

# EU expansion worsens Portugal's economic crisis

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Portugal's economy contracted by 1.2 percent in the first quarter from a year earlier in real terms, according to the National Statistics Institute (INE). Gross domestic product (GDP) was down due to weak domestic demand, which contracted further after a decline observed during the previous quarter.

On a quarter-on-quarter basis, GDP rose by 0.1 percent in the first quarter, technically pulling out of recession. But though the textbook definition of recession is two straight quarters of contraction, it is clear that the economy is in big trouble. In the final quarter of 2002, GDP fell 0.8 percent from the third quarter. In the last quarter of 2002, GDP contracted by 1.3 percent from a year earlier, and by 0.3 percent in the third quarter of 2002.

In recent weeks, almost daily reports have stated that the economy is in free fall. Figures published by the Bank of Portugal stated that the business confidence index is the lowest recorded since the last major recession in 1993.

Officially, unemployment rose by a massive 49.6 percent when compared with the same period last year, with the number who lost work last year rising by 26.3 percent from 2001.

Unemployment now stands at 6.7 percent compared with 4.3 percent for 2002, while the unions claim a real figure of more than 7.6 percent. The target figure set by the European Union (EU) is for no more than 5.0 percent, but most European countries are running at above 7 percent unemployment. Most affected by the increase in Portugal is the male population in the age group of 25 to 34, where there was an increase of 81 percent. This has been compounded by an increase in the available workforce by 700,000 in 2002, set to increase by the same amount again with this year's school leavers.

According to data published by employment centres, those with the highest qualifications are worst hit. The jobless figure for university graduates rose from 24,000 in 2001 to more than 30,000 at the end of the past year.

Portugal was an early enthusiast for the euro single currency, announcing from the beginning its intention to join. When it announced that it intended to join the euro zone, the country's interest rates were running well above those of Germany and France. The Portuguese banks realised that there was money to be made from this interest rate gap and began to borrow heavily in deutschmarks and francs at lower rates than they could domestically. These loans were then converted into the domestic currency and used to fund a lending boom.

With vast amounts of money flooding into the country, interest rates quickly began to converge with those in Germany even before the launch of the euro. The result of this cheap and plentiful credit was a surge in borrowing by companies and households. Residential investment rose, consumer spending increased at an unsustainable pace, and corporate investment became excessive.

The credit boom led to a rise in both the trade deficit and inflation, causing concern in the European Central Bank (ECB). Portugal's inflation was a factor in the ECB's decision to keep interest rates uncomfortably high for Germany, France and Italy. Last week, ECB president Wim Duisenberg cut the euro interest rate from 2.5 percent to 2.0 percent. The euro was trading at US\$1.1814 in late deals, compared to US\$1.1932 earlier, its highest level since the 12-nation currency was launched in 1999.

The credit boom has ended and the economy has slowed, but the situation is far from under control. Portugal was recently rebuked for its fiscal policies and

declared to be in breach of the Stability and Growth Pact's budget deficit rules as it continued to borrow to prop up the ailing economy. At the end of 2002, it ran a huge deficit of 4.1 percent, above the limit set at Maastricht of 3.0 percent of GDP.

With Portuguese banks using foreign currency to finance their lending, it is feared that the country does not have enough money to repay all of its debts.

While the situation is often cited by the anti-euro camp in Britain as being a product of the country's adoption of the single currency, its real source is to be found in the changed global position of Portugal.

In the 1990s, Portugal took over from Spain as the cheap labour platform of Europe. As a favoured production platform for the transnational corporations, Portugal streaked ahead of other countries in the EU with an average growth in the economy of 3.5 percent. The resulting low unemployment and improved public services gave the Socialist Party, led by Antonio Guterres, the most seats it had ever won in the 1999 elections. Within two years, however, Guterres was forced to resign following his party's humiliating defeat in the municipal elections of December 2001.

This paved the way for the PSD (Social Democrats) to resume office after seven years in opposition. The present government headed by Jose Manuel Durao Barroso is a coalition of the PSD and the conservative Peoples Party.

The new government embarked on a programme of harsh austerity measures including a two-percentage-points increase in Value Added Tax (VAT) to 19 percent, cut housing subsidies to youth, and threatened redundancies for up to 50,000 public servants. The government has also launched a Public-Private Finance Initiative for 10 new hospitals to be built in the coming years and opened up the Social Security pensions to the Insurance Corporations. The PSD-PP coalition also approved draconian anti-immigration laws. New labour laws, endorsed by the ECB, have provoked widespread hostility, with industrial action taking place throughout the last year.

Responding to the decision to cut the euro interest rate, Prime Minister Durao Barroso said reforms were more important to boosting the European economy than easing the euro currency from record levels against the dollar.

Durao Barroso cited the rise in Portugal's exports by

6 percent in the three months to February to declare, "What that shows is that the essential problem with the Portuguese—indeed the European—economy, is not a problem over the euro-dollar rate but rather the existence of stimuli to reform our economy."

"I think that with a stronger or weaker euro, we always have to take measures within our reach, namely reforming the economy," he added.

Durao Barroso's plans for reform include tackling the budget deficit through even more severe attacks against the working class while cutting corporate tax from a current 30 percent to 25 percent in 2004 and to 20 percent in 2006. For Portugal to maintain its position as a cheap labour platform for Europe, it must take what are already the poorest workers in western Europe and reduce them to living standards below those of workers from the east.

An average of almost two companies each month close and leave Portugal to take advantage of cheaper labour cost and taxes in the former Eastern Bloc countries. The average salary earned in Portugal is 750 euros, compared to a labourer in Bulgaria who would earn 100 euros, and in the Czech Republic, where a qualified worker earns 350 euros.

The enlargement of the European Union will deepen the crisis confronting Portuguese capitalism. Companies that invest in the poorer European countries will receive substantial EU subsidies, far beyond what Portugal receives from the EU or can afford to give companies to prevent their flight from the country and stave off the social explosion that continued economic decline portends.



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