

Economic Crisis and Austerity Policies in Portugal: effects on the middle classes

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**Conference: The Decline of the Middle Classes Around the World?
Segovia - Spain**

Portuguese Social Model

- Historical context
 - **Recent realization and Context dependence**
 - A contemporary manifestation of 1974 revolution
 - 1976 Constitution:
 - simultaneously ended the unstable post Revolution period and started democracy consolidation in Portugal
 - very generous as far as social rights are concerned, being a complex mix of social and political influences, strongly marked by the revolutionary social dynamics generated by the military cup
 - EU accession in 1986
 - **Unbalanced:** compromise between social policy achievements in the last period of the autocratic regime and new developments generated by democratic aspirations and the influence of the integration into the EU
 - An **encompassing model**

Portuguese Social Model

- Pillars
 - Public education system
 - National Health System
 - Social protection
 - Combination of a contributive and a non-contributive (social) system
 - Labour market regulation

To keep in mind

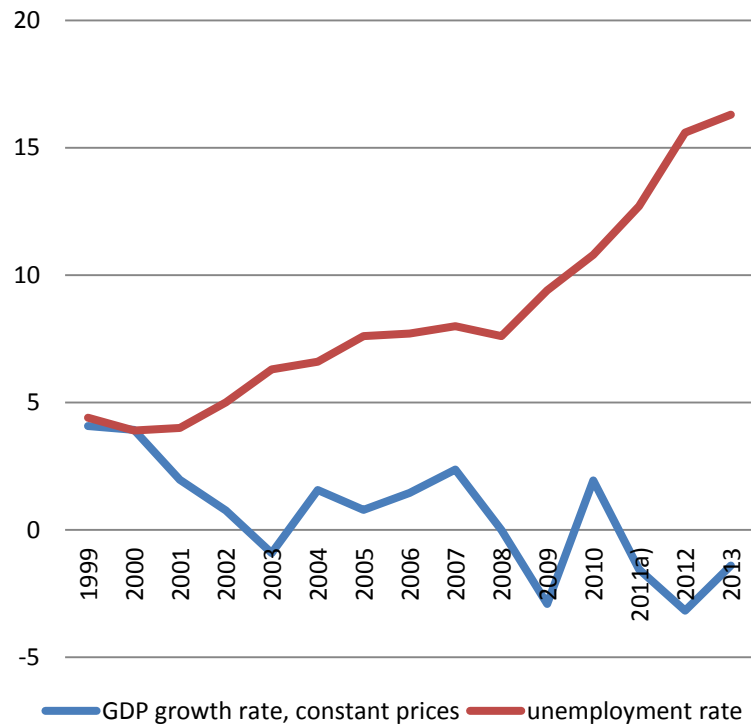
- Before 2008, Portugal was undergoing a process of structural change:
 - Adjustment of the productive specialisation profile to reglobalisation and overvalued Euro
 - Painful transition from a period of high employment creation in non-skilled and low wage jobs towards more skilled jobs, matching progresses in secondary and tertiary education
 - Need to stop or at least reverse the allocation of private and public resources towards non-tradable sectors

Portuguese Social Model

- The reforms of the 2000s: targeted at combining equity and efficiency
 - Labour market regulation: important changes based on Social Dialogue
 - Social Security (namely pensions): important changes based on Social Dialogue
 - Education and Health: rationalising the system
- POSITIVELY EVALUATED BY OECD, IMF and EUROPEAN COMMISSION

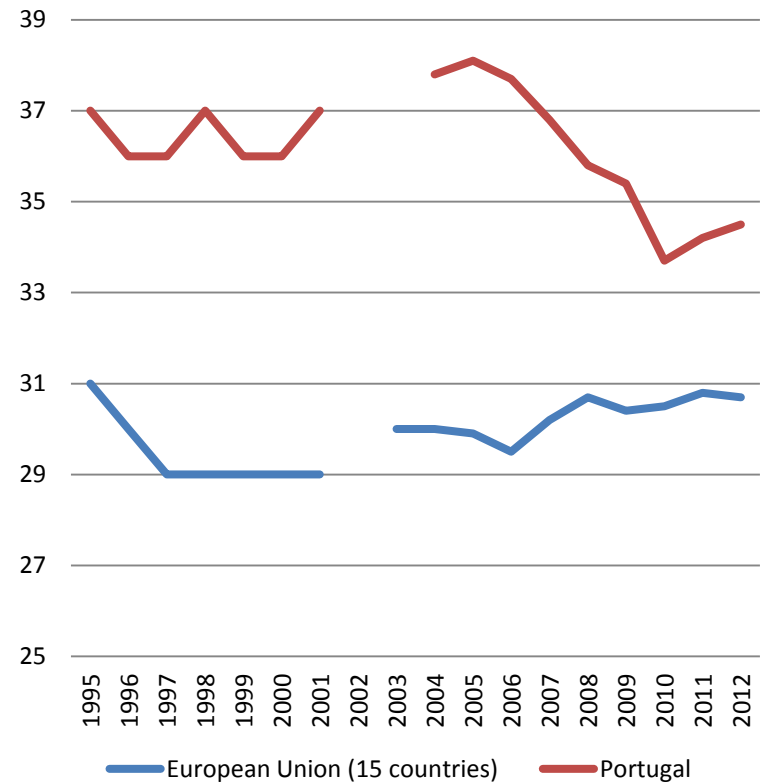
Crisis and MoU: some empirical evidence

GDP growth rate and unemployment rate: 1999-2012



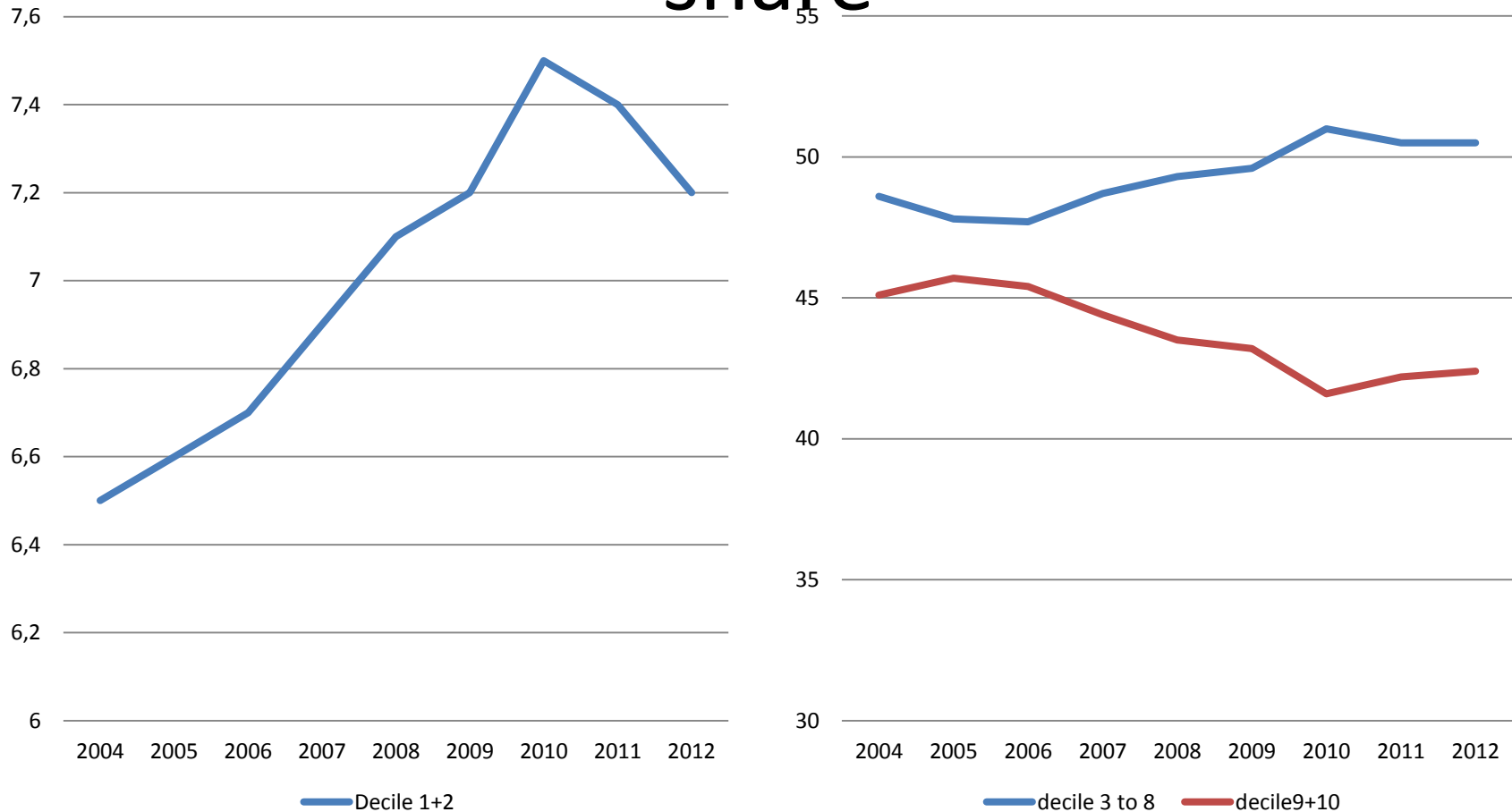
Source: PORDATA

Gini coefficient of equivalised disposable income



Source: EUROSTAT

Redistribution of income: income share



MoU: new dynamics of income distribution between groups

Source: EUROSTAT

But also in absolute terms...

annual growth rate of the cut-off income, Portugal

	2009	2010	2011	2012
Decile 1	2,9%	5,5%	-3,4%	-2,6%
Decile 2	4,5%	4,9%	-2,0%	-0,3%
Decile 3	4,0%	3,4%	-1,7%	-1,1%
Decile 4	2,3%	3,4%	-1,5%	-1,8%
Decile 5	1,7%	4,8%	-3,1%	-1,0%
Decile 6	0,8%	6,0%	-3,8%	-1,4%
Decile 7	1,8%	4,6%	-2,4%	-2,5%
Decile 8	-1,3%	2,3%	-1,8%	-1,5%
Decile 9	-1,5%	3,0%	-2,7%	-1,7%

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- National Income decreased
- It decreased differently in different income groups

Who is the middle class?

- Those in the middle of the income distribution
 - How to define the boundaries?
 - The middle 60% (decile distribution)?
 - A more differentiated (both from the poor and from the rich) group: for example those with an income ranging from 75% and 125% of the median income?
 - How to incorporate the absolute income?
- Those belonging to high qualified professions (managers + professionals)?
- Those that share common expectations, namely: home and car ownership, college education for their children, health and retirement security, occasional family vacations
- Those historically linked to State (central and local) consolidation (in Portugal after the advent of democracy in 1974): public servants

The shrinking of the middle class?

- Very unequal country
- Income cuts (wages, social security benefits, pensions)
- Wage cuts of public sector workers: a main cause of deterioration of the middle class
 - Income cuts + weakened prestige
 - Uncertainty and insecurity
 - Freezing careers
 - Political speech emphasizing a duality between the protected civil servants and the others;
 - Circle: deterioration of public careers; demotivation
- High unemployment even among the high qualified
- Increased homogeneity within income groups
- Significant fall of upward social mobility

In short:

Big Changes

- Structural unemployment
- High unemployment amongst the high qualified
- Income cuts (freezing and cutting wages, increasing taxes, ...) and increasing inequality
- Lower mobility across income groups
- Downsizing the status of some professions

Effect

- Reducing confidence in the future and trust in (some) institutions
- Expectations levelled-down
- Lower capacity to anticipate the future (too much changes concentrated in a short period of time)

Leading to

- **Strong impact in the middle classes**

Main conclusions

- The Portuguese economy was under a strong structural change before the crisis
- Austerity policies negatively extended the penalizing effects of the financial international crisis
- Bail-out measures should not ignore the development stage of the economy: dismantling the recent and vulnerable dimensions of the ESM in a context of strong demand for social protection had very high and not recoverable costs
- Fiscal consolidation of small euro-zone economy not feasible without a solution for the euro zone as a whole
- Portugal faces the emergence of strong dynamic negative effects, penalizing structural change efforts

What negative dynamic effects?

- Inefficient allocation of resources:
 - Returns of education investments by families are falling and there is a risk of inversion of behaviour of families
 - Wages fall are a bad incentive to innovation: dynamic efficiency is penalized
- Social cohesion is undermined and long term unemployment risks to turn into structural and permanent unemployment
- Social Dialogue is loosing visibility: risk of dismantling the previously accumulated trust capital
- Lack of trust in public and EU institutions: democracy in danger
- Growth potential strongly penalized

Thank You!

U. PORTO



ECONOMICS AND MANAGEMENT