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2011 REVIEW

Portugal in 2011: The Downgrade of All Fears

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In 2011 Portugal made international headlines for the worst possible reasons. As much as one might wish to look beyond the structural implications, Portugal's debt woes cast the country into the same category as Greece, demanding the attention of the country's leaders more than at any time since its return to democracy.
That unmistakably constrained and influenced the country's prospects in a significant number of ways. This includes changes at the top of the Portuguese political system, chiefly the government's collapse due to the overwhelming pressure of past mistakes and international market forces. What's more, given that "the recourse to foreign assistance [was] a hard blow to the national prestige and reputation",[1] it is also safe to say that the challenges to Portugal's foreign policy grew exponentially.
In that sense, any analysis of Portugal's course of action during 2011 has to start by precisely considering the ill-fated economic features that evidently scarred the year. This article begins with a description of how Portugal's economy kept itself above the water until 2011. The effects that such a decision had on Portugal's ruling government and on the election of a new one will also be brought into front display. On the other hand, this article will also provide a closer scrutiny of the events, stages and partners that received particular focus within Portugal's foreign policy agenda throughout the year. Finally, some conclusions will be drawn with an eye toward what's ahead for Portugal in 2012.

Economic downgrading
Following bailout requests by Greece and Ireland, Portugal's economic vulnerability grew to unprecedented heights. Looking for the next weakest link within the Eurozone, international investors soon began to eye Portugal's economy and they quickly sold off Portuguese debt, though the degree to which this expresses a loss of confidence in Portugal's solvency, as opposed to a quick and cold effort to make a profit by betting against Portugal, is up to debate. Presenting a common and united political front that could agree and approve a number of structural measures – even more austere than the previous ones enshrined in the ill-fated row of Stability and Growth Pacts (PECs) – was thus forcibly and rapidly needed.
In that sense, after intense bickering and a series of highly publicized negotiations, the government of the Socialist Prime Minister José Sócrates managed to reach an agreement with the main opposition Social Democratic Party (PSD) at the end of 2010 and thus secure the approval of the 2011 budget through the Portuguese Parliament. The outlook was grim enough to prevent any kind of celebratory mood back in Lisbon since international economic forecasts for the Eurozone continued to contradict any optimistic or stable projections for such economies, Portugal included.
For all purposes, the harsh reality of economic data continued on reflecting itself in Portugal's rating abroad. The situation inevitably reached a boiling point when on 11 March Finance Minister Fernando Teixeira dos Santos announced the need for a new austerity package as a "preventive measure" against the bond market's wrath.[2] This *de facto* assumption that previous attempts had not succeeded in tackling Portugal's structural problems triggered a new political crisis when it became clear that it would have no chance of being approved in the Parliament. On 23 March such a package was indeed rejected, prompting Prime Minister Sócrates's resignation and feeding the downturn spiral of Portugal's economy.
With rating agencies successively cutting the rating classification for Portugal, the costs of borrowing abroad soon grew to unsustainable levels. By 6 April interest rates for five-year sovereign debt bonds had climbed

1 Paulo Gorjão, "Portugal e a ajuda externa: um duro golpe no prestígio nacional" (*i*, 12 April 2010).

2 "Governo avança este ano com medidas adicionais este ano para poupar 0,8% do PIB" (*Lusa*, 11 March 2011).

to 10% while ten-year bonds reached nearly 9%. It was therefore evidently clear that Portugal was dangerously bordering a quasi-default scenario in which it would not be able to pay its debts to creditors. As such, the amount of pressure to request international assistance became simply unbearable, and on that same day José Sócrates finally asked the European Union (EU) to step in, place Portugal under the umbrella of its safeguarding mechanisms, and thus "guarantee the country's financing conditions".[3]

After almost a month of negotiations with EU and International Monetary Fund (IMF) officials and with the release of more dismaying data in the background – the official announcement, for example, that Portugal's GDP deficit in 2010 had in fact reached 9.1% as opposed to the 8.6% previously disclosed – a deal was finally brokered. Its content offered a three-year, €78 billion EU-IMF-ECB joint bailout program in return for the country's commitment toward slashing its budget deficit to 5.9% in 2011 and then reduce it to 3% by the end of 2013 – when Portugal could foresee a predictably return to issue long-term debt in the market. Moreover, an overwhelming number of fundamental reforms, justice and health sectors among others were also to be implemented during a tight schedule with the aim of improving Portugal's general economic competitiveness while being consistently evaluated by the troika of representatives from the international lending institutions.

However, even with such an overhaul agreement coupled with a change of political cycle, Portugal only managed to get a few weeks of breathing room until the visible indecision among Europe's highest echelons of decision-making, and the persistently unfolding situation in Greece incited renewed fears of the crisis spreading to other countries, thus potentially bringing about the end of the euro as a whole. Amid all this, the final dent in Portugal's public reputation came on early July 2011 when, despite the recent parliamentary elections, Moody's rating agency cited a "growing risk that Portugal will require a second round of official financing before it can return to the private market" as it reduced the country's rating from Baa1 to Baa2.[4] The general outcry over the criteria behind such a decision was significant but in the end proved meaningless since it was replicated by other rating agencies who all saw developments in Europe and in Portugal as continuously untrustworthy of better evaluations.

Within this context the course for the remainder of 2011 was all but settled. Bound by the terms agreed with the international troika, the new government found its objectives and priorities inevitably constrained by an 'external strait jacket' as it tried to enforce and jumpstart reforms on the ground without provoking an recessive mood that could hamper economic recovery. However, bad news broke again when the financial troubles of the Autonomous Region of Madeira had to be included in revised growth projections. Nonetheless, thanks to the transfer of €6 billion from the banking sector's pension funds to the state's control, Portugal was able to reach an annual deficit bordering 4.5%, significantly lower than what had been agreed earlier. Although it was only made possible through exceptional means, this Pyrrhic victory allowed Portugal to signal its commitment to reform and actively seeking to lift itself up from this crisis.

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Political unfolding

With economic developments buffeting Portugal all year, it would be a mistake to overlook the significant political ramifications that the country also faced. On 2 January incumbent Aníbal Cavaco Silva managed to take advantage of both a relatively innocuous first term and of his opposition's disarray to secure five more years as President of the Republic. This new term heralded an institutional dynamic considerably different than the preceding one. Indeed, although Cavaco Silva and Sócrates belonged to opposing political parties, they previously succeeded in achieving a sizeable degree of 'loyal' cooperation at the helm of the country. But with the pressure growing around Portugal's economy by the day and Sócrates's popularity waning – despite his renewed mandate in the 2009 parliamentary elections – Cavaco Silva undoubtedly felt himself more at ease to

3 Ana Luísa Marques, "Governo já pediu ajuda financeira a Bruxelas" (*Jornal de Negócios*, 6 April 2011).

4 Andrei Khalip and Walter Brandimarte, "Moody's cut Portugal to junk, warns on 2nd bailout" (*Reuters*, 5 July 2011).

make his stand. That much was clear during his oath of office on 9 March, through which he delivered what many then called "the most politically violent speech" by a democratically-elected President, including references to a "lost decade of growth" and calls for a "civic shock" by the Portuguese society.[5]

The announcement of the need for the so-called PEC IV immediately found echo in the main opposition party – clearly emboldened by the President's fiery speech – and as such the government's fate was inevitably sealed. As noted, on 23 March Sócrates tendered his resignation to Cavaco Silva who promptly accepted it and thus scheduled new elections for 5 June 2011. Leading the PSD against Sócrates's Socialist Party (PS) was Pedro Passos Coelho who rode the wave of growing discontent against the beleaguered government and quickly took the lead in this race. On Election Day he thus managed to obtain 38.65% of the votes while the PS was left with 28.06%. However, two factors spoiled victory celebrations. First, even though he achieved a clear mandate, Passos Coelho's win still fell short of a desirable absolute majority – indispensable to the kind of structural reforms he had originally envisioned to carry out – and as such, a coalition government with the smaller Democratic and Social Centre-People's Party (CDS-PP) and its leader Paulo Portas became the most rational choice to make.[6] Second, as much as Passos Coelho would have probably wanted to, he could not entirely detach himself from the legacy of the Socialist government because he also had to face intense domestic and international pressures. Moreover, he had committed his party to the terms enshrined in the memorandum of understanding with the lending troika back when it was first signed in early May.[7] His hands were therefore tied to the upcoming austerity drive even before he took office.

> While Portugal's economic foundations collapsed and its political leadership was dealt with an unscheduled renewal, the country's foreign policy continued on its course. True, the geopolitical ramifications of the international crisis created more concerns than the Portuguese diplomacy might have probably expected at the beginning of the year. Nevertheless, such factors did not entirely overshadow Portugal's foreign policy which continued on the tendency of constantly "punching above its weight" in recent years.

As for the new cabinet, it could hardly be considered a 'team of rivals' but it is still one that includes different factions and personalities. Take the case of Defense Minister José Pedro Aguiar-Branco – who had previously ran against Passos Coelho in the party's primary, but who was called this time around to join the cabinet – or even the role of Foreign Minister assigned to Paulo Portas himself. Portas had already been Defense Minister in a previous PSD-CDS coalition government from 2002 to 2005 and his return to the country's highest offices certainly adds a considerable dose of political gravitas, not the least of which because of his instrumentality in sustaining a workable ruling coalition.

Overall, after six months on the job, the governing styles are substantially different, but as expected the content is – and will remain for the next few years – invariably swayed by the international context. However, it is interesting to note that even with multiple tax hikes and painful spending cuts the coalition government has managed to retain its popularity in the latest polls while showing no sign of internal cracks or of seeking to backtrack the announced spree of structural reforms.[8]

Change and continuity in foreign policy

Paradoxically, while Portugal's economic foundations collapsed and its political leadership was dealt with an unscheduled renewal, the country's foreign policy admiringly continued on its course. True, the geopolitical ramifications of the international crisis created more

5 Nuno Simas, "Cavaco arrasa Governo e apela ao "sobressalto cívico" dos portugueses" (*Público*, 9 March 2011).

6 Sofia Rodrigues e Nuno Simas, "PSD e CDS prometem Governo "forte" e para "quarto anos"" (*Público*, 16 June 2011).

7 "Passos envia carta a troika e declara 'total comprometimento'" (*Sol*, 5 May 2011).

8 Francisco Teixeira, "O ano em que tudo a 'troika' mudou" (*Diário Económico*, 27 December 2011).

concerns than the Portuguese diplomacy might have probably expected at the beginning of the year. Nevertheless, such factors did not entirely overshadow Portugal's foreign policy which continued on the tendency of constantly "punching above its weight" in recent years.[9] This concerned the non-permanent seat at the United Nations (UN) Security Council won by Portugal in late 2010. That alone provided a high-profile stage with a myriad of international contacts year round, regarding a number of security issues and pressing crises. One particular international development, though, eventually grabbed the world's focus and "added a new dose of responsibility to Portugal's term in the Council": the Arab Spring and, more specifically, the unraveling situation in Libya.[10]

As violence erupted into an open conflict between Muammar Gaddafi's regime and the National Transitional Council (NTC) opposition forces, Portugal quickly found itself in charge of the UN's new Sanctions Committee on Libya and was thus included in backstage international diplomacy. Nevertheless, Portugal also sought not to immediately jump on the bandwagon of international recognition of the NTC's legitimacy as the sole representative of the Libyan people, and thus ended up taking its time to consider all the pros and cons of such a move.[11] This was symptomatic of the general carefulness displayed in the first months of this crisis by the Portuguese government evidently keen on securing and preserving the significant political-economic investments made throughout the entire Maghreb region during Sócrates's tenure. When the side effects of the Arab Spring reached Syria, the reaction of Portuguese officials was slightly different since it reflected primarily the change in government and the respective new holder of the Foreign Ministry.[12]

After acquiescing to an international bailout, Portugal was invariably dependent on an European pro-active and unanimous approach to the crisis. That in turn often led to internal and external impressions that Portugal was overly siding with the countries leading the drive for severe sanctions and more austerity measures, i.e. Germany in particular. However, given the need to signal full compliance with the assistance program, there was little else that could have been done.

In this evolving context, it is also worth of noting the focus reserved for the 'new' destinations that, together with Lisbon, increasingly form the priority axis for the country's foreign policy (namely Brasília and Luanda). Regarding Brazil, Sócrates made sure not to miss Dilma Rousseff's inauguration on 1 January 2011 in a bid to showcase deference for the outstanding bilateral relations while purposely laying the ground for potential new Brazilian investments in the Portuguese economy. Rousseff then paid a brief visit to Portugal in March, but the domestic mood fuelled by Sócrates's own resignation stymied any major developments. On the other hand, as if confirming the cross-cutting nature of Brazil as an inherent partner, after he took office Passos Coelho also traveled to Brasília on 27 October with the scheduling of an overdue bilateral summit for 2012 and the extensive privatization program back home high on the agenda.[13]

A similar pattern involved Angola. After years of successive efforts in deepening ties and improving mutual economic and business opportunities in both countries,[14] the bilateral relation reached a point that transcended changes of government in Portugal. For example, not only did Luanda comprise one of the first stopovers for Foreign Minister Paulo Portas abroad, but he also managed to reach a successful agreement with his Angolan counterpart on 15 September regarding traveling visas (long considered

9 Paulo Gorjão, "Portugal in 2010: Punching above its weight" (*IPRIS Lusophone Countries Bulletin: 2010 Review*, 2011), pp. 30-34.

10 Pedro Seabra, "First impressions: Portugal and the UNSC eight months on" (*IPRIS Lusophone Countries Bulletin*, No. 23, September 2011), pp. 3-8.

11 This would only happen on 28 July, after the change of government in Portugal. See Paulo Gorjão, "Portugal and the recognition of the National Transitional Council in Libya" (*IPRIS Lusophone Countries Bulletin*, No. 21, July 2011), pp. 1-2.

12 See Pedro Seabra and Paulo Gorjão, "A sense of déjà vu: Portugal and the regime change in Syria" (*IPRIS Viewpoints*, No. 82, January 2012).

13 "Passos Coelho acorda com Dilma Rousseff cimeira Brasil-Portugal em 2012" (*Lusa*, 28 October 2011).

14 See Pedro Seabra and Paulo Gorjão, "Intertwined Paths: Portugal and Rising Angola" (*South African Institute of International Affairs*, Occasional Paper No. 89, August 2011).

to be a thorn in the way of greater exchanges between the two countries). What's more, Passos Coelho himself visited Luanda on 17 November with the purpose of dispelling any possible rumors that Angola would receive less focus under his term.

Finally, the European context was purely inescapable during 2011. As the EU struggled to present a common front against the risk posed by Greek contagion, Portugal ended up caught in the middle of the firestorm. Discussions regarding the European Financial Stabilization Mechanism (EFSM)/ European Stability Mechanism (ESM) or the terms of assistance to Greece were relevant and urgent to Portugal as well. However, after acquiescing to an international bailout, Portugal started to appear more a part of the problem instead of a part of the solution. Its stance in delicate negotiations, such as the ones surrounding the intergovernmental changes to the European Treaties, was permanently tied up to the fact that the country was invariably dependent on a pro-active and unanimous approach to the crisis. That in turn often led to internal and external impressions that Portugal was overly siding with the countries leading the drive for severe sanctions and more austerity measures, i.e. Germany in particular.

The need for external financial assistance, the loss of prestige, and the unexpected start of a new political cycle all comprised developments that in one way or the other implied a considerable change of priorities, and that will most likely continue to effect the national agenda for years to come.

However, given the need to signal full compliance with the assistance program in order to regain some much-needed credibility, there was little else that could have been done to fight off such views. For all purposes, the number one goal for Portuguese diplomacy became one and the same: above all things, "the improvement of Portugal's perception abroad".[15]

Conclusions

It is clear how 2011 was tainted by both direct and indirect consequences of the financial debacle that hit Portugal. The need for external financial assistance, the loss of prestige, and the unexpected start of a new political cycle all comprised developments that in one way or the other implied a considerable change of priorities, and that will most likely continue to effect the national agenda for years to come. But amid this depressing scenario lies the invariable necessity of trying to pinpoint possible areas through which Portugal will seek to minimize the damage done to its external image, open potential new markets, attract increased foreign investments, and subsequently help the country lift itself up of the present economic and financial situation. Foreign policy orientations and strategy thus gain an added relevance in this matter.

Bearing in mind this constrained context, one can then speculate as to some of the targets within Portugal's external agenda in 2012. Continuing a trend already brought into motion in mid-2011, Latin America will receive more and more Portuguese interest as the business opportunities, sustained by growing high-level political contacts, continue surging in countries like Colombia or Peru.[16] Moreover, given recent bilateral courtesies it is also safe to say that "common political and economic interests between Portugal and Venezuela will override [any] ideological differences or personal affinities" that might have arisen with the change of government in Lisbon.[17] As for up north in Washington, Portas's own Transatlantic views are publically well known (he has already met with US Secretary of State Hillary Clinton on 28 September), but eventual greater bilateral ties will be highly dependent on the evolution of several pressing international security issues and on how well Portugal succeeds in remaining relevant for US interests. Portugal's presence in the UN Security Council until the end of 2012 can constitute, in this case, the main driver for more regular and deeper consultations.

More unusual destinations will focus on several emerging powers in Asia. With privatizations of several Portuguese companies at full steam, investments from the East are gradually seen as a viable alternative to disillusioned Western investors.[18] As such, bearing in mind the need to properly court the political authorities behind such potential flows and present the country as an attractive market, Portas is scheduled to visit China and India during the first semester of 2012.[19] Likewise, Turkey will

15 "Prioridade é "melhorar percepção de Portugal no exterior"" (*Lusa*, 18 July 2011).

16 Pedro Seabra, "Is Portugal rediscovering Latin America?" (*IPRIS Lusophone Countries Bulletin*, No. 24, October 2011), pp. 3-6.

17 Paulo Gorjão, "Portugal and Venezuela: continuity in times of change?" (*IPRIS Viewpoints*, No. 60, June 2011), p. 1.

18 "China e Índia são estratégicas na expansão económica" (*Lusa*, 6 January 2012).

19 "Portas em visita ao Oriente" (*Expresso*, 7 January 2012).

be included in this lot, but such a stop will be inevitably surrounded by additional interest. Indeed, given Portas' previous negative remarks over a possible entry of Turkey in the EU[20] – expressed significantly before he was Foreign Minister one might add – it is still unclear if the Portuguese official position towards such matter has changed or if it will remain traditionally uncompromised. Finally, Brasília and Luanda are also bound to continue receiving meaningful attention as Portugal's foreign policy unequivocally assumes such countries as central cornerstones of its external projection. Naturally, this will primarily happen at the expenses of the EU in light of the perceived excessive weight that European markets have held not only on Portugal's trade balance but also on its foreign agenda in recent years. Whatever accomplishments Portugal achieves outside of Europe will be thus heralded as clear confirmations of the new political reorientations in Lisbon.

The question left unanswered lies precisely with the chances of this kind of recalibration working to Portugal's advantage. Indeed, given the developments that 2011 unleashed on the country, it would be easy to write off any optimistic mood for the time being. The number of varying internal and external factors that can dictate the success or failure of the country's redemption is simply too volatile and too unpredictable to even risk the slightest of predictions. However if realism prevails over optimism in setting the course for Portugal's recovery in 2012, it's possible that Portugal might have a shot of recovering the credibility it lost in 2011.

20 "Paulo Portas não quer Turquia na UE" (*Lusa*, 12 May 2007).

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