

ECONOMIC DIPLOMACY, GEO-ECONOMICS AND THE EXTERNAL STRATEGY OF PORTUGAL

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Abstract

This article examines the challenges that globalisation poses to States and societies as well as the attempted response strategies, in particular the restructuring of external action based on an economic diplomacy approach, which was consolidated in the post-Cold War period with the new relevance given to the geo-economics. A reflection on the reform of Portugal's external action is also developed. The evolution of the conceptual framework demonstrates that economic diplomacy implies a significant innovation and a paradigm shift in external action, based on a holistic approach that articulates the "3Ms" of multidisciplinary (crossing economic, political and security dimensions), multilevel and multi-actor. The text addresses the case of Portugal, analysing the dynamics of external economic relations in the 2002-2015 period, structural vulnerabilities and the various failed attempts to structure a new approach during the last decade, which was essentially centred on the State and marked by the traditional vision of commercial diplomacy. In this context, and taking into account the experiences and good practices of other States, strategic guidelines are discussed for the structuring of an effective economic diplomacy in Portugal that articulates three fundamental organizational, operational and innovation dimensions.

Keywords

Geoeconomics; Globalisation; Economic diplomacy; External economic relations; Portugal's external action

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Introduction

Globalisation and its acceleration in the post-Cold War has generated a set of complex and diffuse effects with significant structural impacts on the Westphalian sovereign States, which has generally weakened them asymmetrically, reducing their respective room for manoeuvre in an international system characterised by increasing complexity and high levels of risk.² This trend is the result of interaction between different mechanisms that are mutually reinforcing.

The growing power and influence of non-State actors, particularly large transnational economic and financial conglomerates, and their impact on the breakdown of regulation, both at the domestic and international levels, contribute to the weakening of sovereign States. Globalisation has reinforced the logic of scale economies, triggering mergers and acquisitions that lead to the formation of large economic and financial groups in different sectors which abuse their enormous market power leading to oligopolization of the global economy. These conglomerates have an unprecedented ability to oppose and resist the mechanisms of public hetero-regulation and frustrate the regulatory action of the State through a combination of regulatory capture and "too big to fail"³ strategies. Internationally, the situation is even more problematic in the absence of a global regulatory framework for multinational corporations and other non-State actors, which take advantage of the enormous freedom of movement associated with this regulatory deficit.

To this decline of sovereignty also contributes decisively the erosion of the tax base of States, which severely limits their capacity for action and public policies implementation. This erosion is mainly a result of the increased tax evasion capacity of large multinational conglomerates⁴ – through transfer pricing, cross-border transactions of under- and over-billing, using offshore locations, tax arbitration and the fraudulent manipulation of accounts and results – exactly when their weight in economic activity is growing, and as

¹ The English translation of this article was funded by national funds through FCT - Fundação para a Ciência e a Tecnologia - as part of OBSERVARE project with the reference UID/CPO/04155/2013, with the aim of publishing Janus.net. Text translated by Thomas Rickard.

² Strange, Susan, *The Retreat of the State - the Diffusion of Power in the World Economy*, Cambridge University Press, Cambridge, 1996, p.14.

³ Stiglitz, Joseph 2010 *Freefall: America, Free Markets and the Sinking of the World Economy* Norton & Company, New York.

⁴ Henry, James, 2012, *The Price of Offshore Revisited*, Tax Justice Network, July 2012.



they increasingly hold significant shares of the market should therefore proportionally pay more taxes⁵ The deterioration of public accounts and increases in public deficits are aggravated by the fact that the erosion of tax bases occurs at the same time that States are forced to increase public expenditure to offset the social costs of globalisation, increasing social spending to support those excluded from the process, as well as to meet new security challenges related to non-traditional and diffuse threats that have intensified with globalisation.

The constraints to public policies are particularly relevant in a context marked by the growing vulnerability of States with respect to the growth of non-traditional, non-military and diffuse security threats. This is a central dimension of globalisation, mainly involving transnational organised crime and international mafias, the growth of different types of trafficking (arms, drugs and people) and international terrorism, whose modus operandi becomes more and more sophisticated with the use of new information and communication technologies and of the international financial system. The new and constantly changing threat of cyberspace, where transnational organised crime has strong influence, and the new challenges of cyber security in the face of cybercrime risks, or even of cyber war, has led to increasing State vulnerabilities.⁶

On the other hand, the quality and effectiveness of State public policies and decisions tend to decrease due to the pressure associated with an increased number and complexity of issues brought about by globalisation and the increasing requirements to manage multilevel governance. In this context, States and their central bureaucracies, which have a know-how shortfall in responding to new problems, also suffer from the syndrome of fragmentation and rigid division of competencies, affecting greater interagency cooperation. This is also true for cooperation with the private and social sectors, preventing a holistic and integrated approach to issues.

Finally, the erosion of State and government legitimacy affects the exercise of power as a result not only of the emergence of new sources of citizens' loyalty – which compete with nationality and fosters multiple identities associated with different transnational social networks – but also due to the inability of political power to control economic power, or the worsening of the crisis of representative democracy.

Sovereign States have sought to meet the challenges arising from the loss of their position of power and monopoly as international system actors through a set of very diverse strategies involving:

- (i) participation in macro-regional integration processes, combining resources and efforts with other States in order to minimise vulnerabilities and better meet the challenges of globalisation;

⁵ The BEPS (Base Erosion Profit Shifting Package) process developed within the OECD/G-20 is a process of soft law that aims to strengthen coordination among states to combat tax evasion via tax arbitration, which allows the artificial transfer of profits to jurisdictions with low tax burden where there are no records effective economic activity (cfr. <http://www.oecd.org/tax/beps/beps-about.htm>, consulted 10/8/2015).

⁶ States, especially those more dependent on cyberspace, are not prepared to control and minimise the risks. On the vulnerability and lack of preparedness of the States, see the case of the US in Richard Clarke and Robert Knake, 2010 *CyberWar: the next threat to national security and what to do about it*, HarperCollins Publishers.

On aspects of regulation see an interesting reflection on the application of international law, namely *jus ad bellum* and *jus in bello*, for cyberwar, Michael Schmitt (ed.), 2013 *The Tallinn Manual on the International Law applicable to Cyber Warfare*, Cambridge University Press, drafted by a group of experts at the initiative of Cyber Defense Center of Excellence NATO (www.motherjones.com/politics/2013/03/can-nato-drone-computer-hackers).



- (ii) the exploration of new models of cooperation and alliances with non-State actors, adopting models of co-regulation that coexist with the traditional models of hetero-regulation, which enhance the effectiveness of rules;
- (iii) the reform and improvement of the governance system by internally promoting decentralisation, in order to create several decision centres that take advantage of regional and local dynamism as well as innovation and the consolidation of regional knowledge networks; or by promoting reform of State structures and enhancing flexibility in responding to change, transparency and accountability;
- (iv) the acceleration of structural reforms for a more robust transition to the society/knowledge economy and enhanced competitiveness in the global economy;
- (v) the reform of the political system, seeking to develop participatory democracy mechanisms in order to encourage the involvement of citizens and contribute to the strengthening of legitimacy.

The development of economic diplomacy and a new paradigm since the 1990s constituted another State response strategy in the context of a global economy that, behind an appearance of market logic and competition, has paradoxically been marked by precisely opposite tendencies. On the one hand, there is an increasing concentration of economic power and oligopoly of many sectors with conglomerates and transnational companies that abuse their growing market power by limiting and distorting competition; on the other, there is a growing interference of political factors in economic issues and the influence of different powers, including new emerging powers, as illustrated by the extreme case of China's State capitalist model.

In this context, and contrary to the optimistic discourse on globalisation, it is not enough to be efficient, competitive or solve the internal structural problems to succeed in the global economy. One must also have the connections, institutional linkages and participate in relevant coalitions. To be competitive and have an innovative economy is only a necessary, but not a sufficient condition to meet the challenges of globalisation and the knowledge society. Economic diplomacy can be seen largely as a strategy to respond to this paradox and the growing integration of economic, political and security dimensions.

The article is structured into four parts. The first part deals with the concept of economic diplomacy and the paradigm shift that it implies in terms of the approach to the international space. The second part develops a partial analysis of Portugal's external economic relations in the period 2002-2015, identifying the key trends that include the development of foreign trade in goods and services, foreign investment and migration flows and their interconnections with economic diplomacy. The third part examines the various attempts to structure economic diplomacy over the last decade and the reasons for their failure. Finally, strategic guidelines are proposed and discussed for Portugal's structuring of economic diplomacy, as an input for the debate and urgent mobilisation for action.



1. Economic diplomacy: concept and paradigm shift

The development of economic diplomacy is one of the manifestations of the new role and relevance of geo-economics⁷ in the post-Cold War international system, in contrast to the era of the bipolar world in which geopolitics prevailed. The new basis for geo-economic power – the ability to generate knowledge and human resources; transforming the agriculture sector and control over resources; consolidation of an urban middle class and governance innovations; the fiscal capacity of States to finance military capabilities and infrastructure – supported the emergence of two paradigmatic cases of geo-economic power in the post-Cold War, China and Germany, which managed to transform their economic power into political power and military capabilities.⁸

Reform of the external action of States began from the late 1990s, led by the most active and competitive States in the global economy, especially the US, China, India, Brazil, the UK, Sweden and Germany.⁹ At issue was the need to reform and adapt a model of diplomacy dominated by political and military issues, marked by tension between the pursuit of economic interests and strategic objectives, as highlighted by Gertz,¹⁰ which prevailed during the Cold War and promote the transition to a model that assigns greater relevance to economic issues and strikes a new balance with political issues. The new emphasis on economic diplomacy does not mean the exclusivity or predominance of economics, but rather a better balance and coordination of the political and economic dimensions of external action, not the emergence of a mercantilist foreign policy.

The concept of economic diplomacy goes far beyond the traditional concept of commercial diplomacy, which is focused on export promotion and subordinated to political diplomacy, and has been analysed by different authors with different perspectives.

Berridge and James¹¹ see economic diplomacy as "diplomatic work to support the business and finance sectors of a given country [through] the use of economic resources, such as rewards or sanctions, in pursuit of a specific foreign policy objective". The basic assumption is the exclusive role of the State and public structures, which does not include the new dimension of non-State actors' action. On the other hand, the essence of economic diplomacy would reside in the use of economic instruments both positive and negative, for political purposes.

⁷ Luttwak, Edward. (1990) "From Geopolitical to Geo-economics, logic of Conflict, Grammar of Commerce", *The National Interest*, No. 20, pp.17-24; Mark P. Thirlwell, "The Return of Geo-economics: Globalization and National Security", *Lowy Institute for International Policy*, September 2010. Available at: <http://www.lowyinstitute.org/Publication.asp?pid=1388> .; Sanjaya Baru, 2012, *A New Era of Geo-economics: Assessing the Interplay of Economic and Political Risk*, IISS Geo-economics and strategic programme, IISS Seminar Paper.

⁸ Sanjaya Baru, *ibid*.

⁹ For a comparative analysis of these models see Miguel Santos Neves (2007) *The Diplomacy-Cooperation-Business Triangle*, In Fernando Jorge Cardoso (coord.) *Diplomacy, Cooperation and Business: the role of external actors in Angola and Mozambique*, IEEI / iPad, Lisbon, 2007.

¹⁰ Geoffrey Gertz, *Commercial Diplomacy and the American Foreign Policy*, GEG Working Paper 119, August 2016, which argues that commercial diplomacy re-emerged as a priority in US foreign policy since 1990, particularly in the diplomatic intervention of the State Department on investment conflict resolution that involves American companies. This is in contrast to the Cold War period in which commercial diplomacy action was seen as dysfunctional, creating serious risks of conflicts in bilateral relations, shifting the priority of strategic political issues and contributing to alienate and push countries into the orbit of influence of the Soviet Union.

¹¹ Berridge, Geoff R. Alan James, *A Dictionary of Diplomacy* Ed. Palgrave Macmillan, Basingstoke, 2005, p. 38.



Other authors such as Bayne and Woolcock link economic diplomacy with international economic decision-making,¹² arguing that its characterisation is not based on instruments but on its content and the various economic issues within it. On the other hand, they point out that the concept involves a qualitative change in the face of traditional diplomacy, whose stereotypes do not apply, highlighting the interaction between domestic and international dimensions of the process, the links between political and economic dimensions and the increasing relevance of non-sovereign actors and their interaction with States, which are not regarded as unitary actors. In the view of these authors, economic diplomacy tries to manage three types of fundamental tensions: (i) between politics and economics; (ii) between State and non-State actors (iii) between international and domestic pressures, international negotiation and domestic negotiation processes.¹³

Kishan Rana reinforces this view stressing that it is a process, not structures, oriented towards responses to external challenges and maximising comparative advantages:

*The process through which countries tackle the outside world, to maximize their national gain in all the fields of activity, including trade, investment and other forms of economically beneficial exchanges, where they enjoy comparative advantage... it has bilateral, regional and multilateral dimensions, each of which is important.*¹⁴

This last reference refers to the multilevel dimension of economic diplomacy that approaches Bayne and Woolcock's position, which deals with the associated interconnection between 4 levels: bilateral, regional, plurilateral and multilateral.

The perspective of Okano-Heijmans¹⁵ highlights the fact that economic diplomacy is not to be limited neither to economy nor to diplomacy, implying a broad concept that must be understood in the light of a plurality of scientific disciplines, that is international relations, economics, international political economy and diplomacy studies.

In short, despite the consensus on the paradigm shift there are differences on the scope and objectives of economic diplomacy in the literature. The perspective that best captures the complexity and the paradigm shift is that proposed by Bayne and Woolcock which implies not only an extension of the subject but also a new logic and ways of designing and implementing external action. Indeed, economic diplomacy significantly expanded

¹² Bayne, Nicholas and Woolcock, Stephen (eds), 2007 *The New Economic Diplomacy -decision-making and negotiation in international economic relations*, Ashgate, 2nd edition.

¹³ Bayne, Nicholas and Woolcock, Stephen (eds), 2007 *The New Economic Diplomacy decision-making and negotiation in international economic relations*, Ashgate, 2nd edition, p.10.

¹⁴ Kishan S. Rana, 2007, Economic diplomacy: the experience of Developing Countries in Bayne, Nicholas, Stephen Woolcock, *The New Economic Diplomacy-decision-making and negotiation in international economic relations*, Ashgate, 2nd ed., pp.201-220.

¹⁵ Maaïke Okano-Heijmans, 2011 *Conceptualizing Economic Diplomacy: the crossroads of International Relations, Economics, IPE and Diplomatic Studies*, in *The Hague Journal of Diplomacy*, Vol.6, Paragraphs 1-2, 2011, pp.7-35.



the range of issues that were traditionally dealt with in promoting the external interests of a country, especially trade and investment, combining seven distinct dimensions¹⁶:

- (i) trade promotion, especially in exports, but also the correction of chronic trade deficits and management of multilateral trade negotiations;
- (ii) promotion of investment, both from the perspective of attracting inward foreign direct investment (FDI) and support the expansion of a country's overseas outward investment;
- (iii) Promotion of tourism;
- (iv) Management of migration flows and attracting skilled staff;
- (v) Promotion of science and technology, which aims to capture new technologies and establish strong ties with leading innovation centres;
- (vi) Development aid management;
- (vii) Promotion of country image.

However, the concept entails, in addition to this extension of the subject, a qualitative change and greater complexity that stems from three fundamental transformations that mark the economic diplomacy of the post-Cold War – the “3 Ms”: multidisciplinary; multi-actor; multilevel.

First, a multidisciplinary approach stems from a more holistic view of the relationship between different economic issues and the interaction between economics, politics and security, which reflects a new balance between geo-economics and geopolitics. Second, its multi-actor nature, as economic diplomacy is no longer an exclusive activity of States, but rather there is a multiplicity of State and non-State actors who act in two ways: firstly, influencing the public policy decision making process; secondly, acting directly in the international stage as autonomous actors. New economic diplomacy requires the adoption of a multitrack diplomacy approach implying an intelligent and flexible combination between track I diplomacy (official formal channels), track II diplomacy (unofficial, unstructured, informal channels with the participation of non-State actors, NGOs, academics) and track III diplomacy (informal initiatives at the community level – that is people to people).

Third the multilevel dimension, because action takes place simultaneously at international, macro-regional, national and sub-national levels, including the new dynamics of paradiplomacy, implies coordination and operation of the interconnections among the different levels. On the other hand, it challenges the traditional view of dichotomy between the external and internal levels with a rigid separation between domestic policies and external action, which must be seen as a unit and in a continuum.

It should be stressed that economic diplomacy is not a homogeneous and uniform reality, being a process that is subject to a gradual evolution and variety of patterns. The contribution of Rana¹⁷ is particularly relevant in characterising this diversity when

¹⁶ The link between the seven pillars expands the narrower view proposed by Rana, Kishan, 2002 *bilateral Diplomacy*, DiploHandbooks, DiploFoundation, ch.4.

¹⁷ Rana, Kishan and Bipul Chatterjee, 2011 *Economic Diplomacy: India's experience*, CUTS International, Japuir. Previously, Rana argued for a slightly different system with three phases (i) salesmanship, (ii) network and advocacy and (iii) regulatory management.



considering that there are different stages of economic diplomacy development. Four key stages, in order of increasing complexity, were identified:

- (i) first is the phase of "promotion" – focused on trade expansion, export promotion and foreign investment attraction;
- (ii) the second phase relates to "networking", which involves the mobilisation of clusters of supporters and participants either in the country or abroad (companies, universities, think tanks, chambers of commerce) in the areas of trade, investment and the acquisition of technologies;
- (iii) the third phase of "country promotion" focuses on strengthening country image and reputation as well as their companies in order to attract investment and tourist flows;
- (iv) the fourth phase, "the regulatory phase", focuses on the completion and management of bilateral and multilateral trade agreements and bilateral investment treaties.

Although these phases have a sequential logic, they tend to co-exist in time and space, being an evolution towards an increasingly complex and systemic impact. Thus, in general, a mixed picture tends to prevail, characterised by the coexistence and partial overlap between the different stages, although in different proportions depending on the degree of system development.

In this context, and in line with Bayne and Woolcock, three deeply intertwined strategic vectors to think about external action can be identified, whose implementation is a key challenge for States.

Firstly, there is the continuity of internal and external dimensions. Transnational phenomena abolished the barriers between internal and external levels and call into question the traditional divisions between domestic policies pursued by specific institutions and foreign policy developed by specialised structures with high levels of discoordination and a deficit of coherence. The new context implies thinking of the internal and external as a continuum in order to enhance coherence.

Second, there is the holistic view of issues and multi-actor approach. The complexity of the issues raised by the knowledge society and systemic competitiveness at the global level involve addressing problems in an integrated and holistic manner. However, this is not facilitated by the sectoral and fragmented logic in which States organize their machine and devise public policies. On the other hand, it involves designing the decision-making process as a participatory multi-actor process, where non-State actors interact and cooperate with the State in a partnership in order to maximise the effectiveness of external action, abandoning the traditional idea that foreign policy is a reserved realm of States.

Third, there is the multi-level approach, although in a different perspective from that of Bayne and Woolcock. Here, there is the need to recognise the legitimacy of different levels of external action – global, macro-regional, national, micro-regional and local – and the management of complex relationships between them, as opposed to a centralist vision based on the predominance of central government and the national level. The growth of the phenomenon of sub-national governments' paradiplomacy, particularly



active in the case of States that have been most successful in responding to the challenges of globalisation, is one of the most significant trends in the current international system. These complements and strengthens – not weakens – the external action of States.¹⁸

2. Portugal's External Economic Relations 2002-2015

External economic relations involve two dimensions: a set of economic, trade of goods and services, financial, tourism, direct investment, technology and migration flows, on the one hand; a network of interpersonal relationships of individuals and organisations with different cultures that generate and maintain these flows. The interconnection between the different political, economic, security and cultural dimensions is becoming denser, but the dominant approach remains fragmented and simplified, rearranging reality into watertight compartments that do not take a holistic view. The analysis of external economic relations means addressing interactions in terms of external trade, investment and financial flows; migration and technology flows as well as cultural aspects associated with economic exchanges; and issues related to economic security, which are an objective of great importance, but distinct from, and sometimes in conflict with, economic prosperity. The analysis developed here focuses on foreign trade, foreign direct investment, tourism and migration flows, for which there is consistent data available.

External trade

In the 2002-2015 period, Portugal's total foreign trade (imports and exports), including goods and services, increased from €90.2 billion to €145.7 billion, although with an irregular evolution registering a significant decline in 2009, as a result of the international crisis, recovering in 2010 and reaching in 2011-2012 similar levels to 2008, followed by an expansion in the subsequent years until 2015 (see Table 1).

The evolution of the import and export of goods and services showed continuous growth between 2002 and 2008 and then a significant drop in 2009 with a reduction of -18.2% for imports and -15.5% for exports.

The fall in exports in 2008 and 2009 resulted from the combined effect of the decline in demand in key markets (particularly the Spanish market) and a strong euro, which adversely affected the competitiveness of exports to non-EU markets.¹⁹ The recovery

¹⁸ On the phenomenon of paradiplomacy Brian Hocking, *Localizing foreign policy - non-central governments and multilayered diplomacy*, London, St. Martin's Press 1993; Hans Michelmann, and Soldatos (d) *Federalism and international relations - the role of subnational units*, Clarendon Press, 1990; Francisco Aldecoa and Michael Keating (eds.), *Paradiplomacy in Action: The Foreign Relations of Subnational Governments*, Routledge, 2013; Miguel Santos Neves "Paradiplomacy, knowledge regions and the consolidation of 'Soft Power'" in Janus.net e-journal of International Relations, No. 1, Autumn 2010.

¹⁹ The evolution of the euro's exchange rate against the dollar has seen an erratic evolution where it is possible to distinguish three distinct periods: (i) an initial phase of the weak euro 1999-2002, with the initial rate of decline of 1.2 to 0.9 in 2001 and 0.85 in 2002; (ii) phase of the strong euro in the period 2002-2008, registering a strong upward trend from 0.9 in 2002 to a peak of 1.6 at the end of July 2008, albeit with fluctuations and devaluation periods between 2005 to 2006; (iii) unstable phase and moderately strong euro between the end of 2008-2013, characterised by greater instability of the euro's successive gains and losses in a band ranging from 1.5 and 1.2 against the US dollar since the beginning of the financial crisis. Valuation movements between Nov 2008 - Dec 2009; June 2010 (1.2) - April 2011 (1.46); July 2012 (1.2) and February 2013 (1.33); movements devaluation between Dec 2009 - Jun 2010; April 2011 (1.46) - Jul 2012 (1.2) - see European Central Bank, ECB Statistical Data Warehouse



started in 2010: exports recovered to 2007 levels and grew significantly and continuously between 2011 and 2015, reaching €74.5 billion by the end of this period. The key driver behind this positive performance was the unprecedented increase in revenues from the tourism sector, increasing from €8.6 billion in 2012 to €11.5 billion in 2015 (accounting for 15.4% of total exported goods and services).²⁰

With regard to imports, after a recovery in 2010 they grew slowly in 2011 and registered a decline in 2012, reflecting the effects of the domestic economic downturn and the impact of the austerity programme. They then stabilised in 2013 and returned to growth in 2014-2015.

Table 1: Foreign trade of goods and services 2002-2015 (€Billion)

Year	imports	exports	Difference	Total trade
2002	50.8	39.4	- 11.4	90.2
2003	50	40.2	- 9.8	90.2
2004	55	42.7	- 12.3	97.7
2005	57.7	43.4	- 14.3	101.1
2006	63.9	50.5	- 13.4	114.4
2007	68.2	55.5	- 12.7	123.7
2008	73.4	57.1	- 16.4	130.5
2009	60.1	48.3	- 11.8	108.4
2010	67.5	55	- 12.5	122.5
2011	68.7	62.2	- 6.5	130.9
2012	64.2	64.4	+ 0.2	129.1
2013	65.4	68.6	+ 3.2	134.0
2014	68.8	70.8	+ 2.0	139.6
2015	71.2	74.5	+ 3.3	145.7

Source: Banco de Portugal. Balance of Payments Statistics; AIFTP "Portuguese International Trade in Goods and Services 1996-2011", in December 2012 and "Portuguese International Trade, evolution of Portuguese exports of goods and services in 2012 Jan/Dec", February 2013, 2014, 2015. Calculations by the author.

External trade relations were marked in the period 2002-2015 by imbalances registering two distinct phases. The first phase from 2002-2011 showed a persistent trade deficit with a negative balance of more than €10 billion, reaching its highest value in 2008 (€16.4 billion). Although, there was a slight reduction in the external deficit in 2009 as a result of a fall in imports (-18.2%) and exports (-15.5%) of goods and services, only in 2011 there was a significant correction with a halving of the value of the trade deficit in the previous year, a result of asymmetric marginal growth in imports (1.8%) and strong growth of exports (13%).

In the second phase (2012-2015), a trade surplus was registered that reached €3.3 billion in 2015. This figure is explained by the balance of services, which more than offset the persistent trade deficit in goods (-€10.5 billion in 2015). This is especially true for tourism, whose surplus of €7.8 billion in 2015 accounted for 56.6% of the total amount of the surplus in services. In 2012, for the first time, there was a marginal surplus of

(http://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=120.EXR.D.USD.EUR.SP00.A#top Consulted on 10.09.2013) and <http://www.ecb.europa.eu/stats/exchange/eurofxref/html/eurofxref-graph-usd.en.html> Consulted on 11.09.2013)

²⁰ According to statistics from the World Tourism Organization (UNWTO), Portugal registered a total of 10.2 million arrivals in 2015 and strengthened its position globally, was the 26th largest tourism market and the 33rd largest in terms of revenue (UNWTO World Tourism Barometer, May 2016).



€229 million, which resulted from the combination of a drop in imports (-6.2%) and growth in exports (3.8%). This was consolidated in 2013-2015, although at low levels, reaching an average surplus of +€3 billion.

The devaluation of the euro against the dollar since 2011 and further intensified in 2015 and 2016²¹ together with the impressive increase in tourism flows, as a result of growing insecurity in the Maghreb, sharp fall in oil prices and the projection of a positive image of Portugal as a tourist destination, can be seen as two key factors that contributed positively to the new trade surplus phase.

Tourist flows

Tourism in Portugal²² (inbound flows) grew rapidly from the late 2000s and, in particular, in the period between 2012 and 2015 when they registered an increase of over 30%. This was up from 7.5 million in 2012 to approximately 10 million tourists in 2015, with growth rates of 13% in 2014 and 10% in 2015. This positive development also had a significant impact on the growth of tourism revenues, which increased even more strongly (33%) in the period from €8.6 billion to €11.5 billion in 2015 (see Table 2).

Table 2: Tourism in Portugal (inbound) and revenues (2011-2015)

	2011	2012	2013	2014	2015
No. Tourists (millions)	7.3	7.5	8.1	9.1	9.9
Sleeps (millions)	27.9	29	31.1	34	36.4
Recipes (€ million)	8.146	8.606	9.250	10.394	11.451
pour memoire					
Total tourists globally (millions)	994	1.040	1.086	1.134	1.186

Source: UNWTO Statistics and Bank of Portugal (tourism revenues)

This positive development is part of a general trend of increase in global tourism flows, which have grown at an average rate of 5% per year exceeding one billion tourists in 2012 and recording in 2015 a record of 1,186 million tourists globally. This positive trend can be partly explained by the reduction in oil prices and the expansion of the middle class in emerging economies. The difference is that the average rate of growth in Portugal has been, since 2012, twice the global and European averages, which is explained by regional and national factors. In terms of regional context, Portugal is located in the Southern Mediterranean Europe the region that attracts more tourists at the global level, accounting for 19% (225 million tourists) of total flows in 2015. There are also specific factors that favour the profile of Portugal as a tourist destination, namely the growing concern over security issues, with Portugal being perceived as a safe country and an alternative to the Maghreb region; strong cultural dimensions and country image; as well

²¹ The Euro average annual exchange rate against the US dollar depreciated from 1.39 in 2011 to 1.11 in 2015 with some fluctuations in this period: devaluation to 1.28 in 2012 with a slight recovery to stabilise at 1.33 in 2013 and 2014, and new devaluation in 2015 to 1.11 vd. Statista ECB data (available at <https://www.statista.com/statistics/412794/euro-to-us-dollar-annual-average-exchange-rate/>).

²² UNWTO Statistics Portugal: Country-specific: basic indicators (Compendium) 2011 to 2015 (09.2016), UNWTO e-library. Available at <http://www.eunwto.org/doi/abs/10.5555/unwtotfb0620010020112015201609>.



as the positive perception of quality and diversity anchored on international awards and positive feedback in digital social networks.

However, the growth of tourism has not been accompanied by a diversification of origin markets and flows remain heavily concentrated in the traditional European markets (United Kingdom, France, Spain, Germany). These represented 82% of tourists in 2012 and continue to account for 80.5% in 2015, followed by the US, East Asia and the Pacific, which increased their weight from 4% in 2012 to 6% in 2015 due to a slight increase in flows of Chinese and South Korean tourists. Considering this background, there has been no strategy of diversification to attract more Chinese tourist flows – the biggest market in the world – or exploring linkages with Spain, the second largest European tourism market.

In general, one of the characteristic of Portuguese external trade is the high level of concentration of exports and imports in a limited number of markets, which involves a low degree of diversification and hence a high level of risk with regard to fluctuations in external demand and vulnerability to external shocks. The high degree of concentration is shown in Table 3.

Table 3: Level concentration of Portuguese exports in its largest export markets (%).

YEAR	(Top 10 markets) % Total Exports	3 largest markets b) % Total Exports
2002	83.1	49
2003	82.8	49.1
2004	82.9	49.3
2005	81.7	49.7
2006	81.1	49.6
2007	79.9	49.5
2008	77.7	48.1
2009	78.3	47.8
2010	77.5	47.6
2011	77.1	46.4
2012	75.3	46.6
2013	74.7	42.8
2014	75.4	42.9
2015	75.4	44.1

Source: Calculations by the author from Banco de Portugal and AIFTP statistics, 2002-2015

- a) The 10 largest export markets include, in descending order, Spain, France, Germany, the UK, Angola, Netherlands, USA, Italy, Belgium, Brazil
 b) The three largest markets are, in order, Spain, France and Germany

The three largest markets, Spain, France and Germany, have absorbed, over the period considered, almost half of Portuguese exports (49% in 2002), rising to 49.7% in 2005 and slightly reducing from 2008, but maintaining a value of 46.6% in 2012.²³ In 2013 and 2014 there was a slight reduction in the concentration to 42.8%, but this trend did not continue and in fact was reversed increasing to 44.1% in 2015. This high concentration affects both the exports of goods and services. For tourism, the three

²³ To measure the degree of concentration of exports in target markets, three indicators are normally used: the Herfindahl Hirschman Index, the Gini Hirschman Index and the entropy coefficient.



largest source tourist markets – the UK, France and Spain – accounted in 2015 for 49.4% of total overnight stays (34.4 million) and 47% of total revenues (€11.5 billion).²⁴

If we analyse the data of the 10 largest markets – Spain, France, Germany, the United Kingdom, Angola, Netherlands, USA, Italy, Belgium, Brazil – for exports during the selected period, it is possible to depict a high level of concentration in these markets which absorbed about 80% of exports in the first part of the period until 2007 (83% in 2002 and 80% in 2007). This percentage decreased slightly from 2008 to 75.3% in 2012 and then remained stable in 2014 and 2015 (75.4%). There was thus a slight diversification of export markets from 2009 onwards, which is seen at the level of the top 10 markets and not so much in terms of the three major markets, although the bottom of the table is a highly concentrated index.

Investment

For Foreign Direct Investment (FDI) in Portugal, the evolution from 2002 to 2015 was erratic and rather unfavourable with modest flows both taking into account the size of the Portuguese economy and the comparative performance of other competing economies. Net FDI flows are characterised by high instability and fluctuations, as shown in Table 4. These were relatively modest in 2002 with €1.9 billion, tripled in 2003 to €6.3 billion, falling back during the following years to grow again in 2006, when they peaked to a total of €8.7 billion. The 2007-2010 phase saw a fall in FDI inflows, which was followed by a recovery phase in 2011 and 2012 to €8 billion and €7 billion respectively. The following years were characterised by a further decline in FDI flows to €2 billion in 2013 and 2.2 billion in 2014, increasing again in 2015 to €6.2 billion.

Table 4: Direct Investment in Portugal. Major investors (% of total FDI); Stocks and Investment Income (€ billion) 2002-2012

country	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Netherlands	14.8	14	13.5	13.2	14.6	14.3	16.3	17.7	12.5	22.5	8.5			
Spain	8.4	11	16.4	14.6	12.8	16.5	15.6	13	14.4	17.7	22.9			
France	18.9	11.5	11.4	14.1	13.1	10.4	12.7	17.5	16.8	16.4	18.2			
United Kingdom	14.5	13.4	15.2	12.6	14	16	15.8	20.5	10.8	13.8	15.7			
Germany	12.8	8.9	12.6	16.8	15.8	19.7	15.1	13.1	16.1	10.1	13.6			
Total 5	69.4	58.8	69.1	71.3	70.3	76.9	75.5	81.8	70.6	80.5	78.9			
Net FDI (€ billion)	1.9	6.3	1.5	3.2	8.7	2.2	3.2	1.9	1.9	8	6.9	2.0	2.2	6.2
Stocks (€ billion)							71.8	79.8	83.5	86.4	86.8	90.4	98.1	105.5

Source: Bank of Portugal and AIFTP

Interestingly, in the context of the sovereign debt crisis in the Eurozone, investment flows increased precisely in the years of the most severe economic recession in Portugal, with inflows quadrupling in 2011 compared to 2010 – a phenomenon that was registered also in Greece and Italy.²⁵ This is a paradoxical trend that can be explained by the interaction between two factors: privatisation and round-trip investment.

²⁴ AICEP, Statistics, Portugal Country Record, Sep 2016.

²⁵ World Investment Report 2012, pp. 62-63.



First, the implementation of a privatisation programme, in the context of the Memorandum of Understanding with the Troika, which attracted foreign investors. This was the case in 2011 with the privatisation of 21.35% of EDP acquired by the Chinese state-owned China Three Gorges for €2.7 billion. According to data from the International Monetary Fund, global revenue from privatisations between 2010 and 2013 generated a revenue of €7.2 billion.²⁶

The significant increase in FDI flows in 2011 and 2012 and the following years is largely due to the new phenomenon of large-scale Chinese investment in Portugal, as occurred in other EU countries, especially in Southern Europe. This investment, achieved through mergers and acquisitions, was conducted mainly by Chinese state-owned enterprises, with the exception of Fosun, who took the opportunity to acquire assets at low prices in the context of a highly fragile and vulnerable economy. A pattern of strong concentration is also seen in strategic sectors with the consolidation of dominant positions, especially in the energy sector (stakes in EDP, EDP Renováveis and REN), the financial sector (BES Investimento, Caixa Seguros Saúde/Fidelidade, and more recently BCP), the health sector (BES health), as well as real estate and utilities (i.e. water), reaching a total of €5.5 billion by 2014. This corresponds to an investment pattern with unique characteristics: high political profile, without added value in terms of technology and job creation, but with significant impact in terms of restrictions to competition and regulatory challenges.²⁷

Second, a distorting effect associated with the round-trip investment process through which the great Portuguese multinational groups have been increasingly investing in Portugal from abroad for purposes of tax avoidance has created an illusory effect since it is not real foreign investment.²⁸

It is important to note the high degree of concentration of FDI inflows in a very small number of origin countries – the Netherlands, Spain, France, the UK and Germany – which have collectively accounted for about 70% of FDI in Portugal in 2002, and whose weight further increased from 2007 onwards, reaching 80% of total FDI in more recent years (Table 4). In short, by 2011 there has not been a trend of diversification, but a greater concentration in traditional investors.

This situation has changed to the extent that the recovery of FDI flows in 2011 is associated with a diversification process, with the entry of Chinese investment diminishing the relevance of the effect of round-trip investment. However, the most intense phase of Chinese investment shows signs of having exhausted, despite new but smaller investments may still materialise over the coming years. This restores the significance of the effect of round-trip investment as is visible in the 2015-2016 investment data, where the Netherlands emerges again as the top investor (24.3%)

²⁶ Vd. IMF 2013 Portugal: Seventh Review under the Extended Arrangement, Country Report No. 13/160, June 2013, Table 4.

²⁷ On the pattern of Chinese investment in Portugal see Annette Bongardt and Miguel Neves, 2014 *The Chinese Business Community at the Crossroads between Crisis response and Global China's Assertive Strategy - the Case of Portugal*, MPC Research Report 2014/02, and Robert Schuman Migration Policy Center, European University Institute.

²⁸ Rodrigo Fernandez, Jesse & Katrin MaGauran Frederik, 2013 *Avoiding Tax in Times of Austerity - Energias de Portugal (EDP) and the Role of the Netherlands in Tax Avoidance in Europe*, Centre for Research on Multinational Corporations SOMO, the Netherlands, September 2013. About the process and mechanisms of tax evasion of large conglomerates and their impact see James S. Henry, 2012 *The Price of Offshore Revisited*, Tax Justice Network, July 2012.



followed by Spain (23%) and Luxembourg (19.3%).²⁹ This surprising new position of Luxembourg, which has never been a traditional investor, suggests a further intensification of round-trip investment, with two offshore centres now emerging as the main sources of FDI in Portugal, accounting for almost half of total inflows (43.6%).

The decline in the capacity to attract FDI is explained by a combination of external and internal factors. Externally, due to the strengthening of international competition from other destinations and the consequent redirection of these investors to other attractive locations (Eastern European EU members especially after the 2004 accession, and emerging economies, particularly China, Turkey, India, Brazil). Internal factors are mainly related to the weak performance of the Portuguese economy and above all the instability of the legal framework and the tax system, which are subject to constant changes that create uncertainty and impairs investors' long-term planning. This joins the systemic problems of the Portuguese justice system that exacerbates uncertainty and transaction costs for businesses.

However, despite these factors, it can be argued that the absence of an external strategy and structured economic diplomacy has also aggravated this negative evolution, insofar it did not allow to proactively counteract, or at least attenuate, these trends and develop an effective action to attract new investors.

As to Portuguese direct investment abroad (PDIA), after the peak reached at the end of the 1990s, which was a period of major investments dominated by investment in Brazilian privatisation programmes and in Spain, PDIA fell to more modest levels, with gross investment varying between a minimum of €7.7 billion in 2007 and a maximum of €19.6 billion in 2011. Net investment recorded modest levels and even a negative trend, with strong reductions especially from 2008 (between €1 and €2 billion) as well as a sharp decline in 2010 of € -5.6 billion. The positive trend in 2011 has an exceptional nature, explained by the large increase in direct Portuguese investment in the Netherlands, which grew by 800%. This was related to the restructuring of major Portuguese multinational groups' operations; however, this did not change the dominant pattern of decline that especially marks the second half of the decade, confirmed in 2012.

This development does not result only from the economic crisis, since there were already signs of reduced PDIA in the first half of the decade, but from the interaction between other factors, in particular the retraction of many Portuguese investors affected by the impact of the crisis and the fact that Portuguese multinational groups now invest abroad from offshore centres.

Table 5: Portugal Direct Investment Abroad – main destination countries (% of total PDIA); stocks and investment income (€ billion) 2002-2012

Country	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Netherlands	51.1	11.2	21.7	25.6	37.5	38.7	32.2	31.1	21.0	73.2	59.4
Spain	23.8	9.4	22.5	17.7	11	13.1	19.6	16.2	7.9	9.2	12.6
Brazil	9.4	1.9	4.3	3.6	4.3	4.5	4.7	6.7	17.2	3.6	7.3
Angola	0.4	0.4	0.9	2.7	2.8	0.0	6.8	8.9	6.8	1.6	3.5
Denmark	0.2	25.6	23	3.6	1.2	3.0	1.2	6.8	0.1	0.5	1.0
Total %	84.7	48.5	72.4	53.2	56.8	62.3	64.5	69.7	53	88.1	83.8
Net investment (€ billion)						4	1.8	0.6	-5.6	10.7	1.5
stocks (€ billion)	11.6	10	11.9	9.7	9.8	14.8	11.3	7.7	9.8	15.6	

Source: Bank of Portugal, AIFTP; author's calculations

²⁹ AICEP, Statistics, Portugal Country Record, Sep 2016.



Also in terms of PDIA, a significant concentration is found in a limited number of destination countries – the Netherlands, Spain and Brazil – which account for around 2/3 of the total. There is also a decreasing trend of PDIA's total in 2011 (about 86%) and in 2012 (about 80%). The most significant changes since the last decade have to do with the significant drop in investment in Brazil and a reduction in the weight of Spain as a destination market for PDIA.

On the other hand, the Netherlands has increased in importance as the largest destination of direct Portuguese investment abroad, especially in the second half of the decade. On average, it accounted for more than one third of PDIA, a trend that accentuated in 2011 and 2012 (73% and 60%, respectively). This phenomenon, coupled with the fact that it is also one of the largest foreign investors in Portugal, reflects the intensification of round-trip investment whereby major Portuguese economic groups invest in Portugal from the Netherlands. This is motivated by mechanisms of tax evasion that first justified capital outflows to the Netherlands only for re-entry in the form of FDI in Portugal later on.³⁰ It is therefore consistent with the fact that FDI in Portugal has focused on wholesale and retail sectors, which absorbed 38.9% of flows in 2011 (up from 31.9% in 2002), followed by financial activities (22.3%, compared to 19% in 2002) and manufacturing (21%, compared with 32.1% in 2002). The latter sector, which occupied the first place in 2002 with 32.1%, recorded the biggest drop in FDI flows, illustrating the process of deindustrialisation of the Portuguese economy.

In turn, the distribution of PDIA by sector reveals an overwhelming concentration in the financial sector (financial and insurance activities), which in 2012 represented 75.8% of the total, over three quarters, followed at a great distance by manufacturing with 8.2%, and consulting activities with 5.1%.

Migration

The management of migration flows, the mobility of human capital and the ability to attract highly qualified personnel is of critical importance from a geoeconomic perspective and for the consolidation of scientific, technological and innovation capabilities of a country in the context of the knowledge economy. For Portugal, the striking aspect of the evolution of migration flows was the combination of the fall in immigration flows from 2009 onwards with the expansion of emigration flows that have accelerated since 2011. This resulted in a negative migration balance, with a negative impact on demography.

Growth in immigration until 2009 was followed by a steady decline in the resident foreign population, which fell by about 15% from 451,754 in 2009 to 388,731 in 2015. This is explained by the combined effect of the low attractiveness for new flows or the return of immigrants associated with labour market worsening conditions and the granting of citizenship.³¹ As to emigration, after the 2007 peak and its reduction by 2010, there has been an increase in annual flows since 2011 that grew from 80,000 to 110,000 in 2013

³⁰ See the study on tax evasion of large multinational groups Rodrigo Fernandez, Jesse & Katrin MaGauran Frederik, 2013 *Avoiding Tax in Times of Austerity - Energias de Portugal (EDP) and the Role of the Netherlands in Tax Avoidance in Europe*, Center for Research on Multinational Corporations SOMO, the Netherlands, September 2013.

³¹ SEF Aliens and Borders Police, Immigration Reports, Frontiers and Asylum, 2010-2015.



and 2014, making up a total of about 400,000 exits between 2011 and 2014. Most of this comprised of young qualified workforce.³²

These trends are explained by the impact of the economic recession in Portugal and its effects on the labour market in terms of unemployment and salary reductions, as well as by a lack of strategy to value qualified personnel in the double perspective of attracting qualified workers from abroad and retaining existing Portuguese workers.

With the absence of consistent data on qualified personnel flows to Portugal, there are some scattered data indicators, including the percentage of residence visas and temporary residence for highly skilled immigrants. This has a marginal expression, representing only 3.3% of total residence visas and 9.5% of the total granted visas for temporary stays in 2011. In general, there is not a proactive and consistent policy of qualified foreign personnel recruitment, with only two instruments: (i) the scientific research system under the 2007 Immigration Act (Articles 61 and 90); (ii) and the 2009 Blue Card Directive that was transposed only in 2012 that gave rise to a new article introduced by Law 29/2012 of 9th August, which, along with the Blue Card Directive, has not produced significant results.

There are some exceptional cases of sectors that have implemented policies of recruitment of foreign qualified workers. These include medicine with the hiring of foreign doctors for the National Health Service³³ as well as some scientific research institutions that have actively sought to recruit highly qualified foreign staff for the development of projects.³⁴

Since 2011, qualified workers, particularly highly skilled young people, have emigrated in ever greater numbers. This "brain drain" has been seen as a loss for the Portuguese economy and society. However, in a knowledge society characterised by high mobility and circular migrations, simultaneous connection with and circulation between different knowledge networks in various territorial spaces is viable and therefore their departure should not be seen as a definitive or irreversible loss. On the contrary, it should be seen as an opportunity for the involvement of a qualified diaspora in more internationalised and denser knowledge networks that may actually promote and contribute to foster knowledge networks in Portugal.

In other words, even from a distance these Portuguese workers are still able to make an important contribution to their country of origin. Therefore, the most appropriate strategy is not to encourage immediate return as there are little chances of success, but rather to establish links to institutions in Portugal and promote participation in projects. Thus, the strategy outlined in Strategic Plan for Migration 2015-2020³⁵ seems inadequate and dysfunctional not only because it emphasises the promotion of return in the short term and reintegration of Portuguese emigrants, especially those who left after 2011, but also because there is no priority for devising a strategy to attract skilled foreign human resources.

³² Observatory of Emigration, Statistical Report 2015.

³³ SEF 2013 The National Attraction Countries qualified and highly qualified third party: the Portuguese case, in 2013.

³⁴ One example is the Champalimaud Foundation of the Centre for the Unknown that researches in the area of neuroscience, cancer and biomedicine, and has an active policy of attracting highly qualified scientists recruited worldwide.

³⁵ Approved by Resolution of the Council of Ministers No. 12-B/2015 (available at [http://jrspportugal.pt/images/memos/20150125-madr-pem-consulta-publica%20\(1\).pdf](http://jrspportugal.pt/images/memos/20150125-madr-pem-consulta-publica%20(1).pdf)).



Dominant trends

The evolution of the various dimensions of Portugal's external economic relations in the period 2002-2015 reveals three key trends worth highlighting due to their implications for the structuring and implementation of economic diplomacy.

First, excessive concentration of external economic relations in a small number of partners within the EU as well as non-EU countries, which creates an unfavourable environment of strong dependence and high risk that can only be reduced and controlled through an effective diversification strategy. Worse still is the evolution of this indicator, which calls into question policies: in the case of foreign trade, a high level of concentration and a very marginal reduction in the level of concentration in the 10 largest export markets is detected, but unchanged in its three largest markets; as to investment, either FDI or PFDI, the trend is to an even greater concentration, which the transitional diversification introduced by the new phenomenon of Chinese investment in the Portuguese economy failed to reverse. On the other hand, positive developments associated with some diversification of export products (tourism, food industry and agriculture) are not enough to offset the increased risk associated with persistent high degrees of concentration in a limited number of markets.

Second, a strong financialisation of external economic relations either through import and export operations, in many cases using offshore centres, or through investment flows in both directions that are fundamentally linked to financial transactions aimed at tax evasion. This is especially true for round-trip investment which Portuguese conglomerates and multinational companies practice. This financialisation process not only weakens the State, aggravating the erosion of its tax base and reducing its ability to implement public policies, including economic diplomacy, but also accentuates the speculative nature of flows and reinforces their illusory nature.

Third, there is the oligopolisation of economic flows both in terms of exports and investment, which is mostly associated with the activity of large economic groups with dominant market positions. For the export of the main goods and services – with the exception of tourism that ranks first – are sectors dominated by large groups, including machinery and equipment, vehicles and transport equipment, refined fuels and metals. Together in 2015, these accounted for almost 50% of total exports. This is well illustrated by the significant growth of the share of exports of refined fuels due to the company GALP and the fall of the share of other sectors such as clothing (whose weight halve from 11% in 2001 to 5.4% in 2012) and footwear, where the participation of small- and medium-sized enterprises (SMEs) has greater significance. The consolidation of oligopolies and the growth of monopoly rents devalues qualified human resources – feeding undesirable migration flows – and creates adverse conditions for SMEs and the growth of entrepreneurship, which is essential to strengthen innovation in the economy.

This trend reflects the fact that the level of internationalisation of SMEs is still very low and even registered a decline by the end of 2010, with exporting companies being a minority (9.7%) in 2009.³⁶ At a European level, a study based on a 2006-2008 survey

³⁶ According to the study of the National Statistical Institute, *Estudos sobre Estatísticas Estruturais das Empresas 2007-2009*, June 2011, only 9.7% of SMEs were exporting, although they were the most dynamic companies, accounting for 40% of total SME turnover.



discloses contradictory data pointing to the percentage of Portuguese SMEs that export or exported in the previous 3 years. It shows that this is three times higher with 31%, above the EU average of 25%.³⁷ However, considering that the data refer to the previous years and includes companies that have exported and stopped to do so, the study of the National Statistical Institute reflects a more accurate picture of the situation in 2009, making it possible to consider that the discrepancy is partially explained by time lag and the fact that, in recent years, there has been a trend of decline in the internationalisation of Portuguese SMEs.

Notably, the low level of SME internationalization is precisely a consequence of a lack of economic diplomacy, which should primarily mobilise and involve this sector, as well as an active clustering strategy. On the other hand, this trend of oligopoly creates obstacles for the structuring of active and participatory networks as there is a significant divergence in interests and objectives between SMEs and large multinational conglomerates, which remain highly influential in shaping public policy. This poses significant challenges to promote cooperation and additional actions.

3. External action model in Portugal

Portugal's external action model has been marked by four key features: dualism, centralisation, state-centred and reduced innovation.

First, dualism involves the simultaneous intervention of two government sectors and open competition as well as a lack of coordination between the Ministry of Foreign Affairs (MFA) and the Ministry of Economy. The model corresponds essentially to the model of "competition" identified by Rana,³⁸ which also exists in countries such as France and India, coupled with a high level of non-coordination, unaccountability and reduced effectiveness. From the analysis of concrete experiences, Rana identified five distinct types of organisational models:

- (i) unified – unification of foreign affairs and foreign trade, such as that in force in Sweden after the reform of 2001, as well as in Canada and Australia, where the union is done under the leadership of the MFA;
- (ii) partially unified – involving the creation of a joint institution operating between the MFA and the Ministry of Commerce, as in the case of the UK Trade and Investment (UKTI)³⁹ in the UK, created jointly by the Foreign and Commonwealth Office and the Ministry of Trade and Industry.
- (iii) third agency – the MFA has little involvement in economic diplomacy except in the definition of broad guidelines as in the case of Singapore, without intervention at an operational level, which is attributed to two special institutions, the Singapore Trade Board and the Singapore Economic Development Board, that are under the supervision of the Ministry of Commerce and Industry;

³⁷ European Commission, *Internationalization of European SMEs*, 2010, a study on the level of internationalisation of SMEs in the 27 Member States that concluded that, on average, 25% of SMEs in the EU-27 export or exported in the last three years (available at http://ec.europa.eu/enterprise/policies/sme/market-access/internationalisation/index_en.htm#h2-3 Consulted on 10.10.2013). They include several forms of internationalisation.

³⁸ Rana, Kishan, 2002, *Bilateral Diplomacy*, DiploHandbooks, DiploFoundation, pp.70-71.

³⁹ On the evaluation of some of the programmes see the British Parliament report (available at <http://www.publications.parliament.uk/pa/cm200910/cmselect/cmbis/266/26607.htm>).



- (iv) competition – a model notable for its competition between the MFA and the Ministry of Economy/Trade, with both having intervention in economic diplomacy which is marked by high levels of non-coordination, unaccountability and reduced effectiveness (such as France, Portugal and India);
- (v) renunciation – the MFA has no active role in economic diplomacy, serving only as support for the Ministry of Commerce that displays a status and political weight greater than the MFA, as in the cases of China and Germany.

Portugal is currently in a phase of uncertainty after a transition from the competition model to the unified model, following the 2011 reform initiative (considered below), where economic diplomacy has to be led by the MFA. However, in 2013 there was a setback in the process with the emptying of the MFA's role and a partial return to the competition model.

Secondly, it is a centralised model with reduced autonomy of operational centres on the ground, particularly embassies, and has an almost non-existent decentralised business association structure with little input to the formulation of policies, in particular bilaterally.

Third, it is a heavily state-centric system dominated by the State, with a very low participation of non-State actors – companies, NGOs, think tanks and universities – both in policy formulation and in its implementation. There is also a lack of cultivation of multi-actor partnerships in the promotion of the country's interests externally.

Finally, it is a low innovation system with great aversion to risk and resistance to innovation which lacks a culture of effective evaluation. It is also clearly oversized when looking at the country's resources and capacity, with a network consisting of 79 embassies (71 bilateral and 8 multilateral) and 51 consulates; besides this, it incurs in heavy costs, which is largely the result of high costs with premises and human resources.

Over the last decade, changes using the concept of economic diplomacy aimed at overcoming some of these limitations and improving the effectiveness of the system were proposed and approved, though often not implemented. However, the essence of the traditional system has not changed, nor has a paradigm shift occurred, which is essential in dealing with the new challenges of globalisation and the knowledge society.

The first attempt to reform the system and launch the foundations for economic diplomacy failed in the XV Constitutional Government (2002-2004), whose programme included the objective "to promote active economic diplomacy".⁴⁰ The approach taken, despite referring to the concept of economic diplomacy, was closer to the traditional model of commercial diplomacy where the State is the only actor in external action (without any involvement of non-state actors), with economic issues being addressed in a piecemeal instead of in a holistic interdisciplinary fashion. The approach was essentially minimalist since the central issue related to an attempt to enhance coordination between the Ministries of Foreign Affairs and the Ministry of Economy, "coordinating the action of the Ministry of Economy agencies with the activity of embassies" in a system that remained essentially dualistic and dominated by competition between departments. It should be noted that, despite the concern for coordination and coherence in the same

⁴⁰ XV Constitutional Government Programme, p.21.



period, contradictory measures were adopted that went in an opposite direction, namely the establishment in 2002 of the Portuguese Investment Agency (PIA), which contributed to a further fragmentation of the system, thereby increasing coordination problems.

The implementation of the new guidelines would only begin in 2004 following the joint dispatch of the Minister of Foreign Affairs and Portuguese Communities and the Minister of Economy,⁴¹ which focused on formal coordination at the top ministerial level and the adoption of a dual protection system in which the ambassadors could indiscriminately receive instructions from either of the two ministers on economic issues (Point 1 of the dispatch), thus generating ambiguity and uncertainty. On the other hand, they should design and implement a business plan for commercial action for each individual country, which would include quantified targets on exports and tourism revenues arising from each market (Paragraphs 7 and 9). At the same time, there should be a link between the ambassadors and the president of ICEP (Point 14), a rather vague mechanism. This initiative, inspired by the French model, corresponds to the logic of the first phase of "promotion" in economic diplomacy according to Rana's classification. It was a formal approach that was not implemented and did not produce concrete results. In terms of exports, for example, statistical data for 2004 and 2005 do not reveal any trend of growth or diversification of export markets, maintaining the same high levels of concentration in a limited number of markets.

The strategy in the 2005-2010 period was dominated by the rationalisation of the State external action system in the economic area, marginally reducing fragmentation with the merger of the Foreign Trade Institute of Portugal (ICEP) with the Portuguese Investment Agency (PAI). This gave rise to the creation in 2007 of the Agency for Investment and Foreign Trade of Portugal (AICEP) that adopted a more flexible business nature and client-driven approach. However, the AICEP remained exclusively under the control of the Ministry of Economy, so this reform did not change the essence of the two-tier system or put an end to the competition model between the Ministry of Foreign Affairs and the Ministry of Economy.

In 2011, the second attempt to implement an economic diplomacy strategy was carried out in the context of the XIX Constitutional Government, whose programme included strengthening economic diplomacy as a new national strategic priority.⁴² In order to design an operational plan to implement the new focus on economic diplomacy and assess several alternative solutions, a working group coordinated by a former Finance Minister Braga de Macedo was created, to reflect on a new model of organisation and coordination of State services and agencies involved in external action, which finally delivered a report containing reform proposals.⁴³ The identification of the need for reform aimed at strengthening the effectiveness of the system, rationalise the articulation of competencies between the Ministry of Foreign Affairs and the Ministry of Economy as well as the unification of external networks were all positive aspects of a pragmatic rationalisation effort to be implemented in a difficult environment.

⁴¹ Joint Order No. 39/2004 of 6th January, the Minister for Foreign Affairs and Portuguese Communities, Teresa Gouveia, and the Minister of Economy, Carlos Tavares da Silva.

⁴² The XIX Constitutional Government Programme p. 104, in detail, in terms of operational objectives pp.105-106.

⁴³ Working group set up by Prime Minister's Order No. 9224/2011, whose report dated 19th September 2011 was publicly presented on 26th September.



However, this document had several limitations that worked as impediments to the implementation of a genuine economic diplomacy. In fact it focused almost exclusively on issues of institutional design of public actors and formal channels, overlooking the role of non-State actors, networks and informal channels in external action. A marginal reference to the participation of major business organisations in the Advisory Council is not sufficient, especially if they do not represent the interests of SMEs. The active participation of the business sector in decision-making, in a logic of true partnership, and the assumption of operational responsibility for external promotion in a pragmatic division of labour with the State seem a necessary condition to improve the system more systematically.

On the other hand, the document does not provide a real and operational strategy for external action as it set so many goals and priorities which can not be pursued all at the same time. There was a clear lack of choices and of clear definition of the relationship between all pillars or the level of economic diplomacy to be developed. Indeed, mere action at a "salesmanship" level is not enough, when the document refers to the promotion of exports and attracting FDI, as it is equally important to articulate this level with the development of more complex "regulatory management", involving, for example, the negotiation of bilateral investment treaties, which Portugal has neglected.

Third, there is a clear deficit of reference to best practices and experiences of other countries that started the reform process several years ago (e.g., there is only marginal reference to the experience of Sweden and Denmark in support of option C), while a benchmarking logic can positively contribute to the debate on potential solutions.

Finally, the document contained a mere definition of an institutional model without addressing key operational aspects and practical issues of external action that determine its effectiveness, particularly the level of decentralisation and autonomy of local structures, the profile and training of human resources, and the exploration of informal channels; nor does it ponder the implications of adopting a "multitrack diplomacy". The philosophy of action, informal practices, actors involved, the level of social capital, innovation capacity, and the quality and training of human resources are as important as the organisational model.

Following this process, the Government introduced two key changes. The first change was the adoption of a unified model for the institutional organisation of the State, inspired by the reform of Sweden 2001. This puts the Ministry of Foreign Affairs as a leader in the process, ensuring the consideration of political dimensions and the coordination of the main external action instrument – that is the network of embassies and consulates. Potentially this could help to eliminate the disfunctionality and waste of resources resulting from competition among different public actors and create conditions for a more holistic approach able to integrate economic and political dimensions.

However, what appeared to be a clear strategic option for the future with regard to the organisational model of the State was surprisingly called into question and reversed in July 2013. A new decision was adopted reversing the 2011 option insofar it promoted the return of the AICEP to the exclusive sphere of responsibility of the Ministry of Economy and assigned to the deputy prime minister the coordination of economic diplomacy, thus undermining the role of the Ministry of Foreign Affairs. This erratic evolution and return to an even more complex and competitive two-tier model – without any previous evaluation of the unified model – does not create favourable conditions for the



consolidation of an effective economic diplomacy, and represents a retrogression in relation to what was probably the first ever structural measure to break with the traditional model.

The second change involved the alleged rationalisation of the external representation network – embassies, consulates and permanent representations – in order to resize and adapt it to the new objectives, i.e. the promotion of Portuguese exports, market diversification, FDI attraction and tourist flows. This initiative resulted in the closure of seven embassies – one in Africa (Kenya) and six in Europe (Andorra, Slovenia, Estonia, Latvia, Lithuania, Malta) – five vice consulates (two in Germany and three in France). There was also the elimination of autonomous representation in two multilateral posts: UNESCO, where representation has to be assured by the ambassador of Portugal in Paris; and the OSCE (Organization for Security and Co-operation in Europe), where representation has to be ensured by the ambassador in Vienna. Still, a new embassy in Qatar was also created. As a result, the number of bilateral embassies went down from 77 in 2011 to 71 in 2012.

However, this rationalisation turned out to be a marginal exercise without substantive changes, appearing to have been more determined by short-term considerations related to the reduction of public expenditure than by the objective of implementing a new long-term external action strategy that reflects a paradigm shift. Several arguments support this view. First, the absence of greater investment in Asia, a decisive region for the global economy, which would have justified the creation of some new embassies to compensate for a clear high deficit with only eight embassies (Japan, China, India, South Korea, Indonesia, Thailand, Singapore, East Timor), as well as the closure of more embassies elsewhere.

Second, changing the list of diplomatic missions is only a formal aspect which does not by itself lead to greater efficiency as it has to be complemented with a change in operational aspects on the ground. There was no definition of a new operating model for embassies that could address key problems such as the low level of local autonomy; inadequate staff profiling, which should include more local and less expatriate staff; or poor local operational articulation with entrepreneurs and other diaspora sectors.

It should also be noted that the attempted 2011 reform has other substantial deficiencies, detected also in previous initiatives, since it assumes that economic diplomacy is essentially a State activity. In fact, even though marginal collaboration from companies and other non-State actors is admitted, it is far from adopting a multi-actor approach. Portuguese companies are seen more as clients of the State and AICEP rather than as partners. As a result, attention has focused only on the reform of State apparatus and in relations between government departments, excluding prospects for active partnerships between State and non-State actors in the planning and implementation of external action.

This means that Portugal is lagging behind and has a clear deficit in the implementation of the second phase of economic diplomacy, the "networking" phase, which is geared towards creating consistent support networks in the country and abroad. This puts the attempts to project the country image at risk as it may see its sustainability compromised insofar it is not supported by friendly coalitions and is not anchored in a robust network.

Despite the vital importance for Portugal of the development of an economic diplomacy in order to meet the challenges and threats of globalisation, take advantage of



opportunities and project interests in an increasingly complex global economy, the truth is that the last decade was a lost decade in terms of structuring and effective implementation of economic diplomacy with negative consequences for the Portuguese economy and society.

4. Challenges to strengthening the effectiveness of external action and strategic lines of economic diplomacy

The reform of external action and diplomacy in Portugal is in essence a matter of governance and should be thought out and planned whilst taking into account not only the conditioning factors referenced above, but also the strategic axis for the future in the context of a deepening glocalisation.

The analysis involves three distinct but complementary areas: the organisational dimension, the operating dimension and the innovation dimension.

4.1. Organisational dimension

The organisational dimension has a structural nature and involves a number of key changes to meet the new challenges at three different levels.

First, the definitive choice for the unification model in external action within the State, similar to the Nordic model, especially Sweden⁴⁴ and Denmark. This unifies foreign affairs and international trade/investment under the leadership of the MFA and has to be definitively consolidated. This ensures not only a more holistic approach that maximises interconnections between economics, politics, security and culture, but allows the same group of people to consistently manage and explore synergies that promote exports, foreign direct investment, attraction FDI and development aid. This option avoids the dysfunctional effects of institutional competition and high costs of non-coordination, while reducing the risk of a marginalised MFA and the rise of sectoral ministries externally that generates an underutilisation of the diplomatic representation network, which is one basic instruments that absorbs considerable resources.

Second, the challenge of adopting a true multi-actor approach involving greater openness to the participation of non-State actors – companies, NGOs, universities, think tanks, chambers of commerce – in strategy as well as the consolidation of an active partnerships for external action, combining know-how, financial and human resources. Assigning direct responsibility to these actors for the implementation of concrete actions (organisation of shows, market research, trade missions) according to their comparative advantages is fundamental and contributes to the dilution of excess State action – which may even generate resistance abroad – and to reaching out to non-State actors and civil society in target countries. The involvement of these non-State actors allows more space for more informal track II and track III diplomacy to be explored.

In this context, and in order to facilitate the team/partnership logic, it is essential to promote the circulation of human resources between companies/NGOs and the MFA/embassies, with short to medium term stays of diplomats in private firms international departments. The promotion of staff turnover is therefore essential.

⁴⁴ *Swedish Policy for Global Development* (2003).



Third, there is the challenge of the re-qualification of human resources, involving the recruitment of a greater share of diplomats with economic training and management on the one hand, and higher levels of appropriate professional experience in the economic diplomacy area on the other. In this sense, it is essential to increase the flexibility of a too rigid and traditional system and admit the possibility of direct entry of more qualified staff at higher levels of the diplomatic career without having to go through the early stages, which would quickly increase capacity for intervention and stimulate innovation.

In addition to recruitment, enhanced on-the-job training is essential at the beginning and throughout careers. The initial training of diplomats in internationalised Portuguese companies, multinational companies or sectoral ministries would go a long way to strengthen training and partnerships. Also, the creation of itinerant trainers to train staff when placed abroad in diplomatic representations should also be considered.

On the other hand, the system of "in-out" turnover through which the senior managers of public administration are involved during a certain period in external representation – dealing with dossiers in its technical areas of expertise – and later returning to the country to perform functions in the State, allows for better integration of internal and external levels. This has significant advantages at two levels: strengthening the quality of external action through technical areas where experience in national dossiers management allows them to provide crucial input to increase the credibility of international participation and, consequently, influence; and international experience of negotiation gives them a broader perspective and a sense of interconnection between the various levels of governance when managing national dossiers in Portugal.

Similarly, institutions must integrate internal and international dimensions, ending the artificial divide that still prevails in Portugal. One of the practical business implications about promoting exports and investment is that it does not make sense for the IAPMEI – which is oriented towards domestic level – and the AICEP – oriented externally – to coexist. A single structure that combines onshore and offshore initiatives starting from a support system to consolidate the competitiveness of enterprises is more effective. In the case of SMEs, much depends on clustering promotion efforts that the State has not stimulated, and face internationalisation as one step in a process. This is the positive experience of the UK with the creation of the UK Trade and Investment in 2003, which promoted the integration of onshore and offshore initiatives to support internationalisation.⁴⁵

Thus, external action should be built from internal networks of relations established with companies and sectoral business associations. External action is therefore a natural extension of domestic action depending on its consolidation. The decentralised domestic network set up for the close monitoring of business plans should discuss with the firms the internationalisation plan. This would avoid duplication and inconsistencies in public policies for entrepreneurship and strengthen the competitiveness of SMEs.

⁴⁵ Another of the innovations was the bet on the strategy of sectors with the identification of priority sectors from which to decide on the markets as an alternative to traditional strategy of focusing on markets. Vd. <https://www.gov.uk/government/organisations/uk-trade-investment>, consulted on 12.05.2015.



4.2. Operational dimension

From an operational perspective complex challenges arise when promoting effective economic diplomacy.

The reduction and rationalisation of the network of embassies and consulates, an option that started to be implemented in 2012 but only marginally, must be further deepened. The idea of creating the figure of itinerant ambassadors would introduce flexibility and partially replace permanent structures. It is not enough to reduce the network, one must change it qualitatively and ensure it does things differently. Indeed, as important as the structure of the network is how it works and take action to remove the bottlenecks which reduce its effectiveness.

In this domain two operational issues are of particular relevance. First, the challenge of enhancing decentralisation in external representation systems, strengthening the power of the local decisions of embassies and missions, after the previous definition of parameters, objectives and approval of an annual plan. This allows greater flexibility and timing for a more appropriate response, but also increases the quality of decisions given the fundamental input that embassies and other foreign representation structures should provide for the formulation of bilateral policy. One of the structural problems of Portugal's external system is its high degree of centralisation as Lisbon is required to decide both on substantive issues and on matters of detail, which becomes dysfunctional and creates an enormous burden that is overwhelming for the central structure of the MFA.

Strengthening decentralisation was one of the choices made by the United Kingdom and Sweden in the reform of the external action system. In the case of Sweden, and in relation to development aid, some foreign representative offices now have a system of "full delegation" with skills to prepare the "annual plan of the country", approved by the centre in order to monitor and evaluate results, ensure financial management and human resources, and provide inputs to the definition of the bilateral cooperation strategy.

Second, the strengthening of local recruitment of qualified staff is important, whether foreign or members of the Portuguese diaspora, departing from the current representation structures with excessive emphasis on expatriates. This has three clear advantages: (i) the reduction of costs, particularly those associated with moving expatriates; (ii) stability in the performance of functions by reducing the problem of expatriate turnover; (iii) greater knowledge of reality and local language and the ability to activate links with local knowledge networks, contributing to greater depth in action. In many cases, embassies and consulates need only to have one or two nationals, career diplomats or technical staff, while the remaining staff can be recruited locally. In this context, and considering that it can also contribute to boost relations with the Portuguese diaspora in various countries, the recruitment of qualified members of the diaspora gains a special relevance.

4.3. The innovation dimension

The third dimension is innovation, particularly in the use and promotion of essential informal channels which are crucial in the context of the functioning of the global economy and the knowledge society. In Portugal, three dimensions appear to be priority: the Portuguese diaspora, paradiplomacy and economic intelligence.



The mobilisation of the Portuguese diaspora, more than 5 million people,⁴⁶ in particular two sub-sectors, the business community and the scientific community, is a strategic factor of economic diplomacy and foreign policy in general. One of the paradigm in this matter has been the mobilisation of the Chinese diaspora, one decisive informal factor, perhaps less visible, for the successful integration of China into the global economy.⁴⁷ This has been one of the most significant shortcomings of Portuguese foreign policy strategy, wasting the potential contribution of the diaspora in promoting the image and interests of the country. Four notable aspects include: (i) entry points of Portuguese exports, especially given that many entrepreneurs of a Portuguese origin are linked to the distribution sector; (ii) direct investment sources in Portugal; (iii) provision of economic intelligence to Portugal; (iv) links to the most dynamic knowledge networks in the country and links with networks in Portugal.

Examples of practical measures to stimulate this involvement include: (i) decentralised involvement of Portuguese businessmen in the Diaspora Advisory Board of embassies in each country; (ii) greater involvement with the scientific community through demands for consultative work and foresight analysis of Portugal's relations with the country in question as well as exploration of opportunities; (iii) the recruitment of qualified local staff of the diaspora to diplomatic representation structures; (iv) better coordination with Portuguese diaspora associations with a view to strengthening the participation of diaspora members in the political life of the destination country. The recent creation of the Council of the Portuguese Diaspora globally, consisting of "300 notables", assumes a centralised logic that does not seem to be the most appropriate response nor a substitute for local coordination mechanisms. These take into account the need to create local support networks that are essential for the implementation of the second phase of economic diplomacy.

The development of paradiplomacy is another essential informal dimension, particularly in the areas of "low politics". It involves more decentralised action in target countries and has a proactive strategy and effective response to the paradiplomacy of regional and foreign local governments, many of whom are associated with the most dynamic regions of knowledge in the world. In this perspective, the highest priority should be given to the promotion of direct relations with Spanish autonomies, some Chinese provinces that have a very active paradiplomacy, some Brazilian states, US states, Indian states and a selection of one or two key partners in emerging economies.⁴⁸

This strategic shift will reverse the primacy of central government to central government relations that Portugal has followed in a mirror effect as a result of a system marked by excessive centralisation. The absorption syndrome in relations with the central government has produced scant results since the most dynamic economies have a high level of political and economic decentralisation and their central governments have less

⁴⁶ The Portuguese diaspora has grown in recent years and currently reaches a higher estimated global dimension of 5.5 million people (Portuguese and Portuguese origin) spread across different countries. The main communities are located in the USA (1,380,837), France (1,190,798), Brazil (612,203), Canada (429,850), Switzerland (288,465), Venezuela (268,500), South Africa (200,000), United Kingdom (171,497), Germany (171,166), Spain (148,789), Angola (113,194) Luxembourg (99,730) and Australia (50,157) - official data from the 2012 Emigration observatory. (<http://www.observatorioemigracao.secomunidades.pt/np4/11> Consulted on 09.15.2013).

⁴⁷ Miguel Santos Neves and Annette Bongardt, 2006 *The role of Overseas Chinese in Europe in Making Global China: the case of Portugal* INA Papers, No. 29.

⁴⁸ About paradiplomacy and knowledge regions see Miguel Santos Neves, 2010 *Paradiplomacy, Knowledge Regions and Consolidation of Soft Power*, in Janus.net, E-Journal of International Relations, no.1.



and less decision-making power in economic matters, as well as in culture, education or research. This involves betting on the conclusion of international agreements with sub-national governments and the development of close institutional relations.

The lack of organised knowledge regions with proactive leaderships in Portugal, partly the result of non-regionalisation, implies some limitations in Portugal's ability to compete in the global market and take full advantage of participating in paradiplomacy. However, even in the current centralised model framework, there are opportunities since these sub-national governments have significant interest in direct relationships with foreign central governments.

There are obvious synergies between these informal channels, since the Portuguese diaspora in some countries is strongly integrated into local communities – in some instances, diaspora members participate in regional or local governments – and can therefore play an active role in accessing and strengthening decentralised institutional ties. In many other cases, links with regions of origin in Portugal are maintained, allowing links in the reverse direction to materialise.

The third dimension involves investing in the creation and management of an effective economic intelligence system,⁴⁹ involving the collection, processing and prospective analysis and use of information and knowledge to improve the efficiency of economic actors.⁵⁰ This is a key element to support the decision and definition of an economic diplomacy strategy as demonstrated by the experience of the US, UK, France, Germany and China. A critical aspect is quality tacit knowledge, which implies face-to-face relations and trust that allow to better analyse of the behaviour of actors in foreign markets, as well as to identify and exploit opportunities and predict threats in advance. Accordingly, this dimension depends on the efficient operation of networks and capacity to articulate relations with sub-national governments and foreign investors with the diaspora, as well as alternative sources of information that allow an escape from the "cyberspace trap".

Finally, the development of soft law and hard law mechanisms of regulation, which are fundamental legal instruments guaranteeing the rights of national actors that can contribute to a reduction of risk and uncertainty. A paradigmatic case for hard law instruments are bilateral investments treaties for the promotion and protection of investment, which should frame Portuguese direct investment processes abroad, protecting investors against political risks, including expropriation. However, Portugal neglected this dimension for a long time and only recently has there been progress. Currently, there are 39 treaties out of which 11 are not yet in force; most have been signed after 2005 but the majority only became operational in 2009/2010. The conclusion of international agreements with sub-national governments in areas as diverse as trade, tourism, science and technology, and education is an essential dimension of paradiplomacy and soft law involving non-State actors. In short, it is about the development of the third most complex phase of economic diplomacy that Rana refers to as the "regulatory phase".

⁴⁹ See IEEE, 2013, *La inteligencia económica en un mundo globalizado*, Cuadernos de Estrategia 162, Spanish Institute for Strategic Studies, Ministry of the Defense.

⁵⁰ Baulant, C. 2004 *Les outils de l'intelligence économique face aux défis de la mondialisation*, colloque du 28 septembre 2004 at Angers, p.54, available at: www.master-iesc-angers.com.



5. Conclusions

Economic diplomacy developed in the 1990s during the post-Cold War as a response strategy to the interrelated challenges of globalisation and knowledge society/economy, as well as the emergence of geoeconomics. The process of multidimensional and asymmetrical globalisation has led to increasing challenges for sovereign States and their societies, which are faced with a process of economic power concentration and the formation of conglomerates that consolidate dominant positions in various sectors of the global economy and interfere increasingly in politics. This oligopoly of the global economy limits international competition, generates inefficiencies and increasing inequality and poverty, which threaten peace and social cohesion.

Failed States, primarily through the erosion of their tax base as a result of a concerted process of large-scale tax evasion, are powerless to exercise effective regulation, control the abuse of power and safeguard the interests of the majority by protecting it from the syndrome of "too big to fail". In a distorted global economy, subject to increasing restrictions to competition rules, it does not suffice to a country and its companies to be competitive and efficient in order to succeed. There are fundamental non-economic factors requiring the articulation and implementation of an economic diplomacy that is not limited to economics or diplomacy.

Contrary to the traditional view, the concept of economic diplomacy requires a new paradigm of external action not mere adjustments in a traditional diplomacy dominated by politics if challenges of geo-economics are to be met. This change involves three essential aspects: a multidisciplinary holistic approach linking the economy, politics, culture and security that considers interconnections and cross-effects; a multi-actor approach that rejects the idea that it is a single process or one dominated by the State, and, by contrast, assumes a cooperative partnership between State and non-State actors with increasing influence and domination of informal channels and networks; and a multilevel approach able to articulate different geographical levels of action and jurisdiction that actively incorporates the sub-national level.

The analysis allows support for the three key conclusions regarding the construction of economic diplomacy in Portugal. First, the central argument is that there is not yet a consolidated economic diplomacy in Portugal, despite the frequent and inaccurate use of the concept, insofar the traditional model of commercial diplomacy still prevails. Although in the last decade attempts to reform the external action system have been carried out geared towards the creation of economic diplomacy, the truth is that some have not come to be implemented. The most recent, in 2011, did not reach the threshold of paradigm change and it is still far from adopting a multi-actor approach, keeping instead a State-centric view, streamlining internal and external networks and failing to operate on a multitrack approach.

Nevertheless, as far as the institutional organisation of public actors is concerned, a correct option was adopted in 2011 in order to promote a transition from a French-inspired competition model to a unified model under MFA leadership. This was recently reversed, confirming a trend of erratic developments, hesitations and a lack of continuity of public policies in this area over the last decade. In short, the current moment is marked by a transition from commercial diplomacy to economic diplomacy, but what can be called the first phase of development of economic diplomacy the "promotion" phase.



Second, the analysis of some dimensions of Portugal's external economic relations in the last decade shows that less positive developments in foreign trade and foreign investment have structural causes and result from non-adaptation to new operating conditions of the global economy, and are not merely based on economic factors such as the recessionary impact of the sovereign debt crisis in the country. Although not the single or even the determining factor, the absence of an active economic diplomacy was certainly one important factor to the extent that it prevented the control of risks, the minimisation of negative impacts and the capacity to take advantage of opportunities.

The high degree of concentration of export markets and a small number of partners as well as the financialisation and oligopolisation of economic flows make economic diplomacy the more urgent, but paradoxically also raise obstacles to its effective implementation. The obstacles are more political than financial. They result from a lack of political will, a lack of clear objectives, bureaucratic resistance to change, as well as the continued exclusion of SMEs, rather than a lack of government funds, where the activation of networks and the participation of non-State actors also allows the pooling of resources.

Third, the progress of transition to an effective economic diplomacy and carrying out the various stages of its development requires active partnerships between government, business, NGOs, think tanks, universities, chambers of commerce and basic choices at three levels: organisational, operational and innovation. As to innovation it involves mostly informal aspects related to the Portuguese diaspora's strategic involvement, the management of paradiplomacy and the consolidation of an economic intelligence system, key dimensions that are interrelated and mutually reinforcing.

The challenge of economic diplomacy is one of the most significant and urgent for the country's future and requires significant mobilisation of the Portuguese society as well as reform of the State, which continues to play a central though not exclusive role in this process, especially in the way it relates to society. Moreover, an increase in the level of social capital is needed to consolidate levels of confidence and ability to cooperate to achieve the common goals of different relevant actors.

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