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Europe Watches as Portugal's Economy Struggles

By RACHEL DONADIO FEB. 9, 2010

LISBON — Along the hilly, cobbled streets of this moody Atlantic city, known for its melancholy even in good times, people seem to be holding their breath, unsure if Portugal's foundering economy will improve — or worsen, and weaken Europe's overall financial health.

"We're waiting for the government to do something, but they're totally disorganized," said Conceição Bobião, 63, a saleswoman in a shoe store off downtown Rossio Square, near monuments to the country's colonial past.

One of Western Europe's most introverted and unassuming countries, Portugal was unsuspectingly thrust into the international spotlight last week when markets plummeted on fears that it — and Spain — might be seen in the same category as Greece, whose soaring debt, deficit and credibility gap have been undermining confidence in the euro.

This week, the Socialist government of Prime Minister José Sócrates scrambled to reassure markets and its domestic constituency that it had what it took to bring its deficit — which reached 9.3 percent of gross domestic product last year — below the 3 percent ceiling set by the European monetary union by 2013.

"We will do the job in three years," Mr. Sócrates said Tuesday in an interview in his official residence here. "It is a difficult job, of course, but I am prepared to do it."

But markets and observers are not so sure. Beyond the economic crisis, the Socialist leader faces intense political pressure as he tries to reduce public sector spending. He lost his majority in September's elections and now struggles to keep order with an unruly if unfocused opposition.

Last week, markets slumped after the commissioner for European economic and monetary affairs, Joaquín Almunia, listed Portugal, Greece and Spain as countries that had shown "a permanent loss of competitiveness" since they joined the European economic and monetary union.

Mr. Sócrates, a dapper dresser with an open, expressive face who underlines his points with theatrical hand gestures, seemed at turns deeply concerned with the gravity of his country's problems, and puzzlingly dismissive of data on the European Union.

He rejected the notion that Portugal lagged behind European Union counterparts in productivity and skilled labor. "That is a preconceived idea," he said. "It has nothing to do with our economy."

Yet after decades of basing its economy on its low labor costs, Portugal was hit hard by the eastward expansion of the European Union and the loosening of trade barriers with Asia. Today, it struggles to compete with its richer European Union neighbors, having experienced flat growth in the past decade.

"Countries are like companies; you have to keep one step ahead," said Camilo Lourenço, an economic commentator in Lisbon.

Portugal "didn't recognize that it was becoming obsolete with E.U. expansion," he added. "No one pays attention until there's a shock."

Mr. Lourenço said he did not think the government had the political skill or a coherent plan to bring the deficit in line. "That's what worries me," he said.

Mr. Sócrates attributed the steep rise in Portugal's deficit to a sharp drop in tax revenue, and noted that it was not out of line with that of other European Union countries. France's budget deficit for 2010 is expected to be 8.2 percent of gross domestic product, down from its earlier estimate of 8.5 percent, while Germany's was 3.2 percent for 2009. Last month, Spain announced that its deficit had soared to 11.4 percent of G.D.P., well above its earlier estimates.

Having a deficit now is "very normal," he said. "All the developed countries have problems now with their deficits."

Some business leaders in Portugal seemed genuinely taken aback by last week's market panic, especially since no new data had been published.

"Clearly the markets overreacted," said Paulo Moita Macedo, a vice chairman at Millennium bcp, a Portuguese bank, who as Portugal's top tax official from 2004 to 2007 earned plaudits for revamping the tax collecting system. "But no one disagrees that we need to spend less."

Portugal's debt is expected to rise to 85 percent of gross domestic product this year, from 76.6 percent in 2009, because of rising unemployment and government spending on infrastructure projects like dams, hydroelectric power systems and a high-speed rail line to Madrid.

Portugal's main opposition, the Social Democrats, has criticized the government for throwing borrowed money at problems. Mr. Sócrates himself shunned the term "stimulus spending," saying in the interview, "Not spending, investment."

The government is hoping its track record will raise confidence. When Portugal's deficit rose above 6 percent in 2005, it brought it below 3 percent by 2007 by cutting public spending.

"We did it in the past — we will do it again," Finance Minister Fernando Teixeira dos Santos said Tuesday in a telephone interview. "We are the same guys. We are committed to doing it."

But this time the same guys lack a solid majority.

Last Friday, Parliament sent an anti-austerity message by passing a regional spending bill to nearly double funds to Madeira and the Azores.

"I told Parliament that that would be a wrong message to pass to the markets," Mr. Teixeira dos Santos said Tuesday. He said he would use all the laws in his power not to apply the increase.

Mr. Sócrates took pains to distinguish Portugal from Greece. He said the country had carried out "very serious" structural reforms in recent years, including reducing the public sector, raising the retirement age and changing the social security system. Unlike Greece or Italy, it has also instituted sophisticated e-banking systems in which citizens can file taxes at A.T.M.'s.

As talk grows of a possible bailout for Greece, Mr. Sócrates insisted that Portugal did not need help from the European Union. "We don't need anything from Brussels," he said emphatically.

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