

## Agenda: A scheme to make Charles Ponzi proud

• By IRWIN STELZER



It is one year since the powers-that-be in the euro zone crafted a plan to get Greece over a liquidity hump and onto the sunlit meadows of fiscal sustainability. Since then, the fiscal situation in Greece has deteriorated, the economy has gone into recession, and the team sent to check on Greece's progress today will undoubtedly struggle to find the words to translate the reality of the country's failure to meet its deficit-reduction targets into euro-zone-speak for "success." Buoyed by that success, the euro-zone team is administering similar medicine to Portugal. The patient is unlikely to recover.

In return for agreeing to reduce its deficit from 9.1% of GDP to 3% by 2013—one year faster than Greece and Ireland—Portugal will get a €26 billion (\$37 billion) loan from the International Monetary Fund at an interest rate of 3.25%, and a €52 billion European loan at a rate to be announced at the May 16-17 meeting of the EU finance ministers, when the package is to be formally agreed. Unless, of course, Finland, in deference to the strength shown by the anti-bailout True Finns party in the recent elections to the Eduskunta, vetoes dipping into the €440 billion European Financial Stabilization Mechanism.

Portugal's unsustainably high debt is to be cured by, er, lending it more money. The new €78 billion loan will raise Portugal's public debt to 120% of its GDP. In the manner of the late, great financier Charles Ponzi, Portugal is borrowing money with which to pay off creditors. Not to worry, once it gets past this troublesome liquidity crisis, it will be able to borrow in international markets to repay the loans it is receiving from the IMF and its European partners, loans being used to repay other loans, with money it borrows from private-sector investors. If you don't get it, you get it.

And if you do get it, you might also understand two other features of the deal. The first is how needed growth can be stimulated by a package that includes:

- reductions in pensions in excess of €1,500 per month;
- a limit on unemployment benefits to €1,048 per month for 18 months instead of the current three years;
- a cut in health-care benefits;
- a freeze on public-sector salaries;
- an increase in excise taxes.

If you doubt that these measures can bring the budget deficit down from 9.1% of GDP to 3% by 2013 in a country about to trade near-zero growth for a significant decline, you are not alone. Portugal's education system is among the worst in Europe, its workers are largely unskilled, its labor markets rigid. Its economy is not competitive with Central Europe, much less China and other Asian countries. Which explains why Portugal has grown at an average rate of only 1% in the past decade, and has an unemployment rate in excess of 11%.

The measures adopted to meet what Poul Thomsen, head of the IMF mission to Portugal, calls "by any standard [an] ambitious and a strong pace of adjustment" will cause the economy to shrink by about 2% between this year and next. That is what Portuguese Finance Minister Fernando Teixeira dos Santos now forecasts, replacing the 0.9% and 0.3% he had forecast for 2011 and 2012, respectively, before the bailout package was provisionally agreed.

More debt loaded on a shrinking economy almost certainly means that a restructuring is in Portugal's future. Which is what the markets have started to realize: when the deal was announced the yield on 10-year Portuguese bonds rose 16 basis points to 9.68%, a full 6.52 percentage points above 10-year German Bunds.

The second difficult-to-understand part of the bailout scheme is that about 15% will be used to shore up the nation's undercapitalized

banks. The troubled banks will be recapitalized with government money if they fail to raise enough capital in the market to bring their tier one capital ratio—the measure of a bank's solidity—to 9% this year and 10% by the end of 2012. The government will issue up to €35 billion of government-backed bonds if, as is highly likely, the private sector does not see investment in Portuguese banks as the investment opportunity of a lifetime. Why a guarantee from a government presiding over a heavily indebted, shrinking economy will encourage investors to make funds available to banks that have been on life support from the European Central Bank is not explained.

Both the departing government and the opposition party are said to have agreed to these terms. Understandable, given the situation in which Portugal finds itself, and politicians' preference for "kicking the can down the road," to use President Barack Obama's favorite expression to disparage his opponents, never mind that he is America's can-kicker-in chief. But it seems a bit of a stretch for Prime Minister José Sócrates, a candidate for re-election on June 5, to chortle that the bailout is "a big success."

He seems at home in the reality-averse world of the euro zone. France's Finance Minister Christine Lagarde says that restructuring the debt of any euro-zone country is not even on the agenda. Luxembourg's Jean-Claude Juncker, chairman of the euro-zone finance committee, agrees, although he is open to "a further adjustment" in the terms of the Greek bailout. Better that than the restructuring of Greek debt being considered by German and Greek officials, or having Greece forsake the euro for the dear old drachma, as the rumor mill was predicting at week's end. For if Greece restructures or exits, can Portugal be far behind?

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