NEWS ANALYSIS

Portugal's Debt Efforts May Be a Warning for Greece

Mario Proenca/Bloomberg News

The Portuguese public so far has generally gone along with the government's policies, but it is starting to lose patience. Above, a protest against austerity measures last week in Lisbon.

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LISBON — As debt-plagued Greece struggles to meet Europe's strict terms for receiving its next round of bailout money, the lesson of Portugal might bear watching.

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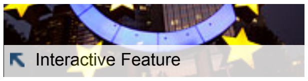
Debt Rising in Europe

Unlike Greece, Portugal is a debtor nation that has done everything that the European Union and the International Monetary Fund have asked it to, in exchange for the 78 billion euro (about $103 billion) bailout Lisbon received last May.

And yet, by the broadest measure of a country's ability to repay its debts, Portugal is going deeper into the hole.

The ratio of Portugal's debt to its overall economy, or gross domestic product, was 107 percent when it received the bailout. But the ratio has grown since then, and by



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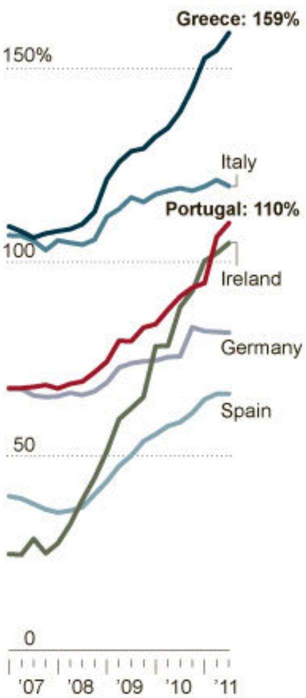
Debt levels as a share of gross domestic product (a measure of the size of a country's economy) have risen across Europe, including in Greece, where efforts to cut spending have taken a toll on economic growth.

GOVERNMENT DEBT
As a percentage of G.D.P., quarterly



Source: Eurostat
The New York Times

next year is expected to reach 118 percent.

That's not necessarily because Portugal's overall debt is growing, but because its economy is shrinking. And economists say the same vicious circle could be taking hold elsewhere in Europe.

Two other closely watched countries on the debt list, Spain and Italy, also have rising debt-to-G.D.P. ratios — even though they, like Portugal, have adopted the budget-slashing and tax-raising measures that the European officials and the I.M.F. continue to prescribe.

And on Tuesday, new figures showed that the Greek economy shrank even more than expected last year, as Greece struggles under ever heavier austerity demands by its European lenders.

Without growth, reducing debt levels becomes nearly impossible. It is akin to trying to pay down a large credit card balance after taking a pay cut. You can slash expenses, but with lower earnings it is hard to set aside money to pay off debt.

Vitor Gaspar, the Portuguese finance minister who came to power as part of a new government last summer, is highly regarded by European economic and finance officials. He has reduced the government's budget deficit by more than one-third so far, through tough measures that include cuts in spending and wages, pension rollbacks and tax increases.

But many economists say those moves are also a reason Portugal's economy shrank by 1.5 percent in 2011 and is expected to contract by 3 percent this year.

"Portugal's debt is just not sustainable," said David Bencek, an analyst at the Kiel Institute for the World Economy, a research organization in Germany. "The real economy does not have the structure to grow in the future and thus will not be able to pay back its debt in the long run."

The Portuguese public has so far has generally gone along with the government's policies without the violent demonstrations that have rocked Greece, but it is starting to lose patience.

On Saturday, more than 100,000 people assembled peacefully in Lisbon's sprawling Palace Square to rally against the austerity measures and the nation's 13 percent unemployment, while chanting "I.M.F. doesn't call the shots here!" The head of Portugal's largest labor union vowed to hold additional protest rallies around the country.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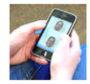
The Materialist Fallacy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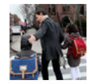
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The I.M.F., for its part, predicts that Portugal will eventually grow enough to cut its debt to a manageable level. But even the I.M.F. warns in its recent economic review that if growth were to disappoint, Portugal's debt "would not be sustainable."

The finance minister, Mr. Gaspar, an economist who is a former research director at the European Central Bank and a disciple of the bank's austerity-focused philosophy, insists that his country's debt is manageable. And he has no plans to ease up. This year he intends to slash government pension payments by 1.2 billion euros (close to $1.6 billion) and cut the bonus payouts that public sector workers in this country have long earned.

In discussing his record, Mr. Gaspar prefers to focus on the effect his efforts have had on Portugal's budget deficit — the difference between what it spends and what it takes in — which has fallen to 5.6 percent last year, from 9.1 percent in 2010. For this year, Mr. Gaspar forecasts a decline to 4.5 percent.

"We have delivered, and our adjustment program stands out in the euro area," he said during an interview on Friday in the ornate surroundings of the finance ministry here.

Once Portugal's budget reforms take hold, Mr. Gaspar predicts, the country's economy will grow by more than 2 percent from 2014 on, and the debt will fall accordingly.

Mr. Gaspar has won plaudits from Europe's leadership and the I.M.F., which are eager to champion an exemplar of economic revamping in contrast to Greece's unspooling disaster. In fact, Portugal is deemed such a model of reform that the Europe Union and I.M.F. are widely expected to come up with more money for Portugal next year if necessary — as was suggested in an overheard exchange between Mr. Gaspar and the German finance minister at a meeting last week in Brussels.

But as Portugal's slowly rising debt-to-G.D.P. ratio indicates, being Europe's model debt patient does not necessarily make it easier to get out of debt. Others might find it even tougher.

Spain, whose debt-to-G.D.P. ratio was 36 percent before the debt crisis began, is projected to be more than double that — 84 percent — by 2013. Italy, whose ratio was already at 105 percent in 2009, is expected to reach 126 percent by next year.

Greece's number is even worse — nearly 160 percent by the most recent measure. And that calculation was made last week by Europe's official Eurostat research organization, before the Greek government on Tuesday released its latest economic figures showing that its economy shrank by 7 percent in the fourth quarter and by 6.8 percent for all of 2011 — even worse than the full-year contraction of 6 percent Athens had expected. Even if Greece receives all the bailout money it has been promised — a sum sure to exceed 200 billion euros — its debt-to-G.D.P. ratio is still expected to be onerous, 120 percent, in the year 2020. That grim outlook even factors in the big write-down of its debt that Greece is now trying to negotiate with its private creditors and the European Central Bank.

If Portugal and other European debtors find it increasingly difficult to pay off their creditors because of slow or no growth, some experts predict they, too, might eventually need to negotiate debt write-downs. That was how things played out in Latin America in the 1980s, once it became clear that the I.M.F.'s relentless austerity push was impeding the growth that countries needed to pay down debt.

Charles Wyplosz, an international economist, argues that until economic activity resumes in debt-burdened countries like Greece, Portugal and Italy, it is pointless to punish citizens with growth-sapping policies.

"It's all pseudo-science," he said. "That is why I think Portugal will have to default on its debt, and you can argue that Italy will have to restructure as well."

Mr. Gaspar, though, contends that once his country's reforms take hold, "we will put our debt-to-G.D.P. ratio on a sustainable path again." And he is adamant that Portugal will not try to renegotiate its debt obligations, because of the permanent damage it might do to Lisbon's reputation as a borrower.

"That possibility is completely excluded," he said, adding that George Washington believed one of a country's most precious assets was its ability to borrow in the bond market.

Economists accept that during the initial stage of a major spending adjustment program, the debt-to-G.D.P. ratio will spike as economic growth suffers. The bet, however, is that over time the economy will pick up enough that the country starts to generate a primary surplus — that is, a budget in the black, once debt payments are excluded.

But there are many who believe that just as Greece's debt picture is fundamentally untenable, so is Portugal's.

According to the calculation of Mr. Bencek, the economist, Portugal would need to produce a primary surplus of about 10 percent of G.D.P. in the coming years to reduce its debt ratio to a permanently serviceable level. That, he said, would require a degree of cuts in spending far beyond what Mr. Gaspar and his team have already been able to achieve.

As even the current cuts bite ever deeper, many Portuguese are asking if it might not be better for their government to try to negotiate easier terms with its lenders.

"Portugal would save 3 billion euros a year if it restructured its debt," said Pedro Lains, an economic historian and a blogger at the University of Lisbon.

Mr. Lains spoke not only as a theorist. He feels austerity firsthand. Because his salary at the government-run university has been slashed by 30 percent in the last year, his family has needed to dip into its savings.

He said that wage contraction throughout the country was prompting increasing numbers of Portuguese to leave the country, even as their government labors to prove it is worthy to remain part of the euro zone.

Why, Mr. Lains asks, should he and his fellow citizens suffer while the bondholders get their money back? "It's not the fault of the Portuguese people," he said. "The fault lies with the structure of the euro."