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# Portugal and the Straitjacket of the European Financial Crisis

Paulo Gorjão

The austerity program negotiated with the Troika (IMF-ECB-EC) and adopted by Portugal in 2011 is having a devastating impact on the Portuguese economy. Although the Portuguese government is clearly fulfilling the measures agreed with the Troika, the final outcome of the adjustment program is not entirely in its hands, but rather awaiting further EU decisions involving measures to stimulate economic growth, mutualisation of public debt and additional steps towards a federal Europe. As time goes by, the negative repercussions – in particular social and political instability, as well as the erosion of the Portuguese democratic regime – are inevitable if there is no light at the end of the tunnel.

***Keywords:*** Portugal, Troika, European Union, financial crisis

Financial instability has hit world economies hard in the last few years. Southern Europe in particular, has moved into the eye of the storm with a number of countries requiring massive international assistance to face the onslaught of market pressures over their external ratings and debt borrowing costs. Of these, Portugal has been the third to receive such concerted support, after requests from Greece and Ireland.

Unsurprisingly, the terms associated with this assistance are nothing less than absolute game-changers for a government's range of action. The externally imposed adjustments in focus and shifts in domestic policy agendas are unavoidable.

Seeking to provide a better understanding of the challenges and adversities that Portugal is facing in this crisis, this article will start by highlighting the major economic problems that the country is bound to face in the short and medium term, as the austerity measures begin to 'bite' seriously and as the international

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outlook continues as bleak as ever. It will then turn to the impact that the current crisis has had on political and institutional dimensions at the national level, with a special emphasis on the latest electoral cycle that brought the current government to power. Finally, some conclusions will be drawn.

## An economic straitjacket

Ever since the international Troika, made up of representatives of the International Monetary Fund (IMF), the European Central Bank (ECB) and the European Commission (EC), landed in Lisbon back in 2011, there has really been no question as to who would dictate the pace and developments of the Portuguese economy in the next few years. For all intents and purposes, Portugal was placed in an inescapable straightjacket by a series of rigorous obligations with which it was forced to comply, to the letter. Indeed, in exchange for a €78 billion bailout, a wide range of sectorial reforms were imposed upon the country, as well as regular evaluations of its performance in terms of implementation of the internationally agreed conditions. Thus, Portugal was put under strict surveillance. The Portuguese government's only viable option was to submit to it and pass each scheduled review in order to garner the much needed external credibility and subsequent leverage for use abroad. So far, at least that much has been achieved, as the consecutive reviews appear to indicate.

Worrisome effects associated with excessive austerity, however, have begun to take their toll on Portuguese society and pose significant risks for any effective recovery. Unemployment, in particular, reached an all-time high of 15.9 percent in August 2012 and is widely expected to cross the 16 percent threshold in 2013. More importantly, unemployment between ages 15 and 24 has increased steeply, reaching 35.9 percent during 2012.

The fragilities of the country's economic fabric are thus in evidence and the latest official projections still do not allow for any measured level of optimism. More importantly, if one considers that increased joblessness leads to further spending for unemployment benefits and that lower tax revenues are to be expected during any recession, then it becomes considerably more complicated to meet the goal of a balanced budget that the Troika would like Portugal to achieve by 2014.

Credit for local companies has become a thorny issue. After a deal with the Portuguese government, most of the heavyweights in the country's banking sector – including the two biggest private banks, *Banco Comercial Português* (BCP) and *Banco Português de Investimento* (BPI), as well as the state-owned *Caixa Geral de Depósitos* (CGD) – received public financing of more than €6.65 billion to improve their liquidity and thus satisfy the new standards drawn up by the European Banking Authority. That, however, has still not helped meet the demands for greater financing on the ground. In fact, in February 2012, the amount of credit

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given by banks to companies reached a new historical low, triggering discussions about the possibility of an eventual 'credit crunch', if such a situation were to continue. Even though the latest data allow for some breathing room – in March 2012, there was a 39.5 percent increase in credit concessions to private companies compared to the previous month – it nonetheless remains a worrisome feature of Portugal's current economic context. Indeed, in August 2012, Portuguese banks granted only 3.2 billion in loans, according to the latest data provided by the Bank of Portugal, the lowest monthly figure since 2003.

Still, internal hindrances aside, any prospects for the country's economic future are invariably much more constrained and dependent on exogenous factors than is publically perceived. Given the continuing concerns over the eurozone's cohesiveness, any decision or lack thereof at the European level has an almost automatic impact on whether markets deem the Portuguese efforts credible in the long term. In other words, when European leaders end one of the many summits without any concrete results, risks over the viability of the Portuguese austerity program increase; when they do agree on new steps to tackle the crisis, the country is given new breathing space.

Moreover, there are still serious concerns about possible contagion from a deteriorating situation in other eurozone countries, like Greece, but also and especially Italy and Spain. In light of the latter's request for help with the financing of its banks and given Portugal's overwhelming exposure and economic dependence on its neighbour, it is to be expected that the Portuguese economy will be hit, yet again, with more disturbing woes. Portuguese exports – the main bulwark of the government's current plans for recovery – will likely be the first to suffer, as Spain remains Portugal's single most important external market.

With these challenges in mind, it is hardly surprising that rumours about the possibility of a second bailout or an extension of the deadlines of the first have already been floated. In any case, although it is not impossible, it will be difficult for Portugal to regain market access anytime soon, let alone in 2013 as initially foreseen by the Troika program and government predictions.

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## Changing tables at home

Of the consequences triggered by the bailout request of April 2011, the most important one is undoubtedly the change in Portugal's political cycle. Indeed, this turn of events basically represented the swan song for former Socialist Prime Minister José Sócrates, who resigned in March 2011, after he failed to secure the passing of new austerity measures in parliament. The subsequent parliamentary elections, held on 5 June 2011, gave Pedro Passos Coelho, leader of the opposition Social Democratic Party (PSD), the opportunity to step in and win 33.3 percent of the popular vote.

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On its own, however, that was not enough for a working majority in parliament. Consequently, Passos Coelho chose to set up a coalition with the smaller Democratic and Social Centre - People's Party (CDS-PP), led by Paulo Portas, to form a stable right-wing cabinet with enough parliamentary support to be able to pass the painful measures already anticipated at that time. Indeed, even before the elections, Passos Coelho had committed himself to the terms negotiated with the international lenders. It was therefore no surprise that his electoral program was so closely aligned and, in some cases, even went beyond what the Troika's remedy prescribed.

Portugal was faced with an interesting political situation with the institutional co-habitation of a government and a president, in this case Aníbal Cavaco Silva, from the same end of the political spectrum, that is from the PSD. That alone increased the odds of implementing the extremely ambitious reform program and provided additional assurances of internal stability for the government's intended course of action.

As for the main opposition party, the Socialist Party (PS), under the new leadership of António José Seguro, who succeeded Sócrates after he lost the June 2011 parliamentary elections, it has essentially relied on an economic growth agenda as opposed to austerity *per se* while trying not to break off entirely with the memorandum of agreement with the international Troika, to which it had also previously subscribed. There has, however, been increasing pressure within the party to step away from the agreement, as it is detrimental to the PS's future electoral calculations, and chances are that, with time, the PS will distance itself increasingly from the ongoing economic adjustment program.

Meanwhile, public opinion, in general, appears to have supported most of the policies and steps taken by the new government. Manifestations of outspoken discontent have mostly been restricted to specific sectors of society, the targets of some of the intended reforms. Nevertheless, as the cuts in wages and other public services begin to be felt, it is widely expected that general strikes will also increase. Even though a reasonable level of consensus between industrial confederations and trade unions has been touted as one of Portugal's positive features within the European context, there are several indications that if further austerity measures are required, social tension will most certainly escalate. What's more, the latest polls appear to confirm that the government's popularity is decreasing – even though that was also to be expected – and as unemployment numbers go up, that will most likely remain a persistent trend. Local elections in 2013 will provide a better overview of the level of popularity of the ruling coalition.

## What lies ahead

Ultimately, and despite the fact that Portugal is clearly fulfilling the measures agreed with international lenders, there is a growing sense that any stable economic

outlook is not entirely in Portuguese hands, but rather waiting for developments at the European level to unfold.

The financial crisis will not be overcome and the euro will not survive without additional EU political integration and, therefore, without the member states transferring additional national sovereignty to the European institutions. In other words, the European financial crisis will be overcome only if the member states reach a credible deal involving measures to stimulate economic growth, mutualisation of public debt and additional steps towards a federal Europe.

While there is a growing consensus that the European Union must move in that direction, it is still a long way off. While waiting for EU developments towards further integration, Portugal will continue to cope with the harsh effects of excessive austerity.

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