

# **Economic Crisis and Austerity Policies in Portugal: effects on the middle classes (\*)**

Pilar González (Faculty of Economics of Porto and CEF.UP)

António Figueiredo (Faculty of Economics of Porto and Quaternaire Portugal)

(\*)The research reported here forms part of the project “The European Social Model in Times of Crisis and Austerity Policies” coordinated by Daniel Vaughan-Whitehead and financed by the ILO and the European Commission.

## **Abstract**

Portugal was hit by the international crisis in 2008 and, following worsening difficulties, asked for financial help from the “troika” (the European Commission, European Central Bank and International Monetary Fund) in May 2011. Upon signature of a Memorandum, both Portugal and the troika agreed on a programme to ensure the reduction of the existing fiscal deficit and national debt. Three years after the programme was implemented, the situation has not improved much as the Portuguese economy suffered a sharp recession with severe effects on the labour market.

One of the major discussions of the ongoing crisis concerns its effects on the middle class, the major supporter of democratic regimes. Despite the prevalent discussions on the concrete meaning of the concept ‘middle class’ it generally refers either to intermediate income groups or to groups of the population that anticipate upward social mobility as an attainable goal. In Portugal austerity packages have been implemented in a context of increasing structural unemployment and have been associated with a process of social, political and institutional instability. Instability can bring (in fact is bringing) increasing feelings of mistrust and lack of expectations with regard to the possibility of attaining a better future. This can compromise economic and social improvement but can also damage democracy itself.

This paper aims to discuss the effects of ongoing austerity policies in the Portuguese middle classes considering some important features of Portuguese situation namely) i) high structural unemployment; ii) high deficit of school qualifications of the population in working age; iii) high and increasing inequality and ii) high emphasis of austerity measures targeted at public employees.

## 1. Defining the middle class

Despite prevalent debates both in the academic literature<sup>1</sup> and in the press<sup>2</sup> on the effects of recent economic changes on the middle classes, there is evident disparity on the sense attributed to this concept. The debate is widened if one takes into account the definition of middle classes in poor and emergent countries (Birdsall, 2010; Birdsall, 2012). There is also an intense debate about the shrinking and the hollowing out of the middle class fostered by the impact analysis of the Great Recession effects and of other issues such as for example the polarization of jobs (Autor, 2010; Autor 2014; Autor and Dorn, 2013). Middle classes are the groups that are in the middle of some sort of society ranking. Still, what are the variables to be considered in such a ranking? There is a spread consensus on the fact that, in market societies, income is a decisive variable as it means capacity to access to goods and services provided by the market. So, middle classes are often represented as the group of the population that is in the middle of the income distribution differentiating themselves from those having low income (in the bottom of the income distribution) and from those having a high income (in the top of the income distribution). From this perspective the middle class is defined mainly through income distribution and income level. But this raises additional questions to deal with and often the need to complement the income distribution approach with sociological insights. Without the pretention of being exhaustive we will refer some of the most discussed.

A first question relates to the issue of absolute versus relative income. We can consider middle income to be an amount that ranges between certain boundaries, the more frequently

---

<sup>1</sup> See, among others, Atkinson and Brandolini (2011), Institute for Research in Poverty (2010), Jenkins (2010).

<sup>2</sup> See, among others, Stiglitz (2014), Luce (2014), Porter (2013), Krugman (2013).

adopted being the interval from 75% to 125% of median income, following an early analysis by Thurow (1987). The rationale of this measuring is that middle classes are middle income groups that clearly differentiate from the poor (so having a sufficiently large income gap towards people in poverty<sup>3</sup>) and from the rich (harder to classify<sup>4</sup> and frequently defined by using a symmetric interval in the income distribution). Dallinger (2013) prefers to use quintile analysis to study the evolution of the middle class as it prevents discretionary settling of boundaries (as data is organized in groups representing 20% of the population each) and allows to decompose the middle 60% in three groups of 20% each permitting to differentiate the “bottom”, the “middle” and the “high” middle class.

The previous types of definition rely on relative income: belonging to the middle class depends on the comparison with other income groups. This can be a very informative way of defining the middle classes particularly in static terms. Still if we want to introduce a dynamic and/or a comparative perspective additional questions emerge. In fact, in a context of changing median income those classified as middle class can be in a rather different situation in different periods of time and/or in different regions. This leads to a second important question to consider when we are characterising middle classes. According to the relative criteria, the middle class may include a large scope of income situations that i) differ within that same broad middle income group and ii) differ according to the higher or lower polarization of the income distribution of the country (region) under analysis as high polarization means bigger distance between those in the top and those in the middle and/or in the bottom of the income scale. So, absolute income levels do matter, leading some authors (see, for example, Milanovic and Yitzhaki, 2002; Milanovic, 2005; Milanovic 2012; Banerjee and Duflo, 2008) to use absolute boundaries to define middle classes. Still, the boundaries

---

<sup>3</sup> EUROSTAT defines poverty as the group of those having an income below 60% of median income.

<sup>4</sup> For an instructive discussion of this issue see Atkinson and Brandolini (2011).

defined, whether relative or absolute, are somewhat discretionary in terms of the value assumed even if the rationale is understandable<sup>5</sup> (see, among others, Atkinson and Brandolini, 2011; Ravalion, 2009).

A third issue refers to the limitation of using solely income criteria. Personal income is normally emphasised by economists but other social scientists evidence other characteristics needing to be considered to define a middle class that relate to a certain range of “values, aspirations and expectations”<sup>6</sup>. Other studies identify middle classes on an occupational basis including those belonging to the most qualified professions: managers and professionals (Mateus, 2013). Despite providing important information this is, in our view, if solely considered a rather rough measure of middle classes.

In a research on the US middle classes (Institute for Research in Poverty, 2010: 4-5) aspirations of middle class families have been described as follows: “homeownership, car, college education for their children, health and retirement security and occasional family vacations”. Putting it in a more general way, middle classes share a common aspiration of moving upwards in the social ladder both regarding the present generation and, especially, for children leading the current active age generation to aspire to good and secure jobs as a means of securing the future. This common aspiration of upwards social mobility is a key factor in order to understand the critical role of middle classes in social change and is also a very useful contribution to isolate economic and social mechanisms through which austerity policies affect social dynamics in targeted adjustment countries.

In the European Union (EU) and given the existence of a European Social Model (ESM), some of the concrete aspirations referred above are differently accurate as compared to the

---

<sup>5</sup> This rationale is more problematic to fix the upper boundaries as discussed by Atkinson and Brandolini (2011: 8-9)

<sup>6</sup> Institute for Research in Poverty (2010:2).

US economy. Despite existing differences among the EU member-states, public education, public health and public social security are an important component of the ESM. There is a vast evidence (more documented in the USA than in the EU) that recent crisis and austerity policies affect one of the distinctive and inclusive feature of the ESM, the aspirations of middle classes, leading in some extreme cases to their significant impoverishment.

In the analysis of the Portuguese case we will discuss the particularities of the country's middle class. For this purpose, it is important to generally describe some main economic and social characteristics of the Portuguese model that shape some of the aspirations of the Portuguese middle class and the recent changes on grounds of austerity policies with effects on those aspirations. We argue that recent changes in the welfare state interfered with middle class family's expectations on several grounds with both short term and long term effects on the social country prospects.

## **2. The roots of the ESM in Portugal: recent, context-dependent, unbalanced, encompassing, and vulnerable<sup>7</sup>**

The existence of a coherent Social Model in Portugal is a contemporary manifestation of the 25<sup>th</sup> April revolution in 1974. The new Portuguese Constitution (established in 1976) is very generous as far as social rights are concerned. It represents a complex mix of social and political influences and is strongly marked by the revolutionary social dynamics generated by the military coup. Thus, the Portuguese Social Model is context dependent as well as a recent achievement. But it is also unbalanced and vulnerable.

It is unbalanced as it is mainly determined by specific historical conditions representing a compromise between the incipient social policies from the last period of the autocratic

---

<sup>7</sup> Sections 2, 3 and 4 closely follow González and Figueiredo (2014a).

regime, new developments generated by democratic aspirations and the results of the subsequent integration into the European Union.

The practical implementation of social rights established by the 1976 Constitution applied to a very heterogeneous set of achievements coming from the past. Still, and albeit the improvements observed during the last phase of the autocratic regime, public spending on education and health represented, respectively, 1.3% and 0.3% of GDP in 1973<sup>8</sup>. In that same year, the child mortality rate was very high (44.8 per thousand births) and net enrolment rates<sup>9</sup> in basic (9 years) and secondary education (11 years) were, respectively, 16.5% and 5.0%. These basic figures show the extent of the social challenge faced by the advent of democracy. In 2012, those indicators had radically changed: child mortality dropped to 3.4 per thousand births, gross enrolment rates in basic (9 years) and secondary education (12 years) were, respectively, 89.9% and 72.3% and public expenditures on education and health increased to, respectively, 4.0% and 6.3% of GDP<sup>10</sup>. In fact, after 1974, political and legal changes in education, health and social security made the universality of social rights established by the Constitution a reality. Simultaneously, the workfare of the social system began to be implemented.

The 2007/2008 Great Recession dramatically affected the Portuguese economy, exacerbating pre-existing trends of job destruction. The sustainability of the Social Model that was already under pressure became deeply threatened by generalised austerity-led cuts in public spending. Significant changes in the Portuguese labour market also took place (Figure 1).

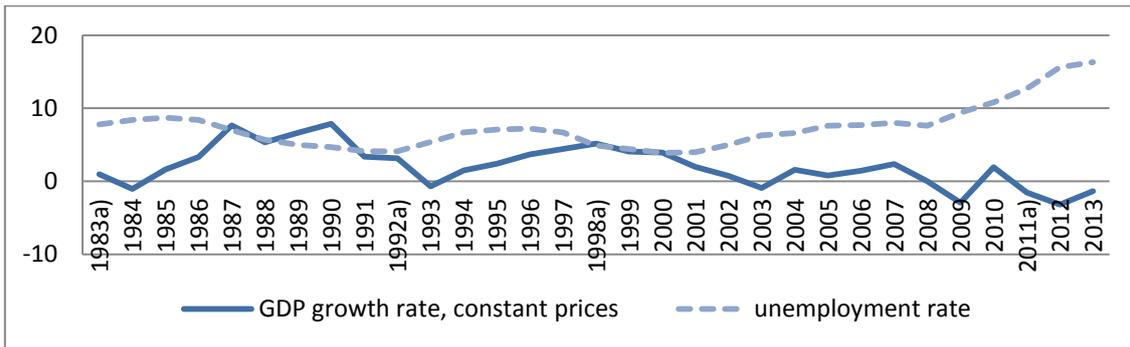
---

<sup>8</sup> PORDATA

<sup>9</sup> Net enrolment rate: Share of students enrolled in a given cycle of studies with the corresponding legal age and the total population of these age segments. (legal age of attendance: basic education: 6-14 years; secondary education 15-17 years)

<sup>10</sup> PORDATA

**Figure 1: Portugal, annual GDP growth rate and unemployment rate, 1983-2013.**



(a) break in the series for the unemployment rate  
Source: PORDATA

In fact, even before the impact of the 2007/2008 crisis, Portugal was undergoing a process of structural change related to<sup>11</sup>: (i) the structural adjustment of the country's specialisation profile linked to (re)globalisation dynamics and to the effects of an overvalued Euro; (ii) a painful transition to the creation of more skilled jobs able to integrate new inputs of more educated youngsters; (iii) the need to redress the allocation of private and public resources out of non-tradable sectors (services, infrastructures, real estate, and finance and banking).

All the main pillars of the Portuguese welfare system experienced important policy reforms throughout the 2000s and were favourably evaluated by the main international organisations: the OECD, the IMF and the European Commission.<sup>12</sup>

As to the labour market reforms the 2000s were marked by changes in labour regulations.. The main concern was to promote flexibility<sup>13</sup> in the labour market while keeping job security. The main areas of change related to: i) the duration of the normal working day (increase of the period considered as normal working time); ii) the increase of duration of fixed term contracts; iii) the introduction of geographical mobility clauses in collective contracts, and iv) changes in collective law (expiry clauses in collective agreements).

<sup>11</sup> See Banco de Portugal (2013).

<sup>12</sup> See, among others, OECD, 2008: 63; IMF, 2008:1; European Commission, 2008:27.

<sup>13</sup> In the late 1990s, early 2000s, Portugal ranked in the top of Employment Protection Legislation indicators mainly because of protection of permanent workers against (individual) dismissal (OECD, 2004).

The reform of the Labour Law evolved in parallel with an increasing visibility and effectiveness of Social Dialogue. An increasing capital of trust among social partners was accumulated throughout this process, in contrast with the conflictive pattern of the 1970s, the 1980s and largely the 1990s.

The Social Security reform has also been implemented aiming at adapting the system to new problems such as ageing, the progressive increase of the pension period and the different growth dynamics of pensions and contributions. The sustainability of the social security system as a fundamental pillar of the Portuguese social model was a joint concern of the Social Partners<sup>14</sup> (union confederations, employer confederations and government) and a tripartite agreement on its major lines has been signed in 2006. A sustainability index<sup>15</sup> has been created (linked to life expectancy, and defined according to the GDP's growth rate and to consumer prices) to be used in the calculation of pensions and other means-tested social benefits. A maximum value for public pensions and the principle of convergence of the existing regimes (the general and the public servants' regimes) were defined. The early and mid-2000s were also characterised by reforms in unemployment benefits, family pay, parental leave, and new measures aimed at preventing elderly poverty.

Reforms of the National Health System (SNS) have been promoted under the rationale of increasing its efficiency and financial sustainability, while ensuring its quality and universality.<sup>16</sup>

One of the main features of the pre-crisis reforms relates to the reorganisation of the education system, concentrating resources in larger institutions providing diverse education services. This was expected to increase efficiency and a more adequate offer of education throughout the regions, as it allowed important scale effects and the improvement of

---

<sup>14</sup> CES, 2007:2.

<sup>15</sup> The IAS – Social Sustainability Index.

<sup>16</sup> Information on this section is based on the official site of the Portuguese Ministry of Health.

apprenticeships and socialisation environments. Large investments in the renewal of school buildings and equipment relied, in part (but importantly) on European Structural Funds (ERDF). A process of teachers' evaluation was also implemented, turning out to be a very tense process with many conflicts and a high mobilisation of teachers by their strong unions. The whole process had ambivalent (and rather extreme) effects on public opinion.

Portugal also implemented, long before the crisis, reforms targeted at reorganising public administration and reducing public expenditure. The OECD classified this reform as “ambitious” considering it “a major component of the budgetary consolidation strategy [... going] beyond fiscal consolidation, to include the enhancement of the quality of public services and strengthening the governance of public institutions.”<sup>17</sup> Two main areas define this reform: i) a reorganisation of central administration (PRACE programme) intended to simplify public services, reduce redundancies and promote E-government, and ii) a reform of human resources including careers, forms of contract and mobility and the introduction of a recruitment limiting rule for public workers (one new recruitment for every two leavers).

These economic and social changes should be complemented with a short historical perspective of the Portuguese middle classes formation. And here the main sentence is the strong dependency upon the central public administration bodies and, after the first years of democracy, the significant increase in the number of public servants in local administration. There is an aggressive debate about the eventual asymmetries between central and local administration workers and private sector employees concerning the level of remunerations and the quality of jobs, which was present in some of the Constitutional Court decisions on austerity measures. For the purpose of this paper, we follow a pragmatic perspective consisting of assuming that a significant part of the middle classes are families with one or two jobs in central and local administration. Some of these representatives are associated to

---

<sup>17</sup> OECD (2008:47).

professions that are crucial to the improvement of the quality of public services delivery such as for example teachers and National Health System workers. Some authors argue that in a context of no reform of state organization, adapted to modern times, more than under-employment within public workers there is lack of skilled workers and a bad distribution between sectors and regions. For our conclusions, we only should take into account that hitting public employment and wages austerity policies didn't succeed in reforming state organization although generating a significant fall of material well-being of a vast part of the middle classes in Portugal.

### **3. Crisis and austerity policy design**

Since 2010 packages of austerity measures have been implemented in Portugal following a change in the European policy regarding the crisis (European Commission, 2010: 1). Portugal strictly followed the initial guidelines towards a fiscal stimulus, partially explaining the increase of public expenditure in the period between 2008 and 2010.

#### **3.1. Austerity before and after the memorandum**

Austerity measures began to be adopted in March 2010 and, during that same year two more austerity packages were adopted<sup>18</sup>.

Following the rejection of a new austerity package by the parliament (March 2011) the government resigned. About a month later, the government, still in office, asked for financial help from the European Commission. Negotiations with the Troika were conducted by the government (Socialist Party) and the Memorandum of Understanding (MoU) was signed by

---

<sup>18</sup> These packages have been denominated PEC1, PEC2 and PEC3, PEC being the Portuguese initials for Sustainability and Growth Programme.

three political parties (centre-left, centre-right and social-Christian right wings) and the Troika. This has been understood as an important sign of the country's political cohesion.

### **3.2. The Memorandum of Understanding<sup>19</sup>**

The MoU is organised according to seven main topics: i) Fiscal policy; ii) Financial sector regulation and supervision; iii) Fiscal-structural measures (including, among others, Public administration and Health care system); iv) Labour market and education; v) Goods and services markets; vi) Housing market, and vii) Framework conditions (including Judicial system Competition, public procurement and business environment).

Each of these topics has general objectives and very detailed targets. The more detailed objectives refer to the labour market (European Commission, 2011).

After the MoU was signed, the Social Partners maintained a climate for negotiation expressed in a Tripartite Agreement on Competitiveness and Employment (January 2012<sup>20</sup>). This agreement<sup>21</sup> gave an important social support to the reforms to be implemented.

Political parties supporting the new government (issued from the 2011 elections) based their electoral campaign on the ideas that “cutting wages and firing workers will not be necessary to comply with the MoU<sup>22</sup>” and “any tax adjustment, if needed, will be done through indirect taxes and not by income taxes<sup>23</sup>”. It is true that in political campaigns

---

<sup>19</sup> Three documents and a letter of intent compose the Economic Adjustment Programme for Portugal. The documents are the following: i) Memorandum of Economic and Financial Policies (MFEP); ii) Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) and iii) Technical Memorandum of Understanding (TMU). All of them are included in European Commission (2011).

<sup>20</sup> A previous agreement on competitiveness and employment had been signed in March 2011.

<sup>21</sup> The agreement has been signed by, the employers' confederations and one (UGT) of the two worker's confederations. In Portugal there are two main union confederations: CGTP is the oldest and largest confederation of workers in Portugal, and closest to the Communist Party; UGT is a confederation of workers created in 1978 to ensure the plurality of unions. It is closer to the Socialist Party (and also to the Social-Democratic Party).

<sup>22</sup> Current Prime-minister's press statement on 30 April 2011.

<sup>23</sup> Current Prime -minister's press statement on 24 June 2011

emotions play a major role. Still, the message of the parties that later became the government was focused on ideas that did not materialise. The measures implemented had a high incidence of wages and pensions' cuts (especially for public servants). Tax increases have also been persistent.

Policy measures taken under high pressing short term needs (normally related to Troika evaluation meetings) have often been designed so as to ensure short term results. Most of the changes aimed at immediate increases in revenue (tax rates, namely indirect taxes, have been increased) and cuts in public expenditure (cuts in the wages of public employees, freezing of new hires and promotions, freezing of insurance benefits and pensions, reduction of means tested unemployment assistance, family benefit and social assistance).

### **3.3. Social, Political and Institutional Stability**

Portugal kept an image of social stability after the Troika intervention. In fact, opposition to the implemented measures has not been expressed through extreme or violent episodes. Still, this does not mean they do not exist. Several big demonstrations in the streets occurred since the beginning of austerity policy, mainly in 2012. Three general strikes (November 2010, November 2011 and June 2013) were organised, bringing together the two workers' confederations for the first time in 22 years.

Political and institutional stability, which have also been considered a main advantage in the Portuguese context, has also been undermined by several conflicts making evident the existence of tensions within the government and between the government and the Constitutional Court that, having declared several measures adopted by the government to be unconstitutional, has been criticised by the government and even by the Troika to be blocking the action of the government.

### 3.4. The painful emergence of structural unemployment

The huge unemployment increase from 7.7% in 2008 to 16.3% in 2013 (13.9% in the second quarter of 2014) is the main sign of the deterioration of both economic and social situation (INE, *Estatísticas do Emprego*).

Unemployment increased in all age groups, but is especially high among youth (the unemployment rate is currently 35.6%<sup>24</sup>). Still, the biggest contributors to unemployment are the elderly (aged 45 and more) representing 31.8% of total unemployment in 2013, and the less educated accounting for 58.9% of total unemployment in that same year.

**Table 1 - Unemployment rate by age group and educational level, %**

	2003	2006	2009	2013
<b>Total</b>	<b>6.3</b>	<b>7.7</b>	<b>9.5</b>	<b>16.3</b>
	<b>Unemployment rate</b>			
	<b>By age group</b>			
15 to 24	14.5	16.3	20.0	37.7
25 to 34	7.5	9.1	10.9	19.0
35 to 44	5.1	6.3	8.5	14.3
45 and more	3.6	5.4	7.0	12.3
	<b>By educational level</b>			
Basic	6.2	7.7	10.1	17.1
Secondary	6.9	8.5	9.6	17.2
Tertiary	6.0	6.3	6.4	12.9

Source: INE, *Estatísticas do Emprego*, 4<sup>th</sup> quarter 2013

While education reduces the risk of unemployment, the unemployment rate hugely increased in all the education groups. Particularly striking is the 12.9% unemployment rate amongst the high educated as Portugal has a very high educational deficit, ranking at the bottom of the EU countries as regards the percent of 25-64 years population with upper secondary education (in 2013 this percentage was 40.0 in Portugal and 75.1 in the EU27<sup>25</sup>).

<sup>24</sup> INE, *Estatísticas do Emprego*, 2nd quarter 2014.

<sup>25</sup> EUROSTAT, edat\_[lfse\_08]

Long-term unemployment currently represents the highest share of the Portuguese unemployed (62.1% in 2013).

Data on the number of families where both members of the couple are unemployed shows a dark picture reflecting a particularly vulnerable situation<sup>26</sup>: it consistently rose from 1 530 couples in October 2010 to 12 365 in April 2014<sup>27</sup>.

A sharp gap also emerged regarding unemployment benefits: in 2008, 61% of the Portuguese unemployed accessed an unemployment benefit but only 46.5% did so in 2014<sup>28</sup>. Consequently, being unemployed is rather different from what it used to be before the crisis.

### **3.5. Wages and income distribution**

Portugal is a low wage country and has a high incidence of low wages compared to other EU member-states<sup>29</sup>.

Minimum wage policies had historically an important effect on sustaining the income of low qualified workers in the country. The freezing of minimum wage in 2010 on the grounds of the austerity measures obviously impacted on income and contributed to an important public debate on the pros and cons of such a measure.

Portugal is also a very unequal country as compared to other EU member-states<sup>30</sup>. A quite different path emerges, however, in diverse periods since the mid-1990s (Figure 2). In the mid- 2000s a clear decrease of inequality emerged reducing the gap towards the EU average. This trend was interrupted in 2011 with the implementation of the Troika memorandum. It is

---

<sup>26</sup> Given the precariousness of this particular situation, the calculation of the unemployment benefit has taken this element into account since 2011.

<sup>27</sup> IEFP, *Informação mensal sobre estado civil do desempregado e condição laboral do cônjuge*.

<sup>28</sup> INE, *Estatísticas do Emprego – 1º trimestre 2014 and Segurança Social, Estatísticas Gerais, Março 2014*.

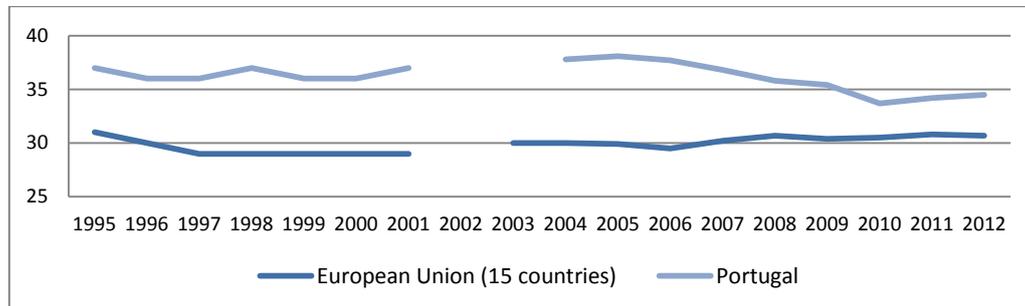
<sup>29</sup> Carneiro *et al.*, 2011.

<sup>30</sup> In the OECD (2012) a distinction has been made between five groups of OECD countries. The highest inequality group (characterised by a high concentration of labour, capital and self-employment income and a high poverty rate) included six OECD countries: Chile, Israel, Mexico, Portugal, Turkey and the USA.

still too early to see any signs that the previous trend will reverse, but it seems rather clear that one thing has to do with the other.

The inequality of income distribution closely follows high at-risk-of-poverty and at-risk-of-poverty-and-social-exclusion rates by EU standards.<sup>31</sup> Still, it is important to bear in mind that the risk of poverty is not neutral, affecting different groups of the population in different ways. Portugal has a particularly high risk of poverty for children<sup>32</sup>: 24.4% in 2012 compared with 18.7% for the total population<sup>33</sup>. The family structure also has a high effect on the poverty risk: “One adult 65 years or over”, “Single person with dependent children” and especially “Two adults with three or more dependent children” households are much more exposed to poverty risks than other household structures (the At-risk-of-poverty rate in 2012 was respectively 22.1%. 33.6% and 40.4% compared with a total rate of 18.7%)<sup>34</sup>.

**Figure 2: Evolution of the Gini coefficient of equivalised disposable income, Portugal**



Source: EUROSTAT, SILC [ilc\_di12]

The importance of education as poverty preventing appears very clearly in the country: the risk of poverty reduces with the level of education and the education of the parents has an

<sup>31</sup> EUROSTAT, SILC [ilc\_di12], [ilc\_peps01]

<sup>32</sup> Aged 17 or less.

<sup>33</sup> INE, 2014.

<sup>34</sup> *Idem.*

important effect on children poverty risk<sup>35</sup>. Moreover, social policies are very effective in reducing poverty incidence

#### **4. Is austerity shrinking the middle class?**

We will now focus in the effects of the crisis and austerity in the Portuguese middle class. We will use both data on income distribution and on the middle class aspirations as defined in Institute for Research in Poverty (2010) and quoted above (section 1): homeownership, car, college education for their children, health and retirement security and occasional family vacations.

##### **4.1. Social aspirations and austerity**

Home and car ownership have been important means of upward mobility in Portugal after the 1970s. Homeownership increased sharply in the last decades (multiplied by three between 1970 and 2011<sup>36</sup>) and currently around 75% of Portuguese households own their own houses<sup>37</sup>. Also did the number of registered cars that was 429 per 1000 inhabitants in 2012<sup>38</sup> (more than double the value in 1990). So, expectations of ownership on durable goods did concretize for a large number of families, in great measure fuelled by the significant increase of banking credit (housing and consumption) mainly observed after the integration into the Euro-zone. The fluidity of housing credit is one of the main factors explaining the strong prevalence of new construction building against housing rehabilitation and is naturally associated to the increasing level of indebtedness of Portuguese families till the 2008 crisis.

---

<sup>35</sup> See, among others, OECD (2012).

<sup>36</sup> PORDATA (data from Population Census).

<sup>37</sup> EUROSTAT [ilc\_lvho02]

<sup>38</sup> European Commission (2014).

The level of education of the Portuguese population, despite remaining the lowest among EU27 member-states, increased steadily in the last decades: college graduates share of total resident population was 2.4% in 1981 increasing to 14.8% in 2011<sup>39</sup>. Public education, National Health System and Social Security have been developing after the 1974 revolution providing universal services most of them without any fee<sup>40</sup>.

The creation and development of a modern welfare state motivated a strong increase in public employment (it doubled between 1979 and 2005 declining afterwards to around 748 thousand in 2005 and 564 thousand jobs in 2013).<sup>41</sup> Education and health public services employ more than 45% of current public employment (DGAEP, 2014) and they were main employers of some of the high qualified professional groups that increased most in recent: between 1970 and 2013 the number of teachers more than triplicate and the number of doctors has multiplied by five. The two processes of development of a social state and of the increase of teachers and doctors professionals are closely interrelated.

As previously mentioned, public servants have been in almost all countries, and certainly in Portugal, prominent representatives of the middle class. The prestige of public service since the autocratic regime (rather difficult to access, but offering stability and promotion) had been reinforced after the revolution of 1974. The need for new services specially linked to the social functions of the state originated an increase in highly-qualified public jobs as referred above. A high share of scarce highly-qualified Portuguese workers thus entered the public sector and, in doing so, reinforced its social status.

Austerity necessarily affected concrete expectations. The reduction of disposable income reduces the purchasing power of families namely on durable goods and challenges the capacity of keeping those previously acquired mainly by the increasing incapacity of families

---

<sup>39</sup> PORDATA

<sup>40</sup> For a detailed discussion see González and Figueiredo (2014)

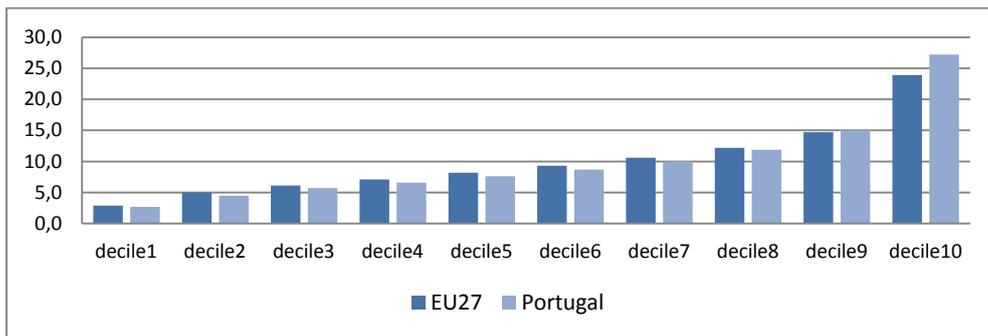
<sup>41</sup> DGAEP (2009); Presidencia Española de la Unión Europea (2010).

to comply with their loan obligations. Also the high incidence of austerity measures on public employees where a large share of middle classes is concentrated contributes to demotivation and distrust, necessarily affecting aspirations towards an uncertain future.

#### 4.2. Austerity and distribution

Looking now to income share, a general comparison of the current (2012) income distribution in Portugal and the average EU27 shows that it is more polarised in Portugal (Figure 3).

**Figure 3- Income distribution in the EU27 and Portugal, 2012**



Source: EUROSTAT, SILC [ilc\_di01]

The contrasting effect of the austerity policy shows up very clearly (Figure 4A and 4B):

- Low-income groups (deciles 1 and 2) represent a very low share of the Portuguese income. The evolution of this share contrasts in recent years: consistently increasing until 2010 and decreasing after;
- Medium-income groups (deciles 3 to 8) shared a higher percent of income until 2010 but this tendency stopped in 2010;

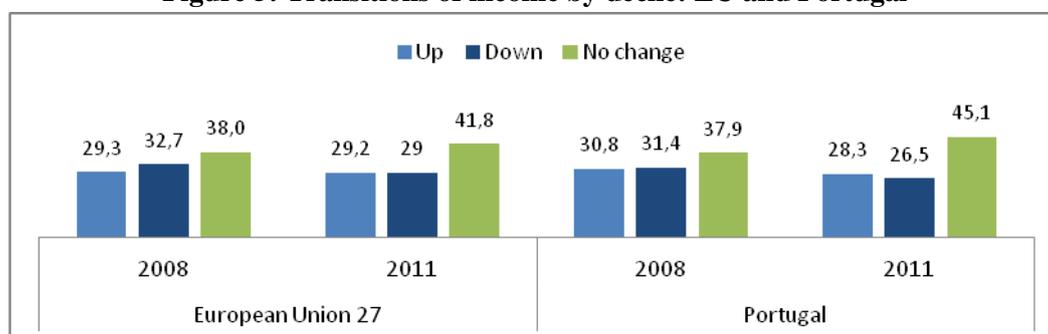


**Table 2: annual growth rate of the cut-off income, Portugal**

	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%
<b>Median equivalised net income</b>	<b>1.7%</b>	<b>4.8%</b>	<b>-3.1%</b>	<b>-1.0%</b>

(Source: SILC) [ilc\_di01]

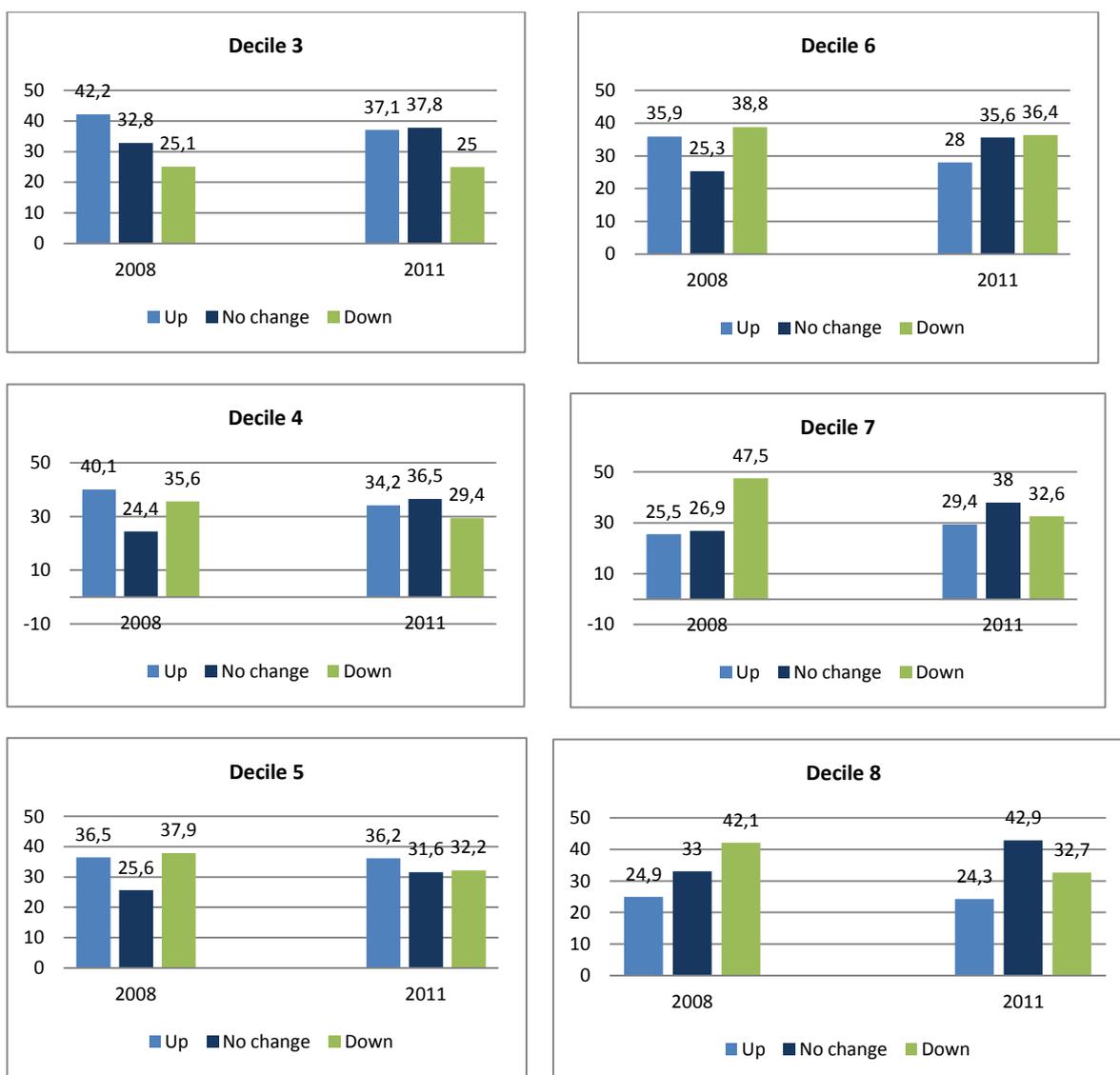
Also there is clear evidence of lower mobility of the population along the income groups throughout the austerity period. This is visible both in the EU27 and in Portugal, but is more intense in Portugal: the percent of the population staying in the same income decile group (no change in Figure 5) increased 3.8 pp in the EU27 and 7.2 pp in Portugal in the period 2008-2011.

**Figure 5: Transitions of income by decile: EU and Portugal**

(Source: EUROSTAT, SILC [ilc\_di30])

Increased immobility characterises all the income deciles and particularly the intermediate ones (Figure 6). In 2008, mobility was particularly high in deciles 3 to 8 (percent of no change ranging between 24.4% and 33%, low behind the national average, 37.9%) and, particularly, middle deciles (4, 5, 6 and 7). These were precisely the deciles where immobility increased the most, meaning fewer opportunities to progress.

**Figure 6: Transitions of income by decile in Portugal: intermediate deciles**



Source: EUROSTAT, SILC [ilc\_di30]

### 4.3. Mass unemployment putting in question upward mobility

Increase in unemployment namely amongst the highly educated may also undermine the upward mobility path that high education traditionally allowed. Lower-income families aiming at improving the economic and social conditions of their children historically found in education an efficient and secure investment enabling them to access more qualified and

secure jobs. This defines a strategy of upward mobility that is a main constitutor of the middle classes.

The emergence of structural unemployment in Portugal has been challenging this mobility on two grounds: i) increasing unemployment reduces family income (as do wage cuts, social security benefits' cuts and tax increases), thus reducing the possibility of financing education, and ii) increasing and very high unemployment rates amongst the highly educated (the 3<sup>rd</sup> higher at the EU27 level in 2013 and almost three times the one of 2002<sup>43</sup>) makes the investment in education, paradoxically, too risky.

As argued in the first part of the paper, the PSM is mainly an outcome of events in the mid-1970s. This promoted an important job creation dynamics absorbing a large number of the highly educated (namely on education and health system). The increase in the level of education of Portuguese population therefore went together with the expansion of the social functions of the State, and public servants represent an important component of the Portuguese middle class. The high incidence of cuts in public servants is another mechanism of disproportionately affecting middle classes.

## **Conclusion**

There's no doubt that the Portuguese Social Model had to go through both short-term changes (in order to deal with the crisis and the needs associated to financial assistance) and structural changes (as some of the basis of the model have been changing, namely by means of the population ageing).

Austerity policies, as previously described, began in 2010, following the new orientations on EU policy and following structural reforms that have started in the early 2000s. Main

---

<sup>43</sup> EUROSTAT, [lfsa\_urgaed]

reforms did concern Social Security (mainly pensions) and Labour Law. The reorganisation of the Education and Health systems has also been implemented. The changes implemented afterwards, and especially those implemented after 2011, have two main distinctive traits.

- i) Cuts in social expenditure are mainly targeted at short term returns and justified using the argument of commitments assumed with the Troika;
- ii) Most of the reforms (partially because of the short-term pressures) have not been discussed, negotiated and compromised namely with the Social Partners, contributing for the weakness of social dialogue.

Would it be possible to do it other way around? Given the targets expressed in the MoU and the exigencies of the Troika in the periodical evaluations, maybe not. Still the process could/should have been different. The existence of an intense Social Dialogue able to continue and ensure the benefits of the investment in “agreement capital” (that did show important outcomes along the 2000s) appears to be crucial. To discuss, to negotiate, to agree on what is assumed as temporary and what must be definitive changes has an utmost social importance. And it’s also a fundament of democracy and welfare states. In any case, there is robust evidence that the institutions represented in the Troika revealed no capacity to understand that the MoU strategy needed a complete revision under the EU recession environment in which it has been implemented.

In such a context, a large majority of citizens do not understand the ongoing changes, which contributes to a rather dangerous process of lack of trust in the State. The emergence of new forms of social contract and the recuperation of trust by citizens will, predictably, be very hard to achieve. And lack of trust strongly interferes with aspirations and expectations towards the future.

In line with the deterioration of trust and social capital, political dialogue became more and more extreme. There's little room for negotiation and neither the opposition nor the government parties seem really interested in political compromise. So citizens distrust, more and more, the political class. And the whole process becomes even more complex as institutional tensions show up involving, namely, the government and the Constitutional Court. An overall social and political environment producing very harmful effects is emerging. Five main issues deserve being stressed.

First of all we must keep in mind that market economies rely on contracts and contracts rely on trust amongst the parts (contractors). Austerity measures, as they have been implemented, are undermining trust especially trust in the State as there's a spread understanding that the Portuguese State has been breaking contracts (with pensioners, with public servants, ...) to comply with a contract with the Troika that relates to deficit and public debt targets. The trust of the Troika and of the financial markets is being gained at the high price of destroying internal trust. Still by the end of 2012 neither did the fiscal budget as a percentage of GDP consistently reduce (-3.6% in 2008, -10.2% in 2009, -9.8% in 2010, -4.4% in 2011 -6.4% in 2012) nor did the percent of the Debt in the GDP (increasing ever year after from 71.3% in 2008 to 123% in 2012).

Secondly, the increase of the unemployment rate, namely amongst the young educated, has been introducing potential disrupting and very harmful effects in a country with huge shortages in human capital. On the one side many families start to question if it does pay to be educated and, on the other side the social devaluation of teacher's role may compromise the renewal (and the quality) of the needed body of teachers. Expectations of upward social mobility are being reducing sharply amongst public employees.

Thirdly, increasing unemployment, reduction of family income, uncertainty towards the future are also compromising other long term decisions of the families. Amongst them and of

utmost importance, the decision of having children that is crucial for the sustainability of social security.

A fourth issue relates to a growing feeling of mistrust towards European Union institutions is also emerging. The same European institutions that co-financed Portuguese investments in infrastructures (and other) are now blaming Portugal for having done so. The same EU institutions that recommended Portugal to increase service sector employment and to reduce primary employment are now advertising that unproductive employment in services is too high. The same European institutions that insisted on measures to fight against poverty and social exclusion are now telling the country that cutting wages and social security provisions is to be done even if Portugal ranks amongst the more unequal EU countries. The EU begins to be seen as a very fragmented institution and a contradictory project, not dealing in a consistent way with citizens' problems. Not ignoring the national responsibilities and weaknesses that led to the present situation, isn't this also a European problem implying a share in costs and a comprehensive strategy to the sovereign debt crisis?

Finally, the Portuguese middle class (whether represented by those with an intermediate level of income or by one of its core groups, public servants) appears to be constrained by all the recent changes in the country: highly pressured by the risk of unemployment they face, if employed, wage cuts, social security cuts, tax increases, low probability of upward social mobility and a process of downsizing of social status. Lack of trust and uncertainty about the future do not shape an optimistic prospective. And this is fatal for the middle classes as it constrains social mobility expectations. And as democratic regimes rely on the middle classes, democracy may well be in danger in Portugal and in Europe.

In brief, the bail-out austerity measures are producing a very contradictory set of signs addressed to the Portuguese society. It is a very wrong thought to admit that after achieving the austerity agenda everything will be ready for recovering the trajectory of growth and

change. Austerity measures introduced a lack of rationale in adjustment efforts that the Portuguese economy was already leading before the crisis, transforming them in a pack of expenditure cuts with no strategic goal. Additionally, blind austerity measures risk to generate negative dynamic effects in the long term penalising growth potential and leading families to inefficient allocation of resources (for example not investing in education as previously noted). Internal nominal devaluation and the pressure to reduce wages also risk to reduce incentives to the innovation of firms<sup>44</sup> and to recruit more qualified workers.

Finally, the Portuguese middle class (whether represented by those with an intermediate level of income or by one of its core groups, public servants) appears to be constrained by all the recent changes in the country: highly pressured by the risk of unemployment they face, if employed, wage cuts, social security cuts, tax increases, low probability of upward social mobility and a process of downsizing of social status. Lack of trust and uncertainty about the future do not shape an optimistic prospective. And this is fatal for the middle classes as it constrains social mobility expectations. And as democratic regimes rely on the middle classes, democracy may well be in danger in Portugal and in Europe.

All these lessons cannot be interpreted as a sign that Portuguese society rejects, without understanding, the need to consolidate its public accounts. The high levels of public and private (families and companies) debt are well perceived by public opinion. But five years after the 2008 financial crash, two and a half of which under a bail-out agreement, the negative effects of austerity are now deeply felt as a burden that have not really resulted in a sustained consolidation of public accounts.

---

<sup>44</sup> We refer here to firms not corresponding to the behaviour of the resilient firms, namely those operating in external markets. Empirical evidence is available showing that these firms usually pay above collective bargaining average wages and are more sensitive to other competitiveness disadvantages such as the high relative price of energy and telecommunications, the administrative burden determined by bureaucracy and the slow pace of justice.

In sum, the combined effects of crisis and austerity policies on Portuguese middle classes show that austerity costs cannot be measured in a static comparative way. The shrinking, hollowing out and impoverishment of middle classes represent in itself a powerful and pervasive dynamic cost, compromising the sustainability of recovery and leading to perverse structural changes due to their role in social change. Although taking into account the obvious differences between the recovery difficulties of the Portuguese economy and of the other developed Eurozone economies, there is a common factor due to the perverse dynamic effects generated by the effects on middle classes.

## References

- Atkinson AB and Brandolini A (2011). *On the identification of the “middle class”*. Working Paper 2011-217, Society for the Study of Economic Inequality, September.
- Autor D (2010). *The Polarization of Job Opportunities in the U.S. Labor Market: Implications for Employment and Earnings*. Center for American Progress and The Hamilton Project, May.
- Autor D (2014). *Polanyi’s Paradox and the Shape of Employment Growth*. Paper presented to Jackson Hole Symposium of Central Bankers.
- Autor D and Dorn D (2013). *How Technology Wrecks the Middle Class*. New York Times, August 24.
- Avram S, Figari F, Levynti C, Levy H, Navicke J, Matsaganis M, Militaru E, Paulus A, Rastrigina O and Sutherland H (2013). *The Distributional Effects of Fiscal Consolidation in Nine EU countries*. EUROMOD Working Paper EM 2/13, January, 2013
- Banco de Portugal (2013). *Projeções para a economia portuguesa 2013-2014*, Boletim da Primavera, Lisbon.
- Banerjee AV and Duflo E (2008). *What is middle class about the middle classes around the world?* Journal of Economic Perspectives 22(2): 3-28.
- Birdsall N (2010). *The (Indispensable) Middle Class in Developing Countries; or, The Rich and the Rest, Not the Poor and the Rest*. Center for Global Development Working Paper 207, March.
- Birdsall N (2012). *A Note on the Middle Class in Latin America*. Center for Global Development Working Paper 303, August
- Carneiro A, Sá C, Cerejeira J, Varejão J and Portela M (2011). *Estudo sobre a Retribuição Mínima Mensal Garantida em Portugal*. NIPE Policy Paper Series, PP 01/2011.

- Dallinger U (2013). *The endangered middle class? A comparative analysis of the role played by income redistribution*. Journal of European Social Policy 23(1): 83-101.
- DGAEP (2009). *A Década: emprego público em números, 1996-2005*. Direção-Geral da Administração e do Emprego Público. Lisbon.
- DGAEP (2014). *Síntese estatística do emprego público 2.º trimestre 2014*. Direção-Geral da Administração e do Emprego Público. Lisbon.
- González P and Figueiredo A (2014). *The European Social Model in a context of crisis and austerity in Portugal* in Vaughan-Whitehead D (ed.) *The European Social Model in times of economic crisis and austerity policies*. Geneva: ILO, 299-347.
- González P and Figueiredo A (2014a). *Crisis, austerity and the European Social Model in Portugal*. Economia & Lavoro (forthcoming).
- European Commission (2008). *Public finances in EMU – 2008*. Directorate-General for Economic and Financial Affairs.
- European Commission (2010). *Public finances in EMU – 2010*. Directorate-General for Economic and Financial Affairs.
- European Commission (2011). *The economics adjustment programme for Portugal*. Directorate-General for Economic and Financial Affairs. Occasional Papers 79. June 2011.
- European Commission (2014). *EU transport in figures*. Luxembourg: Publications Office of the European Union.
- INE (2014). *Rendimento e Condições de Vida, 2013 (Dados Provisórios)*. Destaque, Lisbon, March 24.
- IMF (2008). *Portugal: 2008 Article IV Consultation, Preliminary Conclusions of the Mission*. Lisbon, July 14.
- Institute for Research in Poverty (2010). *Middle class in America*. Focus 27/1, University of Wisconsin-Madison, Summer.

- Jenkins SP (2010). *Did the middle class shrink during the 1980s? UK evidence from kernel density estimates*. *Economics Letters*, 49, 407-413.
- Krugman P (2013). *We were middle class once, and young*. *New York Times*, June 23.
- Luce E (2014). *Tepid US recovery. It's the middle class stupid*. *Financial Times*, June 1.
- Mateus A (ed) (2013). *25 anos de Portugal europeu: A economia, a sociedade e os fundos estruturais*. Fundação Francisco Manuel dos Santos. Lisbon, 331-337.
- Milanovic B (2005). *Worlds Apart. Measuring International and Global Inequality*. Princeton University Press. Princeton
- Milanovic B (2012). *The Haves and the Have-Nots: A Brief and Idiosyncratic History of Global Inequality*. Basic Books. New York.
- Milanovic B and Yitzhaki S (2002). *Decomposing world income distribution: does the world have a middle class?* *Review of Income and Wealth* 48(2): 155-178.
- OECD (2004). 'Employment Protection Regulation and Labour Market Performance' in *OECD Employment Outlook*, OECD Publishing.
- OECD (2008), "Securing Fiscal Consolidation" in *OECD Economic Surveys: Portugal 2008*, OECD Publishing.
- OECD (2012). "Reducing income inequality while boosting economic growth: Can it be done?" in *Economic Policy Reforms 2012: Going for Growth*, OECD Publishing.
- Porter E (2013). *America's sinking middle class*. *New York Times*, September 18.
- Presidencia Española de la Unión Europea (2010). *Public Employment in European Union Memberstates*. Gobierno de España, Ministerio de la Presidencia. May.
- Ravallion M (2009). *The developing world's building (but vulnerable) "middle class*. The World Bank, Policy Research Working Paper 4816, January.
- Stiglitz J (2014). *The Inequality is not inevitable*. *New York Times*, June 27.
- Thurow L (1987). *A surge in inequality*. *Scientific American* 256: 30-37.