

## CRISIS, AUSTERITY AND THE EUROPEAN SOCIAL MODEL IN PORTUGAL\*

by Pilar González, António Figueiredo

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The Portuguese version of the European Social Model has been impacted by the Great Recession and austerity policies. In this paper we argue that the Portuguese experience shows similar effects to other European Union countries (under economic adjustment or simply touched by the consequences of the Great Recession on public finances) but also shows distinctive consequences. The paper collects evidence on reforms targeted at increasing the cost-effectiveness of some pillars of the Portuguese Social Model, which were already in place before 2008, but have since been undermined by austerity measures lacking strategic coherence. The paper focuses on the historical context of the ESM in Portugal to discuss the impact of austerity in the country. We also discuss the noticeable impact of austerity on the Portuguese middle class.

La variante portoghese del Modello sociale europeo è stata colpita dalla Grande Recessione e dalle politiche di austerità. In questo saggio si sostiene che l'esperienza portoghese mostra effetti simili ad altri paesi dell'Unione europea (che sono in fase di risanamento economico o sono semplicemente interessati dalle conseguenze che la Grande Recessione ha sulle finanze pubbliche), ma presenta anche conseguenze peculiari. Il saggio raccoglie i risultati concreti delle riforme volte a migliorare il rapporto costi/benefici di alcuni pilastri del Modello sociale portoghese, già in essere prima del 2008, ma che da allora sono stati indeboliti dalle misure di austerità prive di coerenza strategica. Il saggio si concentra sul contesto storico del Modello sociale portoghese per discutere dell'impatto dell'austerità all'interno del paese. Inoltre, viene affrontato il tema dell'impatto significativo che l'austerità ha sulla classe media portoghese.

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### 1. INTRODUCTION

The Portuguese version of the European Social Model (hereafter ESM) has not been immune to the effects of the Great Recession and austerity policies. In this paper we argue that the Portuguese experience shows similar effects to other European Union countries (under economic adjustment or simply touched by the consequences of the Great Recession on public finances) but also shows distinctive consequences. The paper collects evidence on reforms targeted at increasing the cost-effectiveness of some pillars of the Portuguese Social Model (hereafter PSM), which were already in place before 2008, but have since been undermined by austerity measures lacking strategic coherence.

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Pilar González, Faculty of Economics, University of Porto and CEF.UP.

António Figueiredo, Faculty of Economics, University of Porto and Quaternaire Portugal.

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The first section of the paper will focus on the historical context of the ESM in Portugal. In section two and three we will discuss the impact of austerity in the country. In section four we will discuss in more detail the impact of austerity on the middle class. Section five provides the conclusions.

## 2. THE ROOTS OF THE ESM IN PORTUGAL: RECENT, CONTEXT-DEPENDENT, UNBALANCED, ENCOMPASSING, AND VULNERABLE

The existence of a coherent PSM 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 ESM in Portugal is context dependent as well as a recent achievement. But the PSM 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 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>1</sup>. In that same year, the child mortality rate was very high (44.8 per thousand births) and net enrolment rates<sup>2</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.

After 1974 successive laws on education, health and social security made the universality of social rights established by the Constitution a reality. Simultaneously, workfare of the social system began to be implemented. In 2012, the previously referred to 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>3</sup>.

The 2007-2008 Great Recession dramatically affected the Portuguese economy, exacerbating previous trends of job destruction. The sustainability of the PSM that was already under pressure due to the exhaustion of the growth/development model of the 1980s and 1990s was also threatened by generalised austerity-led cuts in public spending. There were also significant changes in the Portuguese labour market (FIG. 1). Before the 2000s, the labour market followed a clear pro-cyclical pattern: recessions deteriorated both unemployment and employment rates, but recoveries were the opportunity to reduce the unemployment rate and to increase employment so that, peak to peak, structural

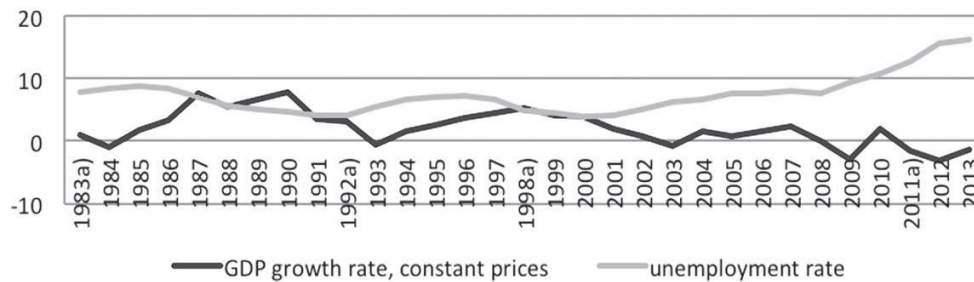
<sup>1</sup> PORDATA.

<sup>2</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>3</sup> PORDATA.

unemployment did not change. In other words, growth seemed to be a good substitute for active employment policies. Very dynamic flows of firms' destruction and creation, new (and increasingly used) forms of atypical work contracts and a complex practice of delaying wage payments were the main vehicles to compensate the rigidity of labour legislation, mainly the limitations to dismiss workers in recession times.

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



<sup>a</sup> Break in the series for the unemployment rate.

Source: PORDATA.

This labour market pattern significantly changed with the increasing signs of disruption in the growth model by the 2000s. Increasing structural unemployment emerged mainly associated to the decline of non-tradable sectors (mainly construction) employing a high share of low qualified workers.

In fact, even before the impact of the 2007-2008 crisis, Portugal was undergoing a process of structural change related to<sup>4</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).

### 3. MAIN RECENT CHANGES IN THE PORTUGUESE SOCIAL MODEL

The PSM has been subject to important reforms in recent times. We will briefly present the main changes in welfare institutions separating the period before and after the emergence of the crisis, in order to identify differences in the rationale of changes and reforms.

#### 3.1. Series of reforms before the crisis

All the main pillars of the Portuguese welfare system experienced important policy reforms throughout the 2000s.

<sup>4</sup> See Banco de Portugal (2013).

### 3.1.1. Labour Law: introducing 'flexibility' while keeping 'security' as a basic workers' right

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<sup>5</sup>. The 2000s were however marked by changes in labour regulations. In 2003, a new Labour Code was adopted and reviewed in 2009, and again in 2012. The main concern was to promote flexibility in the labour market while keeping job security. The main areas of change in 2003 were 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). Employers' organisations supported the changes whilst the two biggest workers' confederations opposed it, though under different rationales: CGTP<sup>6</sup> opposed the Labour Code proposal and abandoned the negotiations, while UGT<sup>7</sup>, despite disagreeing with the proposal, participated in negotiations and contributed to its improvement.

Both workers' confederations claimed that the government proposal included some unconstitutional provisions (namely those limiting the right to strike, the expiry of collective contracts and the possibility given to employers to ask for information on the health status of workers). The document was sent to the Constitutional Court that declared some of its provisions to be unconstitutional.

In 2008 and following intense discussions with the social partners, a tripartite agreement was signed around five main issues: *i*) increasing the adaptability of companies (increased flexibility in working time arrangements both to companies and workers<sup>8</sup>); *ii*) promoting collective agreements; *iii*) rationalising and reinforcing the security of both parts in case of dismissals (simplification of the dismissal process); *iv*) improving the effectiveness of labour law (namely by improving inspection of the working places and fighting against illegal work); *v*) fighting against precariousness and segmentation in the labour market and for the promotion of employment quality.

The reform of the Labour Law evolved in parallel with an increasing visibility and effectiveness of Social Dialogue. The *Standing Committee for Social Conciliation* (CPCS) did play a very important role in connection thereof. Several social agreements were achieved along the 2000s, namely, in 2006, on minimum wages. This agreement recognised the "low value of the existing minimum wage in Portugal as well as the desirability of its gradual increase" and the "importance of defining the evolution of the monetary value of the minimum wage on a medium term basis in order to ensure both predictability and trust either for the companies and the workers" (CES, 2006, p. 1).

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.

<sup>5</sup> See OECD (2004, pp. 61-125).

<sup>6</sup> CGTP is the oldest (dating back to the autocratic regime as a clandestine organisation) and largest confederation of workers in Portugal, and closest to the Communist Party.

<sup>7</sup> 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>8</sup> More family-friendly parental leave provisions.

### 3.1.2. Social Security and health systems under reform for sustainability

In 2006, a tripartite agreement (within the CPCS) on the Social Security reform was signed<sup>9</sup> 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 (CES, 2007, p. 2).

The Social Security reform introduced in the system a sustainability index<sup>10</sup> (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.

The aim of the reorganisation and rationalisation of the National Health System (SNS) was to increase its efficiency and financial sustainability, while ensuring its quality and universality<sup>11</sup>. The main areas of change related to: the implementation of a National Network of Integrated Continuous Care<sup>12</sup> (to develop more adequate answers to population ageing); the creation of a national network of primary health care centres; the reorganisation of the national network of public hospitals; the introduction of fees to be paid by users of the SNS aiming at rationalising and regulating access to health care services.

### 3.1.3. Education: Pre-crisis reforms oriented towards higher efficiency

One of the main features of the pre-crisis measures 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 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.

### 3.1.4. Reorganisation in the public sector

Long before the crisis, Portugal implemented reforms targeted at reorganising public administration and reducing public expenditure. The OECD considered this reform "ambitious" considering it «a major component of the budgetary consolidation strategy

<sup>9</sup> The final agreement was not signed by CGTP (this confederation had signed the preliminary agreement on the strategic lines of the Social Security reform but did not sign the final one, arguing that it would imply the reduction of pensions). All the other social partners signed the agreement.

<sup>10</sup> The IAS – Social Sustainability Index.

<sup>11</sup> Information on this section is based on the official site of the Portuguese Ministry of Health <http://www.portaldasaude.pt/portal/conteudos/a+saude+em+portugal/servico+nacional+de+saude/historia+do+sns/historiadosns.htm>.

<sup>12</sup> Referred to also in the social security reforms as it was a joint initiative of the Ministry of Health and the Ministry of Employment and Social Solidarity.



[... going] beyond fiscal consolidation, to include the enhancement of the quality of public services and strengthening the governance of public institutions» (OECD, 2008, p. 47).

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).

### 3.1.5. A positive evaluation of pre-crisis reforms

Reforms implemented throughout the 2000s were favourably evaluated by the main international organisations: the OECD, the IMF and the European Commission (Box 1). In particular the IMF explicitly considered the importance of not compromising long-term goals with short-term gain measures.

#### Box 1. Portuguese reforms

Portugal has made very good progress in reducing the fiscal deficit, using a wide ranging programme of structural reforms that will continue to pay dividends well into the future. Challenges that remain to anchor results achieved and reduce the deficit further include: fully implementing the human resources reform in the public administration; improving efficiency in the SOE sector; further closing the financing requirement in the contributory pension deficit; and tackling ongoing pressures of ageing on the health budget.

(OECD, 2008, p. 63)

Decisive action, focused on the government sector, is being taken to address the imbalances accumulated during the 1990s, and results are being seen. Weaker global conditions make addressing Portugal's economic challenges both more difficult and urgent. Policies should build on recent achievements, and avoid jeopardizing long-term goals for short-term gain.

(IMF, 2008, p. 1)

The action taken by Portugal in response to the Council recommendation represented adequate progress towards the correction of the excessive deficit. In particular, Portugal (*i*) achieved a 2005 deficit outturn as planned; (*ii*) adopted a comprehensive package of corrective measures which, provided the full and effective implementation, was in line with the required structural adjustment in 2006; (*iii*) confirmed the deficit target for 2008 below 3% of GDP and a structural adjustment path in accordance with the Council recommendation; (*iv*) implemented or initiated expenditure-containing measures and kept fiscal targets in spite of a more cautious assessment of GDP growth prospects; (*v*) planned to bring government debt back on a declining path as from 2008; and (*vi*) took action to improve the quality of public finance statistics.

(European Commission, 2008, p. 27)

### 3.2. Austerity and the labour market

As mentioned previously, when the financial crisis impacted the Portuguese economy it faced rather weak economic growth. The reorganisation of the productive structure was being promoted hand in hand with the improvement of the Portuguese human resources

by means of a relevant, although nowhere near far enough, increase in the acquisition of competences by the Portuguese population.

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>13</sup>). Still, recent growth has been rather striking as that same percentage was as low as 20.2 in 2001.

The unemployment rate has been increasing slowly but consistently since the beginning of the 21<sup>st</sup> century. 2008 represents the start of a huge unemployment increase to unprecedented levels in the country.

Two other characteristics of the Portuguese labour market are worth noting: *i*) low wages by EU standards, and *ii*) high incidence of temporary contracts<sup>14</sup>, the main mechanism of labour flexibility (the share of temporary employees in 2013 was 13.8% in the EU27 and 21.5% in Portugal<sup>15</sup>).

### 3.2.1. The painful emergence of structural unemployment

The huge unemployment increase from 7.7% in 2008 to 16.3% in 2013 is the main sign of the deterioration of both economic and social situation.

Unemployment increased in all age groups, but is especially high among youth (the unemployment rate is now about 40%<sup>16</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
<i>Unemployment rate</i>				
Total	6.3	7.7	9.5	16.3
<i>By age group</i>				
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
<i>By educational level</i>				
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 (2012).

<sup>13</sup> Eurostat, edat\_[lfse\_08].

<sup>14</sup> According to Eurostat, temporary employment includes work under a fixed-term contract, as against permanent work where there is no end-date.

<sup>15</sup> Eurostat, [lfsa\_etpgan]

<sup>16</sup> 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.

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>17</sup>: it consistently rose from 1,530 couples in October 2010 to 12 365 in April 2014<sup>18</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>19</sup>. Consequently, being unemployed is rather different from what it used to be before the crisis.

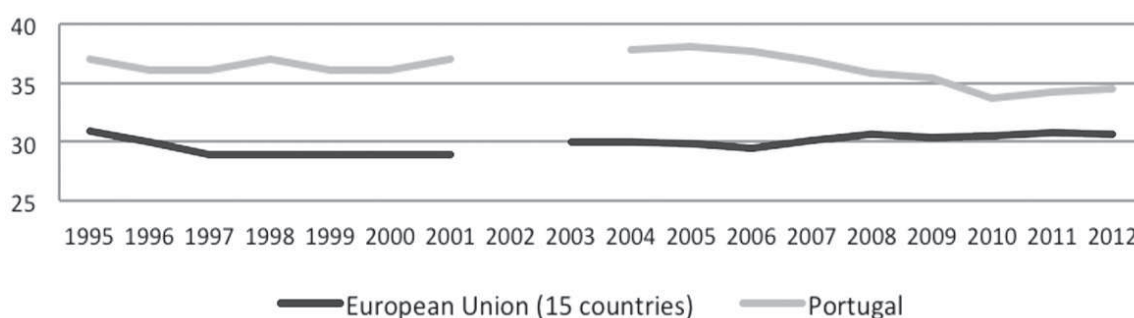
### 3.2.2. Wages and income distribution

Portugal is a low wage country and has a high incidence of low wages compared to other EU member-states (Carneiro *et al.*, 2011).

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>20</sup>. A quite different path emerges, however, in diverse periods since the mid-1990s (FIG. 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 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.

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



Source: Eurostat, SILC [ilc\_di12].

<sup>17</sup> Given the precariousness of this particular situation, the calculation of the unemployment benefit has taken this element into account since 2011.

<sup>18</sup> IEFP, *Informação mensal sobre estado civil do desempregado e condição laboral do cônjuge*.

<sup>19</sup> INE, *Estatísticas do Emprego – 1º trimestre 2014 and Segurança Social, Estatísticas Gerais, Março 2014*.

<sup>20</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.



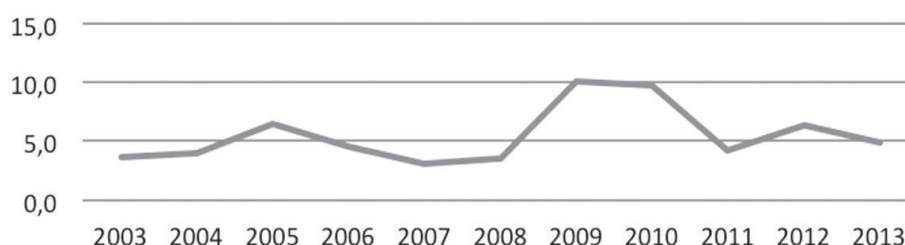
The inequality of income distribution closely follows high at-risk-of-poverty and at-risk-of-poverty-and-social-exclusion rates by EU standards<sup>21</sup>. Still, it is important to bear in mind that the risk of poverty is not neutral, affecting different groups of the population in different ways. Portugal has a particularly high risk of poverty for children<sup>22</sup>: 24.4% in 2012 compared with 18.7% for the total population (INE, 2014). 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>23</sup>.

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 important effect on children poverty risk<sup>24</sup>. Moreover, social policies are very effective in reducing poverty incidence

### 3.3. Recent evolution of the current deficit and indebtedness

The evolution of fiscal policies and of the consequent indebtedness of the Portuguese economy (FIGG. 3 and 4) experienced close European scrutiny after the launching of the Stability and Growth Pact (SGP).

Figure 3. Portugal: Government deficit as a % of the GDP



Source: Eurostat [[gov\_dd\_edpt1].

In recent times<sup>25</sup> Portugal has never had a deficit complying with the established on the Sustainability and Growth Pact (SGP). Still the recent evolution shows relevant differences.

Before the impact of the 2008 crisis, Portugal achieved a significant fiscal consolidation that was reverted immediately after 2008. Despite the very tough austerity measures, the country's indebtedness level does not show positive trends, in particular due to the still unstable financial market conditions and the additional debt determined by the bail-out.

<sup>21</sup> Eurostat, SILC [ilc\_di12], [ilc\_peps01].

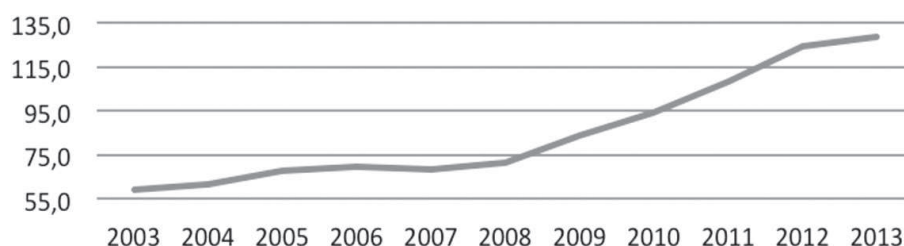
<sup>22</sup> Aged 17 or less.

<sup>23</sup> *Ibid.*

<sup>24</sup> See, among others, OECD (2012).

<sup>25</sup> This applies since 1995 in comparative data.

Figure 4. Portugal: Government consolidated gross debt as a % of GDP



Source: Eurostat [gov\_dd\_edpt1].

Anaemic GDP growth rate, increasing unemployment rate, above the SGP public deficit and public debt existed in Portugal before the crisis and (with the exception of the deficit in 2011) worsened with the crisis reinforcing the previously existing vulnerability of the PSM.

Austerity is having high social costs leading the Portuguese economy to look desperately for a very difficult balance between a sustainable fiscal consolidation and the need to maintain growth prospects and social cohesion. The rationale and the concrete implementation results of austerity measures hardly evolve in that direction.

#### 4. 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, p. 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.

##### 4.1. *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>26</sup>.

A new PEC was proposed in March 2011 and, after it was rejected by the parliament 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 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.

##### 4.2. *The Memorandum of Understanding*<sup>27</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

<sup>26</sup> These packages have been denominated PEC1, PEC2 and PEC3, PEC being the Portuguese initials for Sustainability and Growth Programme.

<sup>27</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 (MEFP); *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).

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 (MoU, 2011, p. 22). Four main aspects should be emphasised. First, employment security/rigidity and working time arrangements appear as top intervention areas; second, the MoU highlights the importance of improving human capital in the country; thirdly it explicitly addresses the importance of Social Dialogue; finally, it explicitly refers the need to consider the constitutional implications of the measures to be implemented.

After the MoU was signed, the Social Partners maintained a climate for negotiation expressed in a Tripartite Agreement on Competitiveness and Employment (CES, 2012<sup>28</sup>). This agreement between the Government, the employers' confederations and one of the worker's confederations, gave an important social support to the reforms to be implemented.

Political parties supporting the new government based their electoral campaign on the ideas that «cutting wages and firing workers will not be necessary to comply with the MoU»<sup>29</sup> and «any tax adjustment, if needed, will be done through indirect taxes and not by income taxes»<sup>30</sup>. It is true that in political campaigns 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).

#### *4.3. 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. The fact that austerity measures did join the workers' confederations that have, in recent times, followed a diverse strategy (UGT a dialogue position with governments and employers' confederations, and CGTP a more rigid position towards negotiation and a more radical striking position) is an important outcome of austerity in Portugal.

Political stability, which has also been considered a main advantage in the Portuguese context, has also been undermined by conflicts. Two episodes clearly illustrate signs of political instability associated with social and institutional instability.

<sup>28</sup> A previous agreement on competitiveness and employment had been signed in March 2011.

<sup>29</sup> Current Prime-minister's press statement on 30 April 2011.

<sup>30</sup> Current Prime –minister's press statement on 24 June 2011.

The first episode refers to the announced cut on employers' contribution to social security in September 2012. Following a declaration of unconstitutionality by the Constitutional Court (cut of the 13<sup>th</sup> and 14<sup>th</sup> month pay to public employees and to pensioners) the government announced new budget measures to counterbalance this decision.

The Prime Ministers' declaration explicitly mentioned that «according to the decision of the Constitutional Court, the 2013 Budget will have to include another combination of charges and sacrifices [...]. The government decided to increase the private sector workers' contribution to Social Security [...], allowing as a counterpart, the decrease of the employers' contribution to Social Security [...]. The increase of 7 percentage points in workers' contributions<sup>31</sup> will also apply to public employees»<sup>32</sup>.

Social Partners, employers' associations and unions immediately reacted with huge criticism to this so-called direct redistribution of income from workers to employers. In the words of the head of the Manufacturing and Construction Employers' Confederation «social stability did suffer an attack [... as] social partners cannot be used to subscribe agreements and then not being heard when it comes to deciding»<sup>33</sup>.

Increased tension and signs of distrust began to surface in Social Dialogue. In June 2013, the four employers' confederations represented on Social Dialogue boards publicly criticized austerity policies. A few quotations of the document illustrate their strong rejection on pursuing the austerity path:

It is urgent to adequate government targets and reality [...]. Fiscal consolidation continues to rely on a reduction in domestic demand, an unwise tax increase and scarce financing opportunities for small and medium companies [...]. Austerity has been a short-term answer (implemented as if it was the only possible answer) but nowadays, given its results, it would be irresponsible to pursue or, even worst, to further develop this way [...] we cannot insist in a policy that is not a solution for Portugal and that, if we insist on it, can lead to a no way back path<sup>34</sup>.

The second episode started with the resignation of the Minister of State and Finance (1 July 2013) (accepted) followed by the resignation of the Minister of State and Foreign Affairs (2 July) (not accepted). The letter of resignation of the Minister of Finance was made public and represented a critical assessment of the austerity policy.

As the Minister of Foreign Affairs was also president of the political party (CDS-PP) that formed a coalition with the Prime Minister's party (PSD), a political crisis opened with significant negative impact on the markets. It was solved only by the intermediation of the Portuguese President, three weeks after it began, with changes in the government that were seen as a reinforcement of the power of the smaller political party of the coalition.

These episodes have added further mistrust among policy agents and political parties.

#### 4.4. Main outcomes

We can summarise the main effects of austerity policies and the changes they brought to the European Social Model in Portugal in some outcomes of different nature.

<sup>31</sup> For the employers, the variation was 5.75 percentage points.

<sup>32</sup> Prime Minister's statement on 7 September 2012.

<sup>33</sup> António Saraiva in a statement aired on Rádio Renascença, 17 September 2012.

<sup>34</sup> CAP, CCP, CIP e CTP unidas por um compromisso para o crescimento económico em Portugal, Press Conference, 24 June 2013.

#### *4.4.1. Unemployment crisis without the tools to solve it*

The huge increase in unemployment and its structural extent is the most important (bad) novelty of the recent Portuguese economic and social situation. It has not only been generated by austerity policies (as unemployment was increasing before their implementation) but austerity policies clearly contributed to further major increases.

Under new massive unemployment the welfare state would be expected to implement policies (both passive and active) to support the unemployed. Still, under austerity, the percentage of the unemployed not receiving unemployment benefits strongly increased. This is, in part, the outcome of the revision of the regulation on unemployment benefits, considered too generous and an incentive to voluntary unemployment. But under mass unemployment, voluntary unemployment, even if existing, is necessarily residual.

The same logic applies to means-tested benefit cuts, namely family pay and minimum income pay. Given the very high poverty rates (particularly high for children), it is hard to understand that family and minimum income pay have to be frozen (reduced).

#### *4.4.2. Income cuts and employees' motivation*

Income cuts were largely accepted in a first phase, when they were presented as a temporary need in the country facing huge financial constraints and designed in a clear progressive manner. They became difficult to understand when minimum wages remained frozen and when the cuts became more and more concentrated on public servants, increasingly regarded as a privileged group of workers. The simultaneity of cuts in wages, increases in working time, changes in career tracks and the freeze on promotions has often been considered socially unfair. Increasing vulnerability and a sense of unfair treatment amongst public servants has led to decreased motivation, thus negatively impacting productivity.

This is particularly evident among teachers. Public schools face new problems (in a time of mass unemployment and high poverty rates, a lot of family disruptions generate a more difficult and complex learning environment) and new less-favoured publics are entering the system but education professionals are less motivated precisely when schools need more diversity of fully committed professionals.

Reforms seem less contradictory in the health care system. Demotivation of health professionals exists but decisions on careers have been discussed with professional boards of the health sector leading to less tense relations. Also the decrease in the price of medications proved to be very important to guarantee access to them in a context of cuts and freezes in wages and pensions.

#### *4.4.3. Halting the development of the educational system?*

As far as human resources are concerned, the education system is facing the consequences of the abrupt consolidation of State Budget at very paradoxical times. In fact, the number of unemployed teachers increased but, simultaneously, the number of early retired teachers who left the system also increased<sup>35</sup>. The education system is then impacted in two ways: on the one hand, more less-favoured youngsters are entering the system requiring more innovative learning environments; on the other hand, the system is now losing the more

<sup>35</sup> See DGAEP (2014).



experienced teachers and cannot recruit (because of budget constraints) young and qualified ones.

Contradictory signals are then potentially disrupting and producing harmful effects in education in a country with huge shortages in human capital. Families start questioning if it pays to invest in education while the social devaluation of teacher's role may compromise their renewal (and quality).

This is a matter of major concern, especially considering the low level of skills in Portugal.

#### *4.4.4. Disrupting social cohesion*

Social dialogue has been affected by the crisis and austerity policy, given that, due to short-term pressures, most of the reforms were not fully discussed, negotiated and compromised, helping to weaken the social dialogue.

Was it possible to do it the other way around? Given the targets expressed in the MoU and the requirements of the Troika, perhaps not. However, the existence of an intense Social Dialogue, able to continue (and ensure the benefits of) the investment in "agreement capital" appears to be crucial. There is robust evidence that the institutions represented in the Troika revealed no ability to understand that the strategy needed a revision under the EU recession environment in which it has been implemented. In such an environment, new combinations of fiscal consolidation, social cohesion measures and timing for adjustment were seen as necessary. The social costs of the adjustment are very high and can contribute to a rather dangerous process of loss of trust in the State. Recovering trust will, predictably, be very hard to achieve. Paradoxically, market economies rely on contracts and contracts rely on trust amongst the parts (contractors). Austerity measures, as they have been implemented, have undermined trust in the State as there is a widespread understanding that the Portuguese State has been breaking contracts (with pensioners, with public servants, etc.) to comply with a contract with the Troika that that relies on deficit and public debt targets.

Trust in the Troika and of financial markets is being achieved at the price of destroying internal trust. Still, by the end of 2013 the fiscal budget as a percentage of GDP did not consistently reduce (−3.6% in 2008, −10.2% in 2009, −9.8% in 2010, −4.4% in 2011, −6.4% in 2012, −4.9% in 2013) nor did the percent of the debt in the GDP (increasing ever year after from 71.3 % in 2008 to 129% in 2013). This is difficult to understand, especially if the situation worsens every year (month).

Moreover, traditional family buffers are getting weaker. The difficulties of the youth who are experiencing increasingly more problems in entering the labour market can less and less be supported by their parents (more and more squeezed by unemployment, wage cuts and tax increases) and less and less supported by grandparents (pension cuts). Increasing unemployment, reductions of family income, uncertainty towards the future are also compromising long-term decisions of the families. Amongst them and of utmost importance, the decision of having children that is crucial for inter-generational solidarity and for the sustainability of social security. Not surprisingly, the fertility rate trend is falling and the marriage age of young couples is increasing.

#### *4.4.5. Increased distrust in the European Union project*

A growing feeling of mistrust towards European Union institutions is also emerging. European institutions co-financed Portuguese investments in infrastructures (and other)

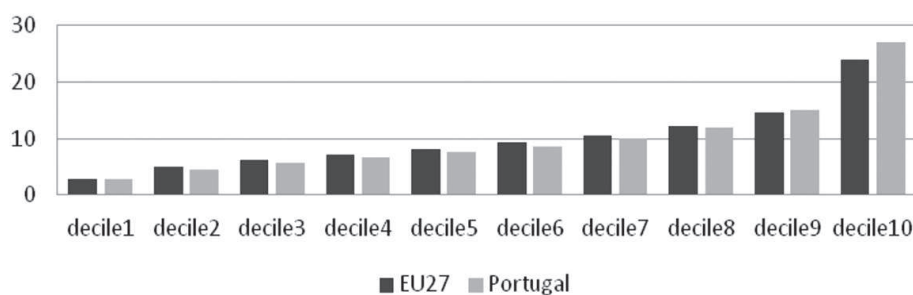
but are now blaming Portugal for having done so. EU institutions recommended Portugal to increase service sector employment and to reduce primary employment, but are now advertising that employment in services is too high. European institutions insisted on measures to fight against poverty and social exclusion but are now promoting cuts in wages and social security provisions (even if Portugal ranks amongst the more unequal EU countries). The EU begins to be more and more represented as a very fragmented and contradictory project.

### 5. IS AUSTERITY SHRINKING THE MIDDLE CLASS?

Despite important discussions on the concrete meaning of the concept of “middle class”, it is a foregone conclusion that it refers to intermediate income groups and to groups that anticipate upward social mobility as an attainable goal. 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. A high share of scarce highly-qualified Portuguese workers thus entered the public sector and, in doing so, reinforced its social status.

A general comparison of the current (2012) income distribution in Portugal and the average EU27 shows that it is more polarised in Portugal (FIG. 5).

Figure 5. Income distribution in the EU27 and Portugal, 2011

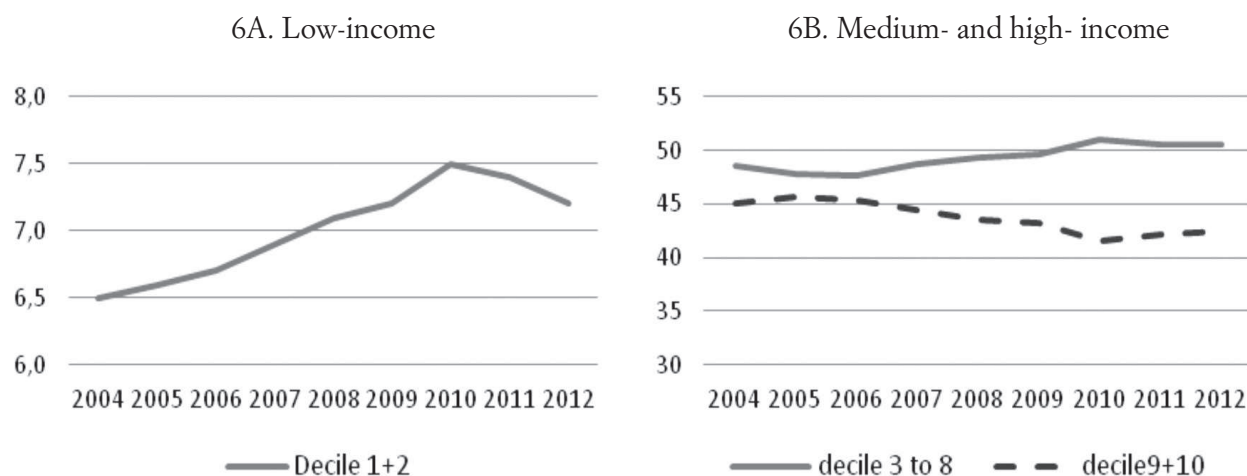


Source: Eurostat, SILC [ilc\_di01].

The contrasting effect of the austerity policy shows up very clearly (FIGG. 6A and 6B):

- 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;
- High-income groups (deciles 9 and 10) maintained a similar share of global income since 2010 (slight increase in fact) after a period of reduction of their share in total income.

Figure 6. Share of national equivalised income of different income groups (%)



Source: Eurostat, SILC [ilc\_di01].

### 5.1. Austerity and distribution

Avram *et al.* (2013) estimate an average 6.3% reduction in household income as one of the outcomes of austerity policies in Portugal. The major contributors to this reduction are cuts in public pensions and in public sector pay (net of contributions and taxes) and, with a much smaller effect, the reduction of means-tested social security benefits.

But one must keep in mind that median disposable income is very low in Portugal according to EU standards<sup>36</sup>.

A range of dynamics surface (TAB. 2) that can be interpreted as a sign of lower income diversity within specific income groups. Considering the cumulative effect of 2011 and 2012, deciles 1, 6 and 7 are the income groups where income diversity has decreased the most (respectively 6, 5.2 and 4.9 percent points).

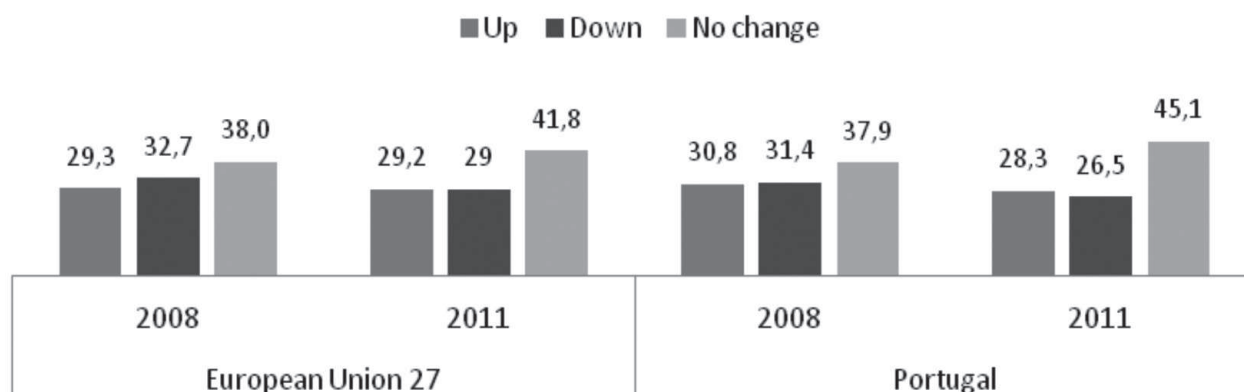
Table 2. Annual growth rate of the cut-off income, Portugal

	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%
Median equivalised net income	1.7%	4.8%	-3.1%	-1.0%

Source: SILC [ilc\_di01].

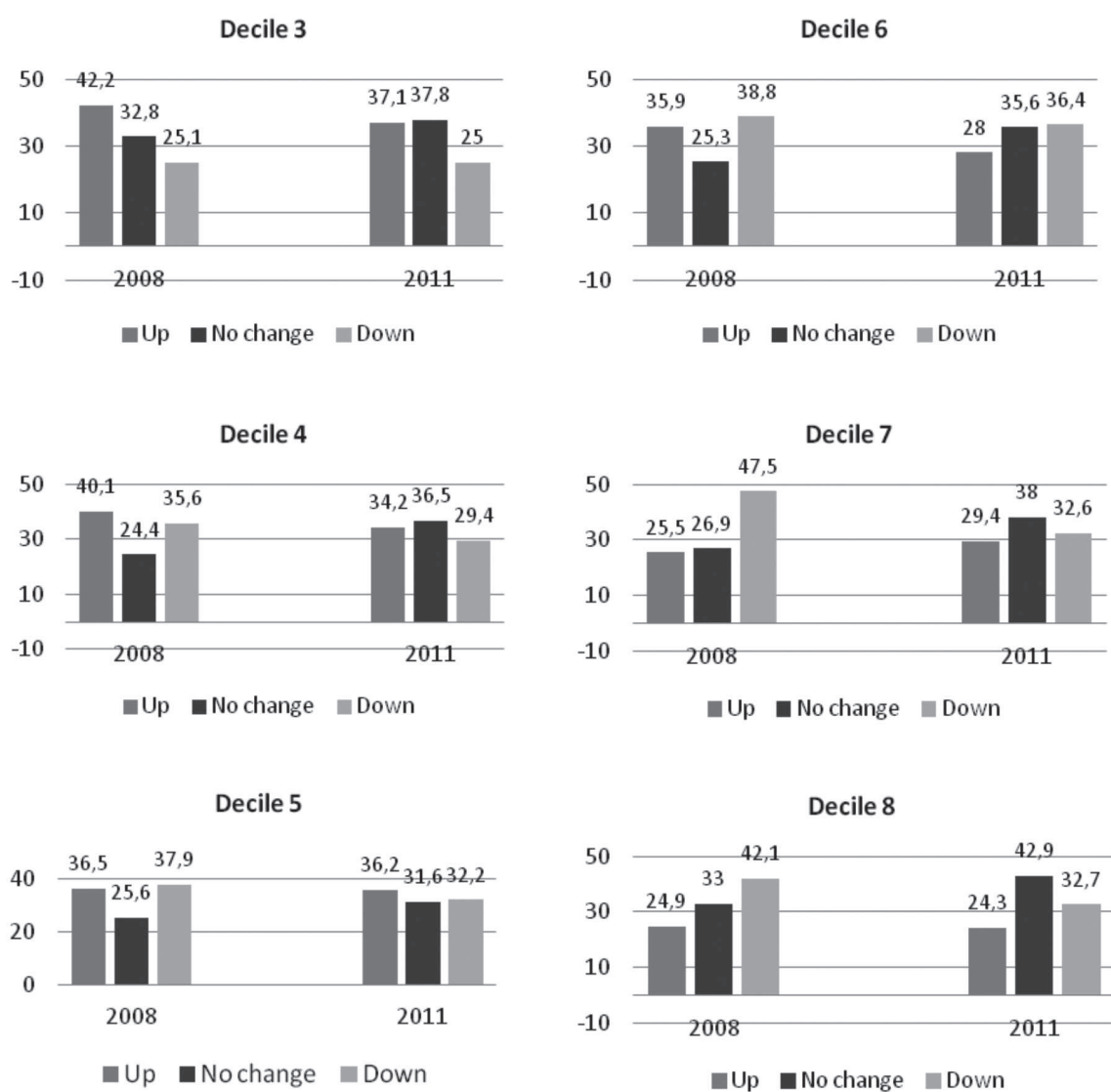
<sup>36</sup> Eurostat, SILC [ilc\_di03].

Figure 7. Transitions of income by decile: EU and Portugal



Source: Eurostat, SILC [ilc\_di30].

Figure 8. Transitions of income by decile in Portugal: intermediate deciles



Source: Eurostat, SILC [ilc\_di30].

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 FIG. 7) increased 3.8 pp in the EU27 and 7.2 pp in Portugal in the period 2008-2011.

Increased immobility characterises all the income deciles and particularly the intermediate ones (FIG. 8). 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.

#### *5.1.1. 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>37</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 disproportionally affecting middle classes.

## 6. CONCLUSION

The example of Portugal clearly illustrates the combined effects and risks of the financial crisis and of the austerity measures.

The international financial crisis impacted on the Portuguese economy in a period of strong structural change, which itself generated a significant destruction of jobs in less performing companies. The demand of social protection was in that period very strong and simultaneously some pillars of the ESM in Portugal were involved in efficiency and sustainability-led changes.

Subsequently, the vulnerability of the Portuguese economy and public accounts to the debt sovereign crisis was very high due to the combination of high and increasing public and private debt, low growth prospects and competitiveness challenges. Austerity measures

<sup>37</sup> Eurostat [lfsa\_urgaed].



and the abrupt consolidation of public accounts significantly reinforced the deterioration of social conditions and unemployment figures.

The first lesson to be learned from the Portuguese bail-out and associated measures is that the development stage of the economy under intervention cannot be ignored. The ESM pillars have been significantly weakened when demand for social protection was rising and structural unemployment strongly increased. High levels of structural unemployment mean that the probability of re-accessing labour market is very low for a vast group of low-skilled. Dismantling the recent and vulnerable ESM in Portugal in such a context will have very high social costs not easy to compensate in the near future.

The second lesson is that one should be particularly aware of the dynamic negative effects generated by austerity. It is wrong to admit that after achieving the austerity agenda conditions for recovering the trajectory of growth will be in place. There is a very high risk that blind austerity measures will generate negative dynamic effects in the long term, penalising growth potential (a lot of people will not return to the labour market) and leading families to inefficient allocation of resources (for example, not investing in education). Internal nominal devaluation and the pressure to reduce wages also risk reducing incentives to companies to innovate and to recruit more qualified workers.

The third lesson concerns social dialogue, a core element of democracy in western societies. The capital of trust between social partners is in risk of being destroyed not because of conflicts between them but due to the lack of trust in government decisions. Competitiveness problems cannot be solved without long-term compromises and Social dialogue is an institutional space to build that compromise. Social dialogue is also a powerful instrument to discuss the rationale of austerity, when needed, and consequently to reduce risks of social dispute, distrust in politics and institutions and threats to democracy.

The fourth lesson is that blind austerity undermines social cohesion that is needed to complete structural changes. The strong increase in structural unemployment needs a solid base of social protection and not the disintegration of social cohesion. It is true that unemployment benefits can be more efficient. However, the number of unemployed people not receiving any kind of social protection and the number of couples in which man and woman are unemployed are now out of control. Besides this, Portuguese society is now blocked in terms of upward social mobility. Uncertainty and the increase in the number of unemployed young graduates are now pushing a large amount of skilled young people to emigration, provoking a huge fall in Portugal's human capital and a negative return to public investments in education made in the last two decades. In this context, families and individuals are now revising their decisions. The risks of suspension or regression in this investment are now very high, also contributing to blocking upward social mobility and to undermining the trust in democracy.

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.

In fact, there is no historical example of simultaneous deleveraging and correction of balance sheets of companies, families and governments without painful and unnecessary recession costs. The fiscal consolidation of a small economy belonging to the Euro zone cannot be achieved irrespective of a solution for the Euro zone as a whole. It is tragic to achieve that same consolidation in a period of anaemic growth prospects for the EU. Notwithstanding the resilience of Portuguese exports in such an unfavourable context, the fall of the “public debt/GDP” ratio requires a more favourable context for Portuguese exports to the EU market. Portuguese public opinion in general and social dialogue partners in particular begin to believe that the painful adjustment costs imposed by austerity may prove to be in vain and will not lead to a sound recovery.

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