

THE FRESH OUTLOOK.

Portugal Agrees £70bn EU/IMF Bail-Out

Published on: 2011-05-05 10:08:37

Portugal is the latest Eurozone country to accept a joint European Union (EU) and International Monetary Fund (IMF) financial bail-out package.

Prime Minister Jose Socrates described the three-year deal as a “good agreement that defends Portugal”. It is thought that Portugal will receive a loan worth in the region of €78bn (£70bn).

Negotiations have been ongoing for more than three weeks, encompassing officials from the IMF, European Commission (EC) and European Central Bank (ECB).

Portugal had fallen behind its projected recovery targets, but Mr Socrates confirmed the country has been granted additional time to achieve new annual goals to cut its budget deficit by 5.9% of GDP come the end of 2011, followed by 4.5% in 2012 and 3% in 2013.

The move comes after Greece and Ireland reached similar agreements with the EU and IMF in May and November 2010 respectively.

Last resort

Upon his request for EU/IMF help last month, Mr Socrates admitted that asking for aid “would be the final way to go” after seeking to solve Portugal’s financial woes internally.

EC President, Jose Manuel Barroso, pledged his support to Portugal’s bid for aid and sought to reassure other EU members that he had “confidence in Portugal’s capacity to overcome present difficulties”.

Today, the prime minister used a televised address to inform the Portuguese people that an agreement had been reached “with the representatives of international institutions” on a “programme of financial aid”.

A meeting of Eurozone finance ministers in May will set out the finer details of Portugal’s loan package, including the rate of interest it will have to pay. The terms must be set in stone by June 15 when Lisbon is due to pay back more than €5bn (£4.5bn) debt.

Prime Minister Jose Socrates must still secure broader party support for the deal in Portugal as his departure from office, scheduled for June 5, after a general election, will see his successor finalise the agreement.

Portugal’s leading opposition party, the Social Democrats, says it will review the proposals and make a decision on whether to support the move in the next 24 hours.

Mr Socrates resigned in March after failing to push a programme of austerity measures through parliament but agreed to retain his position until the June election.

Critics of the bail-out say a number of caveats, including higher taxes, will hamper growth and see Portugal’s economy contract further.

“Structural differences”

Fabian Zuleeg, Chief Economist at the European Policy Centre, told The Fresh Outlook that

while the news was “inevitable”, Portugal’s decision reflects a largely political rather than economic mindset.

“The situation is becoming increasingly difficult now more countries are seeking bail-outs. Portugal has more in common with Greece than it does Ireland, where the problem was caused primarily by a poorly managed banking sector and property crash.

“Portugal has more systemic issues, such as weak growth and increasing divergence from countries in a stronger financial position,” explains Mr Zuleeg.

“Structural differences put Portugal in a different situation to other EU members, which are either largely export oriented or have quickly sought reforms to tackle what was a foreseeable crisis.

“It, however, is in a different stage of development. It doesn’t have the same level of manufacturing or service industry to rely on exports.”

Mr Zuleeg cites Germany as a country that has based part of its economy around “higher-level” manufacturing through its technological and automotive sectors.

“Portugal has never had this level of industry. It has relied, somewhat, on lower-level industry but this is coming under increasing threat from the East, with which it cannot compete.”

The economist suggests there are two strata to Portugal’s long-term financial security. First, by agreeing to reforms at an EU level, including accepting a bail-out, it should avoid what Mr Zuleeg describes as a “car crash scenario”.

Secondly, and crucially, he explains that Portugal must secure significant investment to prop up its domestic industry and fuel “future growth”.

“Contagious effect”

“It was almost inevitable, following the previous bail-outs, that Portugal would follow suit,” agrees Helen Disney, Chief Executive of pan-European think tank, The Stockholm Network.

“Unfortunately, the Greek bail-out in particular has had a contagious effect on other countries and the members of the Eurozone are now becoming insurers of one another’s debts,” says Ms Disney.

She explains that, unlike Ireland, Greece and Portugal’s crises are attributable to “domestic budgetary policy”.

“The Portuguese government fell because parliament rejected its austerity plan which might possibly have avoided a bail-out,” remarks Ms Disney. “This bail-out is therefore largely a failure of Portugal’s politicians who have overspent, rather than of the financial crisis or the banks.”

“Unsustainable”

Like Mr Zuleeg, Ms Disney believes Portugal needs both short-term support, as well as a comprehensive restructuring of its debt.

“In the long-run, it also needs fundamental political reforms and more private investment since current levels of public spending are unsustainable,” she explains.

Ms Disney believes it is important to remember the Eurozone will come under greater pressure as more and more countries seek bail-outs: “There is a significant element of moral hazard involved as each bailout increases the likelihood of other countries doing the same thing.

“Other EU member states, such as the UK, which are not even members of the Eurozone, are also affected. Europe faces a major sovereign debt crisis but countries leaving the euro will not necessarily help. However, each and every bailout prolongs our recovery from the depths of the financial crisis.

“We will continue to feel this pain for many years to come,” Ms Disney concludes.

“Justice for the people”

Oygunn Brynildsen from the European Network on Debt and Development told The Fresh Outlook that it will be the people of Portugal who eventually foot the bill of today’s bail-out.

“While the bail-out is undoubtedly a good deal for Portugal, there is still no justice for the people who must pay back the loan.

“Portugal had to take action, but their decision pursues the easiest political solution rather than the best economic solution.”

More broadly, Ms Brynildsen states that a programme of taking new loans is untenable in the long-run.

“EU countries are paying for unsustainable, unjust debts. It is critical that a fair and efficient solution is negotiated for the benefit both of the public and creditors.”

By James Chapple