysis from the European Commission (2004: 18): 'a major policy change in the direction of nominal convergence, paving the way for rapid disinflation in exchange for a real appreciation of the currency, on the back of persistent, although narrowing, price differentials'.

According to Ferreira do Amaral (2009), the bulk of the Portuguese loss of price competitiveness was due to nominal convergence before the Euro and to the European policy of the strong Euro afterwards. The rest can be attributed to the adverse evolution of prices of particular strategic inputs, such as energy, while wages, contrary to a common narrative, are totally exempted from responsibility for the external difficulties (Ferreira do Amaral, 2009). Portuguese firms, mostly price-takers when operating internationally, where market forces led to a continuing downward pressure on prices, saw a decrease in their profit margins, while those operating in markets for nontradable products, where market power and mark-ups are more resilient, were able to maintain or increase their relative profitability. The differences in the price evolution in these two sectors is now seen in many circles as highly relevant for grasping the evolution and the position of the different sectors, both dominant and subaltern, which comprise and thus shape the performance of the Portuguese economy.

Therefore, the success of the policy of nominal convergence created the conditions for future difficulties, as Portugal, contrary to Spain, entered the Euro with an over-appreciated exchange rate and an already unbalanced economy, exhibiting all the signs of having recently reached a peak in a financialized business cycle (Garcimartín *et al.*, 2010; and Leão & Palacio-Vera, 2011). A huge current account deficit was thus generated, which the government was now unable to manage by traditional means (i.e. currency depreciation). Nevertheless, a complacent narrative developed in Portuguese policy circles (partially revised a few years later), particularly in the

influential Portuguese Central Bank (Banco de Portugal, 2009), which rationalized and celebrated the new-found capacity of the Portuguese economy to attract a huge pool of foreign savings, particularly in the form of foreign bank loans and portfolio investment. This, so the argument went, would enable Portugal to profit from the disappearance of the so-called country risk and thus overcome the traditional balance of payments constraints which had obliged it to seek IMF assistance during the late 1970s and early 1980s.

The strong decrease in interest rates was seen as the most relevant sign of the robustness of the national insertion in international financial markets, to which the Euro had decisively contributed. Supposedly, this would allow firms to accelerate their accumulation of capital, a pre-condition for future increases in overall productivity, and families to increase their wealth, particularly through the increase in housing stock. From indebtedness levels below the European average, in the mid-1990s, Portuguese families and firms were geared to the top in the first decade of the Euro, with levels similar to the UK or Ireland. Looking back at the official justifications and optimistic evaluations that underpinned the strategy of joining the Euro, as in the landmark study of Barbosa (1998) for the Ministry of Finance, it is remarkable how closely these features were associated with the expansion of the financial sector. Going decisively into debt was assumed to be a rational individual decision, in accordance with the signals generated by the efficient financial markets that favoured it. As Constâncio (2008: 61), the former head of the Portuguese Central Bank and now vice-president of the ECB, has argued, 'what matters now is dominantly the credit risk, and this gives a totally different meaning to current account problems'. Confronting the protracted period of stagnation that ensued, Constâncio (2008: 62) showed his confidence in the 'impact of two market-driven self-correcting mechanisms' operating through the compression of credit and private demand. On the other hand, Blanchard (2007), an influential economist in Portuguese policy circles, revised his optimistic account about the patterns of financial markets — see Blanchard & Giavazzi (2002) — and declared that a period of intense wage deflation was unavoidable and should be accelerated through further structural reforms.

In understanding these troubles one cannot fail to take into account the profound institutional transformations, the so-called 'structural reforms', that took place in Portugal, starting with constitutional revision in the late 1980s which opened the way for what was, between 1993 and 2003, the most intense cycle of privatization in the EU, averaging 23 per cent of GDP at 2000 prices (Clifton *et al.*, 2006: 743). This doubled the percentage of the other 'big privatizers', such as the UK, and was important in showing the neoliberal commitment of the Portuguese political elites to both a market-driven European integration and also to its policy underpinnings, as the proceeds of privatization were used to assure compliance with the Maastricht criteria of public debt (and were partially justified on that basis).

These privatizations reconstructed corporate groups which had been enfeebled by the nationalization process following the democratic revolution in 1974. They were part of a wider process of integration, of which the steady financial liberalization, closely following the trend also set by the EU, was a much celebrated example in the early 1990s. Furthermore, it had the originality of not having generated any episode of financial crisis, despite the pattern of economic boom, between 1995 and 2001,

followed by a protracted bust (Braga de Macedo, 2003; Abreu, 2006). Together, then, privatization and financial liberalization were part of a successful state-led effort to reconstruct Portuguese financial capital, favouring the emergence of Portuguese private banks and assuring, also through a very favourable system of taxation, the enormous expansion of their activity.

In this context, it is important to realize that the macroeconomic signals given by the over appreciation of the Portuguese exchange rate, and the relatively profitable sectors that were restructured and privatized, were responsible for the microeconomic crystallization of a politically influential economic pattern of specialization at the national level. The incentives were then geared towards the profitable nontradable sectors of the economy, which were less exposed to foreign competition — from construction to retail and privatized utilities — but heavily inserted internationally. This was initially done through the pivotal role of the banking sector, which channelled most foreign credit directly or indirectly, i.e. through households, to these sectors (on the role of the banking sector in the Eurozone periphery, see also Becker & Jäger in this special issue). More recently, this insertion has manifested itself in the foreign investment strategies of the most successful corporations in those sectors. Initially based in Portugal and profiting from a close relationship with the Portuguese state, these corporate groups have started to use the profits generated at the national level and their access to international financial markets to reduce their dependency on the progressively exhausted internal market, thus becoming progressively transnational in orientation.

An analysis carried out recently on the political strength of what were provocatively labelled the ‘owners of Portugal’ reveals that financial capital has become politically central in the Portuguese political economy (Costa *et al.*, 2010). Among other things, this has taken place through increasingly direct connections with the political parties that have alternated in power, particularly the centre-right Partido social democrata [social democratic party] (PSD) which started the crucial privatization process in the late 1980s. More broadly, financial capital benefited from a process of European integration that it was ultimately dependent upon. This made it incapable, given its focus on relatively unproductive activities, of driving more than a very incomplete and uneven modernization of the Portuguese economy. Instead, the banking sector mostly profited from asymmetric relations with indebted workers plus small and medium-sized enterprises which were heavily dependent upon credit to guarantee their basic operations, thus extracting important financial profits for the banks. Lapavistas (2009) has aptly labelled this feature of financialized capitalism ‘financial expropriation’. Costa *et al.* (2010) added other sources of revenues in this parasitic vein: rents extracted through a presence in monopolistic sectors, land speculation, extremely favourable public-private partnerships or tax benefits, and finally evasion through tax havens.

To the regressive transformations just mentioned two more must be added. First, an economy torn between international finance and an increasingly regionalized landscape, in terms of its reliance on Spain and a few other EU markets for its exports (Reis, 2007), had to face the full impact of the entrance of China into the global economy and the EU’s enlargement to Eastern Europe. The penetration of Chinese exports into the EU, as shown by the country’s increasing market share, was particularly strongly felt by important segments of Portuguese industrial capital, mostly

consisting of small and medium-sized enterprises that had already been weakened by a process of deindustrialization from the 1990s onwards. The ‘China shock’ was felt most intensely by Portugal and Italy, ‘with industrial structures that placed them directly in China’s line of fire’, therefore intensifying the industrial difficulties (Ahearne & Pisani-Ferry, 2006: 4). At the same time, the EU enlargement to the East opened up new markets and labour pools for multinationals. They were able to profit from a combination of lower wages and a more skilled labour force, and used these countries as manufacturing and export platforms. Portugal felt the effects of a strong retraction in foreign direct investment (FDI) after the mid-1990s, falling below EU average levels, and increasing competition coming from Central and Eastern European exports (European Commission, 2004). This reversed the earlier trend from the 1980s until the introduction of the Euro: here, mostly European but also North American FDI had been a modernizing force in some parts of the economy, partially accounting for the slow but continuous climb of Portuguese exports in the value-added chain.

An asymmetric modernization

These troubling trends were occurring in a changing, increasingly complex, and socio-economically fractured landscape that underwent an intense modernization process. Even though it was asymmetrical, this helps us to understand the almost-undisputed hegemony of the project of European integration. This, in certain domains, outlasted the beginning of a divergence process, which the permanent austerity, assuring another lost decade, will prolong with still-uncertain intellectual and political consequences. Louçã (2011: 79), one of the few critical political economists in Portugal, formulated the problem of a ‘bipolar economy’: ‘backward in its system of production, modern in its system of consumption, backward in its system of social protection, modern in the expectations of life improvement it generated’. Unravelling this bipolarity will further allow us to scrutinize the impasses of the Portuguese political economy.

A government document justifying the priorities for the ‘National Strategic Reference Framework 2007–2013’ shows an enduring allegiance to the assumptions of the shattered Lisbon Agenda, and supports Louçã’s diagnosis of a backward system of production (CSF III Observatory, 2007). Indeed, and despite some progress, the economy remains essentially ‘based on a pattern of specialization in which products and processes that are low-technology intensive, poorly organized and use human resources with low levels of qualifications still predominate’ (CSF III Observatory, 2007: 28). However, there is no serious confrontation with the nature of the international integration favoured and the neoliberal policies that shaped it: ‘These characteristics of the Portuguese economic fabric reveal an extensive model of accumulation and economic growth that took root over decades and outlived the first stages of full European membership’. This model, which was incapable of generating sustained productivity increases or fully using and further incentivising the significant publicly-sponsored investment in education, was further locked in by the aforementioned rise of nontradable sectors which were favoured by the privatization process and over appreciation of the currency. It is not surprising that there was an entrepreneurial focus ‘on the internal market (such as construction, real estate, company-oriented and family-support services and educational and health services), heavy

investment in infrastructure sectors (telecommunications, audiovisual, gas, electricity, roads, water and the environment), the consolidation of tourism and a slight improvement in higher value added activities in the manufacturing industry' (CSF III Observatory, 2007: 17).

This pattern of investment reflected and contributed to the consolidation of an economy too reliant on services, aligned with a modernization of the system of consumption that was fuelled by the expansion of credit (Louçã, 2011). This system entered into crisis after 2002. The stagnation of internal demand, which only grew annually by 0.4 per cent between 2002 and 2009, was not compensated by the growth of external demand. In consequence, the current account deficit continued to widen in an unfavourable external environment, which was marked by fiercer international competition and a corresponding decline in export quotas, increases in the energy deficit and in the servicing of external debt, and a continuous decline in emigrants' remittances (traditionally very important for the Portuguese balance of payments) (Leão & Palacio-Vera, 2011). Given this context, it is not surprising that there was a decrease in investment, both private and public. Permanent austerity contributed further to dampening public investment, which impacted negatively on private investment and worsened the overall economic environment. This decrease in investment was only surpassed by a larger fall in savings as a percentage of GDP, which brought about a moralistic discourse that criticised living beyond one's means and blamed the welfare state for it. This was exemplified in the attack on the Guaranteed Minimum Income, which had already been significantly diluted by austerity policies.

The development of social protection or public infrastructures had earlier reduced the backwardness of the social protection system denounced by Louçã (2011) and previously identified by the literature on the 'Southern European Model' (Andreotti *et al.*, 2001). This focuses on what it sees as Portugal's capacity to articulate and make compatible the continuous, albeit uneven, development of social protection with policies of privatization and liberalization (Fishman, 2010). Fishman interprets this as the result of an ongoing consensus among political actors, the fortunate inheritance of the democratic revolution, and the virtues of robust state intervention which assures a certain degree of social embedding of the economy through high levels of employment and a consolidation of social protection. The acceleration of European integration is said to have helped in this regard, by making convergence with more socially embedded models of capitalism a more salient focal point in public debates, and by promoting processes such as the lowering of interest rates, which reduced the burden of public debt while also being compatible with the modernization of the state's fiscal capacities (Rhodes, 2002). On the other hand, Portuguese neoliberals entrenched in the central bank strongly criticised the growth of real wages which were aligned with the evolution of productivity levels, the strengthening of safety nets, and the increase in the duration and levels of unemployment support, which they deemed as the expression of the political refusal to openly pursue a strategy of social devaluation (at least until the beginning of the new millennium) (Rhodes, 2002: 320). The investments inspired by the Lisbon Agenda in Higher Education and R&D could also be added in support of this critique.

Of course, when compared to the most robust and universalistic models of welfare, the backwardness persists at crucial levels. In a critique of austerity policies, Navarro (2011) has recently argued that the socioeconomic troubles of the peripheral countries

can be located in the relative underdevelopment of the public provision of social goods. This is considered to be a factor in these countries' high levels of poverty and inequality, and their vulnerability to the impact of macroeconomic shocks on a dysfunctional financial system. Portugal has indeed very poor results in a host of important socioeconomic areas: for example, heightened job insecurity, comparatively low levels of educational attainment, and widening social fractures in one of the most unequal countries in the EU (there are also high levels of poverty, low levels of social mobility, and entrenched intergenerational transmission of advantages and disadvantages). The progressively entrenched austerity after the Euro marked a rupture in many public policies, as exemplified by the regressive social security reform of 2007 which strongly diminished future pensions. The precariousness of the coexistence between the principles of social protection and neoliberalization, and the ultimate subordination of the former to the latter, is now clear. This is particularly so with the increasing difficulties in accessing foreign credit at low interest rates. The intensification of austerity as a response to the external pressures from financial markets, culminating in an external intervention imposing policies of structural adjustment, can thus be interpreted as an effort to regressively manage the contradictions of embedded neoliberalism in the periphery.

Permanent austerity?

In a critique of the European political economy, Boltho (2003: 20) argued that: 'seen from the outside, the Eurozone looks almost like a developing country on which the IMF has imposed one of those rigid stabilization programmes for which it is so famous: low inflation, fiscal rectitude, deregulation and privatization, all run by a bunch of non-elected officials'. Eight years later, seen from the inside, 'rigid stabilization programmes' are being imposed by European institutions, with the participation of a comparatively more pragmatic IMF, throughout the periphery of the Eurozone in a vain effort to contain a structural crisis of its neoliberal configuration. These deflationary programmes, focused on minimising the risk of losses for financial capital, are the price these countries are paying for official loans.

After Greece and Ireland, a demissionary Portuguese government led by the Europhile Socialist Party asked for the intervention of the troika formed by the European Commission, the ECB, and the IMF. This had the support of the right-wing parties that are now in power. On 7 April 2011 a declaration of the European Council defined the terms of an intervention, planned to last for three years, to be signed one month later: 'strict conditionality', 'ambitious budgetary adjustment', 'removal of the rigidities of the labor market', 'measures to maintain the solvency of the financial system', and 'ambitious privatization program' were the key terms of the declaration. The Memorandum of Understanding signed in May 2011 fixed the terms of the public debate firmly on neoliberal grounds before a general election that would give an absolute majority to a right-wing coalition. The idea, cultivated in the media, that there was no alternative to what was constantly described as foreign help, framed the political debate in a way that favoured those seeking to use the intensification of external dependence, both financial and political, as a means for structurally changing the internal correlation of social forces. Paradoxically, there was, until very recently, a deliberate blanking out of the European dimension of the crisis, in

favour of (the aforementioned) politically convenient moralistic discourse which naturalized the European institutional arrangements and their biases (Reis & Rodrigues, 2011).

Meanwhile, and despite the rhetoric coming from certain quarters about expansionary fiscal contraction and the positive impact on the confidence of investors of a significant reduction in the state's size, the troika's own forecasts point to a decrease in Portuguese GDP of more than 5 per cent in two years and a rise of unemployment to above 14 per cent, the highest level in Portuguese history. This is the result of a planned fiscal adjustment which is unrealistically aimed at reducing the deficit from approximately 9 per cent in 2010 to 3 per cent at the end of 2013. The vicious circle of GDP contraction, violations of the targets for the budget deficit, and new rounds of austerity measures, which inevitably results in an ever-increasing debt burden, confirms that Portugal is following Greece's path to insolvency.

The changes in the tax system, such as the rise of the regressive value-added tax (VAT) rate — which has one of the highest weights in the national fiscal structure in the Eurozone — plus the intense wage cuts for workers in the public sector — which between 2002 and 2012 amounted to 30 per cent of their purchasing power — synthesized the overall logic of the troika's plan: to use austerity measures to engender a reduction of wages and a compression of internal demand in order to allow for a rebalancing of the external position (see also Becker & Jäger in this special issue for the more general implications of the plan). The removal of 'labour market rigidities' through a strong reduction in the legal and financial obstacles to workers' dismissals, coupled with a fall in the duration and level of unemployment insurance benefits and a decrease in the number of public holidays, is deemed necessary for improving competitiveness. Despite some formal employment protection and centralized collective bargaining structures, labour relations are effectively quite decentralized in Portugal: wages and jobs are flexible, giving ample discretionary power to employers. The intensification of labour exploitation, helped by high unemployment rates and the expected contagion of wage cuts from the public sector to the private sector, shows the nature of the adjustment that the troika favours.

As for the ambitious privatization programme, the cycle that started in the late 1980s with a beverages company will now end with the privatizations of the profitable water sector, the profitable part of public transportation, and what remains of the state's participation in utilities and other public infrastructures. This programme thus offers good opportunities for foreign capital with financial muscle, enabling the underlying logic of the privatization of profits and the socialization of losses to become clear: public *support* for the capital position of banks, whose vulnerability will only rise with the insolvency of indebted firms and individuals, but not public *control* of this vital sector.

As is well known, the austerity drive is not confined to the so-called 'PIIGS, Portugal, Ireland, Italy, Greece and Spain'. In a context of a generalized, demand-led crisis, with the banking sector unwilling to provide credit and the ECB forbidden to act as a true central bank (i.e. one that is capable of directly financing the Member States), an increasing number of governments are resorting to austerity measures. The fallacy of composition to which we have alluded above seems unstoppable. At the same time, the 'modest proposal' put forward by two post-Keynesian economists to

deal with the asymmetries at the root of the crisis, based on the issuing of Eurobonds and the promotion of a Europe-wide policy of economic stimulus, lacks the political agency necessary for it to be put into practice (Varoufakis & Holland, 2011). This reflects the difficulties of constructing market-correcting policies and institutions at this stage in the crisis.

Provisional conclusion: Which way out?

The Eurozone and the entire European project are torn between the pressures from financial markets and a decreasing political legitimacy. The prospect of exiting from the Euro, albeit very difficult, becomes potentially attractive for countries in the periphery as the crisis intensifies. Lapavistas *et al.* (2011) have presented a detailed blueprint for Greece's exit, following a default on its public debt. Capital controls, the nationalization of the banking sector, the definition of an industrial policy in the context of the needed devaluation of the new currency, and a new, democratically-controlled central bank are among the indispensable measures. These would signal a rupture at the national level with European embedded neoliberalism. In the context of the recovery of democratic sovereignty, new and more flexible principles of European cooperation and monetary coordination could be considered in order to move beyond the strictures of a common currency area which contains little possibility for progressive reform (Sapir, 2012).

In Portugal, despite the existence of a relatively strong tradition of combative trade unionism opposed to structural adjustment and giving voice to many workers' concerns, and two relevant parties to the left of an increasingly divided Socialist Party, progressive social forces are still incapable of going beyond a general and defensive opposition to the austerity measures now being implemented. The Eurozone strait-jacket creates a strategic conundrum which feeds a sense of extreme political impotency, despite some capacity for social mobilization shown in recent demonstrations and general strikes (Kouvelakis, 2011). One either promotes the exit from a Eurozone which seems reduced, at best, to a financial panopticon offering no avenues for progressive development, or argues for a reconfigured and intensified integration with enhanced democratic accountability, in line with post-Keynesian proposals. Despite its increasing implausibility, the second option is dominant because it is less risky from an economic and political point of view.

Meanwhile, concrete proposals being put forward by social movements (and gaining some support), such as the democratic auditing of the debt to be followed by a debtor-led restructuring, are a good starting point when attempting to overcome the aforementioned dilemma. They represent some of the few weapons that a rebellious periphery could use in a confrontation with an unsustainable and asymmetrical European project. This confrontation would be indispensable for avoiding the consolidation of the neoliberal hegemony and the further erosion of social protection. The Eurozone's fractures, both social and spatial, that the trajectory of Portuguese capitalism has revealed, are a reminder of the dangers of a multi-scalar political project — neoliberalism — which is firmly instituted in a monetary union resembling the Gold Standard.

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Note

- ¹ This means that a more detailed analysis of the actual constellation of the hegemonic social forces which shaped Portuguese capitalism and internally pushed for European integration must wait for a more detailed empirical enquiry.

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