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THE FINANCIAL CRISIS IN PORTUGAL: AUSTERITY IN PERSPECTIVE

Shaan Gurnani

Abstract: As a result of its recent financial crisis, Portugal was forced to request external financial support; and its subsequent international bailout was accompanied by an economic adjustment program, which mandated various austerity measures and structural reforms. This article reviews the origins of the financial crisis in Portugal, provides an overview of the program and its short-term impacts, and analyzes the program's benefits.

Introduction

The origins of the recent financial crisis in Portugal were a combination of strong macroeconomic imbalances, unsustainable public finances, and high public and private debt levels. In April 2011, as a result of the crisis and amid soaring borrowing costs, Portugal was forced to follow Greece and Ireland in requesting external financial support. The International Monetary Fund (IMF) and the European Union (EU) ultimately approved a €78 billion (\$116 billion) bailout package in May 2011.

Along with the bailout, Portugal agreed to an economic adjustment program, which required it to adopt austerity measures (i.e., fiscal consolidation through spending cuts and revenue increases) and implement various structural reforms (i.e., longer-term changes targeting aspects of the economy's operations, such as state-owned enterprises, financial sector regulation, and labor market rules and regulations). The program, however, was controversial and painful for large fractions of the population, raising the important question, "Why austerity?" Whereas countries such as the United States introduced easy monetary and fiscal policies to stimulate their economies following the crisis, the adjustment program may have been necessary in Portugal in order to regain credibility and regain access to international capital markets in the short term and, more importantly, to bring about much-needed structural reform, which will benefit the country in the long term.

This article begins with a brief discussion of the origins of the financial crisis in Portugal and the government's potential response options. It provides an overview of Portugal's economic adjustment program and considers the program's short-term impacts. After an analysis of the program's benefits — namely, that it allowed the country to maintain its international reputation

and undertake significant reforms — the article concludes by discussing the need for Portugal to continue its reform efforts in a post-crisis environment.

Origins of the Financial Crisis in Portugal

I begin with a discussion of the financial crisis in Portugal.¹ In the late 1990s, Portugal's commitment to join the Eurozone, a monetary union of EU member states that have adopted the euro, led to historically low interest rates, with real rates approaching zero percent. Easy credit resulted in a decrease in private savings and increases in both consumption and investment, which, coupled with expansionary discretionary fiscal policy, led to strong economic growth and low unemployment. Importantly, increased spending was mostly directed at current expenditure, and investment was concentrated in non-tradable (i.e., domestically supplied) uncompetitive sectors, such as telecommunications, electricity, and healthcare (Gaspar, p. 2). The result was a “political economic equilibrium which was certainly stable for a while,” but that allowed for prices in excess of market prices in non-tradable sectors and was not conducive to innovation, productivity, and sustainable employment creation (Gaspar, p. 2).

As nominal wage growth outpaced labor productivity growth and competitiveness shrank, Portugal's current account deficits became increasingly larger. At the same time, the economy was also under pressure through increased competition from Central and Eastern European countries and emerging markets, especially in its two main export industries, footwear and textiles. In the early 2000s, Portugal continued to experience a current account deficit, this time, however, accompanied by a steady increase in the unemployment rate.

Economic growth stalled beginning in 2001 due to a combination of a sharp decline in private domestic demand (which had driven the recent economic boom), globalization and

¹ For a thorough analysis of the financial crisis in Portugal, see the articles by Blanchard, Gaspar, and Lourtie.

increased competition, and a weak business environment. Portugal then began to adjust, albeit slowly, to having joined the Eurozone. Portugal underwent two phases of budget moderation/consolidation, in 2002–2004 and 2006–2008, and introduced structural reforms related to increasing the sustainability of public spending, notably social security reform and public administration reform (Lourtie, pp. 65–66). Portugal also began to regain competitiveness, through both salary disinflation (i.e., a decrease in the rate of wage growth) and higher productivity growth, and it implemented important structural reforms in areas such as education, research and development, energy dependency, public administration, and the labor market (Lourtie, pp. 58–64). However, Portugal’s labor market remained relatively rigid — as exhibited by factors such as high employment protection, strong government influence on wages, and generous unemployment benefits — which threatened unemployment, competitiveness, and growth.

Overall, while average export growth between 2006 and 2010 outpaced the EU-15 average, the increase in exports was more than offset by higher energy prices and a deteriorating income account (Lourtie, pp. 69, 72). Thus, current account deficits remained high (Lourtie, p. 72). Additionally, unlike the other peripheral countries (i.e., Greece, Ireland, and Spain), Portugal entered the crisis after a decade of anemic growth, growing at an annual rate of just one percent between 1999 and 2010 (Lourtie, p. 56). In 2009, the depressed economy resulted in declining government revenues. At the same time, public spending increased, in part to comply with the EU’s Investment and Employment Initiative (Lourtie, pp. 67–68). As a result, Portugal’s government budget deficit soared from 2.7 percent of GDP in 2008 to 9.3 percent of GDP in 2009 (Lourtie, p. 67). As Vítor Gaspar, Portugal’s then Finance Minister, noted during a March 2012 presentation at the Peterson Institute for International Economics in Washington, D.C.,

“The trigger for the crisis in Portugal was the decision by the Portuguese government in 2008 to expand the budget quite aggressively in response to the global crisis” (Gaspar, pp. 2–3).

Despite indications that Portugal would politically be able to undergo fiscal consolidation over the following years, markets were not convinced (Lourtie, p. 86). Secondary market bond yields for Portugal’s sovereign debt did not improve. It soon became clear that progress at the national level could be overpowered by a deteriorating environment at the European level (Lourtie, p. 78). A vicious cycle of contagious negative shocks spread throughout Europe. The result was a growing consensus that a Portuguese bailout was inevitable. On top of Portugal’s economic vulnerabilities and its conservative approach, the interest rates on Portugal’s sovereign debt continued to increase. The final blow was in late March and early April of 2011, when Fitch lowered Portugal’s rating from A+ to BBB– and Standard and Poor’s from A– to BBB– (Lourtie, p. 86). Yields soared and borrowing became unsustainably expensive. Portugal was forced to request assistance from the international lenders of last resort just a few days later.

In short, prior to the global crisis, Portugal had sustainable debt levels but faced soaring government budget deficits and expectations for continued slow growth (Contessi, p. 209). Portugal’s economy was in a vulnerable state. Its path of slow adjustment to the new monetary regime ceased to be an option once the crisis hit and the risk of contagion increased the cost of Portugal’s sovereign debt (Lourtie, p. 74). Under pressure from the European Central Bank, Portugal requested financial assistance through an IMF-EU program on April 5, 2011. The organizations ultimately approved a €78 billion (\$116 billion) bailout package on May 16, 2011. Each disbursement of the bailout was dependent on the outcome of quarterly evaluations of Portugal’s progress in implementing the economic adjustment program imposed in conjunction with the bailout. As part of the program, Portugal was required to adopt austerity measures and

implement various structural reforms in order to reduce the government budget deficit and promote economic growth.

Portugal's Potential Response Options to the Financial Crisis

Portugal's unique situation was one in which it was forced to tackle anemic growth and high unemployment while also combatting low competitiveness and trade imbalances (Blanchard, p. 9). One potential response option is expansionary fiscal policy, which can help close a recessionary gap by increasing aggregate demand and reducing unemployment. Specifically, the government can increase government spending through both government purchases and transfer payments. Additionally, the government can cut taxes, thereby increasing disposable income and stimulating consumption. However, in the years leading up to the crisis, expansionary fiscal policy was difficult because of Portugal's high sovereign debt levels. That aside, as Olivier Blanchard notes, the increase in growth and reduction in unemployment would have limited the improvement in competitiveness and current account deficits, ruling out expansionary fiscal policy — at least on its own — as an option (Blanchard, p. 9).

On the other hand, perhaps a stronger adjustment (i.e., more contractionary fiscal policy) was warranted to keep Portugal's current account deficits in line. However, as Pedro Lourtie, Portugal's former Secretary of State for European Affairs, suggests, a stronger adjustment would have resulted in a recession and, as such, would have been politically challenging, especially in the context of growth in comparable economies (pp. 73–74). Additionally, as with expansionary fiscal policy, a stronger adjustment, at least by itself, would not have produced a strong improvement in Portuguese competitiveness. As Blanchard notes, contractionary fiscal policy can spur growth because it permits expansionary monetary policy (i.e., a reduction in nominal interest rates), over which Portugal, having joined the Eurozone, no longer had control (p. 9).

On that note, central banks use monetary policy to influence the money supply and meet objectives such as inflation, employment, and economic growth. Countries can spur economic growth by increasing the money supply and lowering interest rates. Alternatively, Portugal could have employed contractionary monetary policy to instigate a reduction in nominal wages. As part of a stronger downward adjustment of domestic demand, currency devaluation could have helped Portugal improve its competitiveness and reduce its trade imbalances. Again, however, neither expansionary nor contractionary monetary policy was a plausible option once Portugal had joined the Eurozone. The single monetary policy is adjusted based on the environment in the wider euro area, which poses an issue when the economies that make up the union are not in the same part of the business cycle. In fact, as Lourtie notes, the 2006–2010 period, in which current account deficits continued to expand despite Portugal’s strong export growth, demonstrates the difficulties inherent in correcting current account imbalances under a monetary union (p. 88).

Overview of Portugal’s Economic Adjustment Program

Lacking monetary policy options, then, the three focal points of Portugal’s economic adjustment program, crafted alongside the IMF and the EU and signed in May 2011, were fiscal consolidation, financial stability, and structural transformation (European Commission – Directorate-General for Economic and Financial Affairs, 2014, p. 3). At the same time as pursuing these objectives, the program aimed to mitigate the negative social impacts of the adjustment process (European Commission ... Affairs, 2014, p. 3). In terms of the first pillar, the program initially targeted improving Portugal’s government budget deficit from 9.1 percent in 2010 to 5.9 percent in 2011, 4.5 percent in 2012, and 3.0 percent in 2013 (European Commission...Affairs, 2011, pp. 13, 18; “Factbox: Terms of EU/IMF...”). The program’s measures represented a cumulative fiscal consolidation of roughly ten percent of GDP between

2011 and 2013 (European Commission...Affairs, 2011, p. 18). Although the actual 2011 government budget deficit of roughly 4.2 percent was better than the program's target, it was achieved primarily through a one-time transfer from bank pension funds to the state of about 3.5 percent of GDP, without which the target would have been missed (Gaspar, p. 4). That being said, however, Portugal's reduction in its 2011 cyclically adjusted budget deficit of four percentage points of GDP still stands out in context; it was approximately three times that of the average of the euro area (Gaspar, p. 4).

According to the terms of the program, the fiscal consolidation would rely primarily on spending cuts (approximately two-thirds of the adjustment) (European Commission...Affairs, 2011, p. 18). Specific measures on the expenditure side included improving public sector efficiency, reducing government headcount by at least one percent a year, cutting government wages, curtailing health care and education costs, and minimizing social transfers such as unemployment benefits (European Commission...Affairs, 2011, pp. 19–20, 47; “Factbox...”). On the other hand, revenue-raising measures primarily consisted of raising value-added tax rates, revising the list of goods taxed at lower rates, broadening the property tax and income tax bases, selling state-owned assets (i.e., privatization), and raising fees for health care services (European Commission...Affairs, 2011, pp. 19–20; “Factbox...”).

The program supported fiscal consolidation through various fiscal-structural reforms targeting inefficiencies associated with government spending and revenue collection. For example, the program aimed to bring the public financial management system up to par with international best practices (European Commission...Affairs, 2014, p. 33). Program goals also included streamlining public sector services by consolidating and simplifying administrative policies (European Commission...Affairs, 2011, p. 21). On the revenue side, measures included

improving the effectiveness of tax administration (European Commission...Affairs, 2011, p. 21).

The program broadly addressed the public sector with a privatization plan, intended not only to generate revenues but also to rebalance the economy toward the tradable sector by increasing competition in the non-tradable sector (European Commission...Affairs, 2011, p. 22). It also aimed to contain the risks and costs associated with state-owned enterprises, such as their lack of efficiency relative to the private sector, and public-private partnerships, which had allowed Portugal to finance various public infrastructure projects by sacrificing future government revenues, thus only postponing rather than avoiding the associated budget constraints (European Commission...Affairs, 2011, pp. 20–21).

In regard to Portugal's financial sector, absent either a property bubble (as in Ireland and Spain) or significant holdings of toxic assets, the sector entered the financial crisis and subsequent economic adjustment program relatively intact, albeit highly levered (European Commission...Affairs, 2011, p. 22). The program's financial sector strategy was aimed at reducing leverage and strengthening regulatory supervision (European Commission...Affairs, 2011, p. 22). Another goal was to ensure sufficient capitalization, both to combat the existing environment and to improve perceptions of the banking system's solvency (European Commission...Affairs, 2011, p. 22). As such, the Banco de Portugal, Portugal's central bank, mandated Core Tier 1 capital ratio² targets of nine percent by the end of 2011 and ten percent by the end of 2012 (European Commission...Affairs, 2011, p. 22).

Although notable progress was made in these areas — with the average Core Tier 1 capital ratio improving from 8.5 percent in May 2011 to 12.3 percent at the end of 2013 and the

² The Core Tier 1 capital ratio is used by regulators to measure the capital that financial institutions hold relative to the risks that they take on. It is the ratio of an institution's core capital (i.e., highest-quality capital) to its total risk-weighted assets (i.e., each asset is assigned a risk weight given the perceived level of risk associated with it).

aggregate loan-to-deposit ratio falling from 160 percent to 117 percent over the same time period — the resilience of the banking system was thrown into question soon after the program concluded in May 2014 (European Commission...Affairs, 2014, p. 49). Banco Espírito Santo SA, formerly one of the largest Portuguese banks, collapsed in August 2014, shortly after reporting its quarterly performance (Kowsmann). It had suffered significant losses in the first half of the year due to accounting irregularities at its parent, Espírito Santo International SA, which had filed for bankruptcy protection on July 18, 2014 (Kowsmann). The Banco de Portugal subsequently announced a rescue plan for Banco Espírito Santo. It would be split into a “good bank,” to be recapitalized with €4.9 billion (\$6.6 billion) from the government, and a “bad bank” (Kowsmann). Nevertheless, the bank’s trouble and bailout led to fears about the stability of the rest of the Portuguese banking system, the ability of regulators to monitor it, and the potential lack of additional funds available to the government for providing aid to banks (European Commission...Affairs, 2014, p. 49; Kowsmann).

The third focal point, a critical component of Portugal’s economic adjustment program, was ambitious structural reform. It aimed to boost the country’s long-term growth by reforming labor and product markets and by improving the business environment (European Commission...Affairs, 2011, p. 23). Goals of the labor market reform included creating jobs and increasing labor market flexibility through measures such as easing employee protection, reducing compensation for overtime work, and increasing incentives to work by limiting both the amount and duration of unemployment benefits (European Commission...Affairs, 2011, pp. 24–25). The primary objective of product market reforms was to drive down prices in non-tradable sectors closer to market levels, in part by reducing barriers to entry in order to increase competition (European Commission...Affairs, 2011, pp. 23, 27).

To improve the business environment, the program focused on reforming the inefficient judicial system, increasing competition, and easing the regulatory burden (European Commission...Affairs, 2011, pp. 27–28). Specifically, to resolve the backlog of cases in courts within two years, measures included improving the efficiency of courts and strengthening legislation to facilitate out-of-court settlements (European Commission...Affairs, 2011, pp. 28, 54–55). The program planned to increase competition through stronger enforcement of competition rules and to reduce the administrative and regulatory burden on businesses by targeting legal formalities such as licensing procedures (European Commission...Affairs, 2011, pp. 28, 87).

Short-Term Impacts of Portugal’s Economic Adjustment Program

In the short-term, Portugal experienced negative economic and social impacts as a result of its economic adjustment program. For example, as a result of these measures, Portugal experienced a deepened recession, as evidenced by record unemployment rates and lower nominal wages. At the same time, despite the significant fiscal consolidation, Portugal’s debt-to-GDP levels continued to rise during the program, the result of a deeper-than-expected economic contraction. Additionally, although one of the goals of the program was to mitigate its negative social impacts, the fact is that health care, education, and social security budgets were cut at the same time as unemployment rates hit record levels and as household incomes shrank. As Miguel Glatzer, a political scientist at La Salle University in Philadelphia, noted, “Social spending has been cut at the same time as a spike in social need. This has had dramatic consequences for vulnerable groups” (quoted in Wise, 2014).

In terms of health care, the increase in health care fees, by indexing the fees to inflation, resulted in fewer patients in 2012 (Dias, p. 3). Additionally, the spending cuts imposed by

austerity reduced funding for social programs associated with drug decriminalization, including treatment facilities and needle exchanges. Education also suffered a 23 percent reduction in spending between 2010 and 2012, accompanied by an increase in class sizes (Dias, p. 3).

The collapse in domestic demand — exacerbated by a dearth of credit and by austerity measures such as the increase in value-added tax rates — dealt a significant blow to small businesses in Portugal. Bankruptcies increased by 41 percent in 2012 (Dias, p. 1). Small businesses are especially important to the Portuguese economy: companies that employ fewer than ten employees account for 43 percent of private sector jobs compared to 29 percent for the EU average (European Commission – Directorate-General for Enterprise and Industry, p. 2). Job cuts in both the private and public sectors resulted in the unemployment rate soaring to 12.9 percent in 2011, 15.8 percent in 2012, and 16.4 percent in 2013, from about 12.0 percent in 2010 (European Commission – Eurostat). In fact, in both 2012 and 2013, Portugal’s unemployment rate was the third highest in the Eurozone after Greece and Spain (European Commission – Eurostat).

Youth unemployment and long-term unemployment were particularly impacted. Job seekers left the country, increasing net emigration, although at low levels on an absolute basis. At the same time, unemployment benefits were cut and the maximum period over which benefits could be claimed was nearly halved to 18 months (Wise, 2014). As of 2013, only an estimated 44 percent of the jobless were receiving any unemployment benefits (Wise, 2013). Additionally, the number of beneficiaries of Portugal’s main guaranteed minimum income benefit program, RSI (Rendimento Social de Inserção [Social Integration Income]), fell by nearly 44 percent between January 2010 and March 2014 (calculation by author with data from Organisation for Economic Co-operation and Development [OECD], “OECD Economic Surveys: Portugal”).

Ultimately, the package of austerity measures — including the increase in taxes, reduction in tax benefits and incentives, and increase in fees for health care services — caused GDP per capita and disposable incomes to shrink tremendously. In fact, as Ricardo Reis showed, GDP per capita fell more in Portugal between 2000 and 2012 than in the U.S. during the Great Depression or in Japan during its lost decade (p. 144). Anecdotally, according to João Vieira Lopes, head of the CCP (Confederação do Comércio e Serviços de Portugal [Portuguese Commerce and Services Confederation]), “Four or five years ago, shoplifters were taking perfume, bottles of whisky and expensive razor blades from supermarkets.... Now they’re stealing rice and tins of tuna” (quoted in Wise, 2013). And, amidst the recession and the austerity measures, Portugal experienced some of the largest protests since the 1974 Carnation Revolution, which marked the end of the dictatorship and restoration of democracy (Dias, p. 4).

How Austerity Gained Traction

Given contradictory economic theories — as well as the negative short-term economic and social consequences — it is important to consider how austerity measures and structural reforms gained policy traction in Portugal in the aftermath of the financial crisis. Superficially, it is an easy question to answer: Portugal did not have a choice. More specifically, in the context of the financial crisis, it did not have the option to pursue expansionary fiscal policy: Portugal required a bailout, the terms of which involved contractionary fiscal policy. In choosing between accepting the terms of the bailout and defaulting on sovereign debt, the former was surely the better option, as discussed later.

The idea of austerity has been around for years, but throughout 2010 support for stimulus spending began to falter, whereas support for fiscal consolidation began to grow, especially as the Greek crisis highlighted the potential dangers of deficit spending. On the surface, austerity

was easy to justify, because the concept makes intuitive sense: if you have too much debt, you have to stop spending (Blyth, p. 7). It also makes sense on a moral level: in order to balance the scales, we must recompense for the excesses of an economic upswing with the repercussions of a downturn (Blyth, p. 13; Krugman). Indeed, in October 2011, newly elected Portuguese Prime Minister Pedro Passos Coelho said that Portugal would only recover from its situation “by becoming poorer” (quoted in Dias, p. 3).

Research seemed to support austerity as well. An oft-cited 2010 article by Reinhart and Rogoff (p. 573) claimed countries with high public debt exhibited stunted economic growth. Additionally, Alesina and Ardagna’s 2009 article (p. 37) considered the seemingly contradictory theory of “expansionary fiscal consolidation,” a hypothesis introduced by Giavazzi and Pagano in 1990 (Blyth, p. 169). Their research indicated that fiscal consolidation could actually result in stronger growth and lower unemployment, arguing that the contraction could be off-set, among other factors, by a potential increase in current consumer spending driven by consumers’ expectations for long-run increases in their disposable incomes because of the fiscal adjustment in the current period (Alesina and Ardagna, p. 38).

Once such research had entered the official arena, there was no turning back (Krugman). In June 2010, the European Central Bank’s then President, Jean-Claude Trichet, rejected the view that austerity would stifle growth: “In fact, in these circumstances, everything that helps to increase the confidence of households, firms and investors in the sustainability of public finances is good for the consolidation of growth and job creation. I firmly believe that in the current circumstances confidence-inspiring policies will foster and not hamper economic recovery, because confidence is the key factor today” (quoted in Krugman).

Benefits of Portugal's Economic Adjustment Program

Proponents of austerity argue that even if there is some pain in the short term, fiscal consolidation, especially when accompanied by meaningful structural reform, if necessary, is a suitable policy because of the long-term benefits. As discussed previously, Portugal's IMF-EU bailout was conditioned not only on various austerity measures but also on the implementation of an ambitious reform agenda. On one hand, rather than accepting the bailout, Portugal did have the option to default on its sovereign debt, which would have created tremendous instability. On the other hand, the two major long-term benefits of the economic adjustment program are that it allowed the country to maintain its international reputation and to undertake significant reforms.

International reputation is important to ensure continued access to capital markets, of course, because investors burned by a country will be less likely to purchase that country's bonds in the future. Russia, for example, endured no access to the debt markets for 69 years following its refusal to repay Tsarist debts in 1918 (Reinhart and Rogoff, 2009, p. 61). That being said, a country's reputation is important for more than just repeat borrowing. As Reinhart and Rogoff note, a potential sovereign defaulter must also consider the negative impacts on trade associated with revamping trade routes and financing decisions to circumvent creditors, especially in today's global economy (Reinhart and Rogoff, 2009, p. 57). Finally, default can have a harmful impact on broader international relations, including national security arrangements and foreign direct investment, reducing not only investment itself but also the associated knowledge transfer (Reinhart and Rogoff, 2009, p. 58).

In addition to avoiding the reputational costs of defaulting, Portugal reaped the benefits, reputational and otherwise, of accepting the bailout and economic adjustment program. By adopting the program, Portugal began the process of regaining its credibility. As evidence,

Portugal's 10-year bond yields were as low as approximately 3.4 percent around the time of its exit from the program in May 2014, a significant decline from approximately 9.8 percent around the time of Portugal's bailout request and a record of 18.3 percent at the depth of its crisis in January 2012 (Lima, 2011; Lima, 2014; Lima and Nelson). Adopting the program made it clear that Portugal was committed to the painful changes necessary to achieve sustainable economic growth. As discussed previously, quarterly reviews by the international lenders monitored progress made on implementing the program. The results of each quarterly review were made public, which Portugal's former Finance Minister, Gaspar, suggests allowed the country to present its progress in an official, transparent manner (Gaspar, p. 3).

Beyond its importance for international reputation, Portugal's undertaking structural reform under the program stands out for two reasons. First, the bailout insulated Portugal from the vagaries of international capital markets, allowing the country time to address its macroeconomic imbalances (Gaspar, p. 3). Much like a private company is relatively sheltered from the market pressures and additional scrutiny that publicly traded companies face, Portugal was able to focus on meaningful reforms rather than pandering to the financial markets, which are often interested in short-term outcomes. As described previously, Portugal was forced to request the bailout when it became illiquid as a result of markets demanding Portugal pay much higher interest rates on its debt during the global financial crisis to compensate for its higher perceived risks compared to, say, Germany. In other words, Portugal, arguably, was solvent and would have been able to tackle its debt load were it not for the vagaries of the capital markets that lost faith in its ability to pay (Cline, pp. 207, 228). Indeed, once reforms were in place (or at least in progress), Portugal successfully returned to the long-term debt market with syndicated sales of 5-year bonds in January 2013 and 10-year bonds in May 2013, followed in April 2014

by its first auction since its bailout, issuing €750 million (\$1.04 billion) of 10-year bonds at an average yield of 3.575 percent (Lima and Nelson; Ruffoni and Kowsmann; Wise et al.). This was the lowest rate Portugal had ever received for its 10-year debt (Minder).

Second, the economic adjustment program, as a condition of the bailout, made adopting significant structural reform politically feasible. As discussed previously, in the decade prior to the crisis, Portugal began to tackle its economic vulnerabilities only through a slow adjustment (Lourtie, p. 68). Among other reasons, the political difficulty associated with a stronger adjustment helps rationalize such an approach, as the fiscal consolidation measures and reforms most likely to support an economic recovery are often unpopular (Lourtie, p. 74). Coincidentally in this situation, on March 23, 2011, the Portuguese Parliament rejected an austerity package proposed by the government, and the country headed for early elections (Lourtie, p. 86). Elections were held on June 5, 2011, shortly after the agreement with the IMF and the EU had been brokered by the caretaker government (Lourtie, pp. 87, 89). Interestingly, the three-year fiscal consolidation plans presented by the Portuguese government in March 2011 were consistent with those eventually imposed by the agreement (European Commission...Affairs, 2011, p. 18). Assuming that international lenders such as the IMF and the EU will punish noncompliance, perhaps by withholding subsequent installments of a bailout package, governments can use such a threat to help pass unpopular, but necessary, policies (Vreeland, p. 8). On a similar note, internal political issues might make it difficult for a country, like Germany, that is important to the resolution of the crisis, to gain support domestically for providing assistance. Emphasizing the pain and effort that Portugal would be going through during the adjustment program could help in such a situation.

Looking beyond the negative short-term economic and social impacts of the program, in the long-run, the structural reforms will have a significant impact on improving Portugal's competitiveness, macroeconomic imbalances, and, ultimately, economic growth. According to Bouis and Duval, at the time of the program a range of reforms in labor and product markets, as well as in benefit, tax, and retirement systems, could have resulted in a potential increase in GDP per capita of more than 5 percent over a five-year horizon and approximately 13 percent over a ten-year horizon (cited in Gaspar, p. 31). Research from Gomes and colleagues shows similar results (cited in Gaspar, p. 31). Therefore, the positive impact of the economic adjustment program stems not only from a gradual improvement in market perceptions but also from the real, significant benefits of eliminating structural barriers that led Portugal to the financial crisis, including its rigid labor market and weak business environment.

Conclusion and Looking Forward

Portugal followed the tenets of the economic adjustment program assiduously and made significant reform efforts, emerging as one of the OECD's top reformers during 2012 and 2013, given its responsiveness to the organization's reform recommendations (OECD, "Portugal: Deepening Structural Reform...", p. 12). Moreover, Portugal regained partial access to international capital markets in January 2013 and made a clean exit (i.e., without a precautionary credit line) from the program in May 2014 (Minder; Wise et al.). Nevertheless, the subsequent bailout within the banking sector in 2014 has hampered progress. Additionally, Gaspar, in March 2013, noted that work to reduce sovereign debt levels would not be finished even upon successful completion of the program; rather, it would demand "the efforts of a generation" (quoted in Dias, p. 4). Therefore, it is important to sustain reforms going forward, especially in a post-crisis environment, to fully achieve the estimated potential benefit to GDP growth.

Specifically, Portugal should continue reducing labor market rigidity and segmentation by further reforming employment protection and wage bargaining, reviewing the unemployment benefit system, furthering active labor market policies to keep workers involved and to develop their skills, and broadly working to reduce the skills mismatch within the workforce (OECD, “Economic Policy Reforms: Going...,” pp. 268–69; OECD, “Portugal: Deepening Structural Reform...,” pp. 23–26, 29). Within product market regulation, Portugal should work toward improving competition and still-above-market prices within the energy sector, strengthening competition in professional services by minimizing the barriers to entry and limiting the market-stifling role of professional associations, and reducing regulatory restrictions on competition within transport sectors (OECD, “Economic Policy Reforms: Going...,” p. 269; OECD, “Portugal: Deepening Structural Reform...,” pp. 16–18). In regard to improving the business environment, Portugal should consider further reducing administrative burdens, especially for small businesses, and strengthening the enforcement of its competition policy (OECD, “Portugal: Deepening Structural Reform...,” pp. 18–19). At the same time, Portugal should promote innovation by providing access to appropriate funding and improving commercialization prospects for academic research (OECD, “Economic Policy Reforms: Going...,” p. 269; OECD, “Portugal: Deepening Structural Reform...,” pp. 31–32).

In addition to sustaining reforms within Portugal, it will be increasingly important to focus on preventative measures, especially through enhanced cooperation among EU countries. Although Portugal’s economy was struggling long before the crisis, it is important to remain cognizant of the impact of cross-border contagion in Portugal’s crisis. As Lourtie notes, “One of the lessons from the... crisis is that Portugal’s fate is not dependent on its decisions alone” (p. 90). Despite relatively stable fundamentals, a general increase in risk aversion in global financial

markets, coupled with Portugal's slow growth and increasing sovereign debt, led the previously sustainable to be seen as unsustainable (Blyth, p. 71; Contessi, pp. 209, 216–17). Therefore, broad structural reform within the EU as a whole will ultimately be essential to both prevent and mitigate financial crises going forward.

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