Portugal passes austerity budget as speculative attack on Spain intensifies

Andre Damon
27 November 2010

The European debt crisis intensified Friday, as speculators continued their latest attacks on Spain and Portugal. Meanwhile tensions rose between Germany and European officials over the amount of money to be set aside for further bailouts.

Borrowing costs for the Spanish and Irish governments hit their highest levels Thursday since the adoption of the single currency. In response to the ongoing attacks, Portuguese lawmakers, spearheaded by Socialist Party Prime Minister José Sócrates, passed an austerity package Friday. The budget includes cuts to pensions and welfare benefits and tax increases mainly affecting the working class.

The cuts partially abated the appetites of speculators, and Portugal's borrowing cost ticked down slightly after reaching record highs earlier in the day. The speculators then turned their attention towards Spain, sending its borrowing costs to a new record.

Spanish Prime Minister José Luis Rodríguez Zapatero assumed a defiant tone Friday, and, just like the leaders of Ireland and Greece before him, denied considering a bailout from the European Union. “I should warn those investors who are short selling Spain that they are going to be wrong and will go against their own interests,” he said.

Zapatero's threats did little to calm the speculators, and by midday Friday, the *Financial Times* was prominently weighing a Spanish bailout. The newspaper warned that "a Greek/Irish-style bail-out for Spain" would cost €420 billion and "stretch the EU’s financing capacity to breaking point." Spain’s economy is almost three times larger than that of Ireland and Greece combined, and accounts for over ten percent of the Eurozone's output.

The wave of speculation against Spanish debt has given weight to conflicts within the Eurozone over how much to set aside for such a case. The European Union's executive body, the EU Commission, proposed to double the €440 billion emergency bailout fund this week (which, when combined with funds committed by the IMF, amounts to €750 billion). However, Germany opposed such a move, according to the *Wall Street Journal*.

"Many investors and analysts doubt whether the EU has agreed to supply enough financing to rescue Spain if the country were to lose access to bond markets," wrote the newspaper. "Support from Germany, Europe's largest economy and biggest contributor to the EU's main bailout fund, would be essential for any funding increase."

Germany, which would bear a disproportionate share of the cost of any bailout, has insisted strongly that countries requiring funds cut pensions and social services before seeking assistance. The German government has also pushed for restructuring debt and giving a “haircut” to private bondholders. This has generated opposition from other countries and from bond investors, determined to have their speculative activity covered in full.

The defensive statement by Zapatero followed a similar insistence by the Portuguese government, which told the *Financial Times* that rumors that it is seeking a bailout were "totally false." The Portuguese government made the denial after the *Financial Times Deutschland* reported that an official in the German finance ministry said a bailout of Portugal would help Spain.

Portuguese borrowing costs rapidly shot up after the report but dropped slightly after news that the government had passed a new austerity budget. The cuts included a five percent pay cut for public-sector workforce and a two-percentage-point increase in the

value added tax. The country will also introduce new road tolls and delay construction of new infrastructure.

The government is determined to carry out the dictates of the international financial markets. Prime Minister Sócrates said that the cuts were "absolutely necessary to remove Portugal from the center of the financial and economic crisis."

The new budget came after a symbolic one-day strike by the trade unions that were meant to give vent to popular hostility while doing nothing to prevent the budget cuts from going through.

EU's Economic Affairs Commissioner Olli Rehn praised the move, while insisting that more would have to follow. "of course, the fiscal consolidation effort, which is indispensable to build a sound basis for medium-term growth and jobs, will have to continue in subsequent years," he declared.

The banking systems of both Spain and Portugal have fared better in the economic crisis than other European countries. Spain, however, has the highest level of unemployment in Western Europe. The country has experienced a severe real estate bubble collapse, after prices doubled between 1995 and 2007.

For Greece and Ireland, neither austerity measures nor the EU bailouts have stopped speculative attacks. Borrowing costs for those countries continued to rise this week, with those of Ireland hitting a 12-year high Friday. By the end of trading Friday, Greece's cost of borrowing was 9 percentage points higher than that of the US, Ireland was 6.5 percent, Portugal's 4.3 percent and Spain's 2.4 percent.

The euro also fell 0.8 percent against the US dollar Friday, hitting a 9-week low, after fears of further bailouts undermined confidence in the currency. Stock markets throughout the world saw selloffs, and every major index in Europe, Asia, and the Americas fell between .5 and 1 percent.

It is clear from the latest developments that the speculators will not content themselves with preying on small countries like Ireland and Greece. Today they are attacking Spain, but tomorrow they may turn on any Eurozone country.

Whatever the differences between the major European powers over the size and necessity of future bailouts, all are agreed that the working class in Europe must pay for the ongoing financial crisis. Governments, "left" and right alike, will proclaim that they will have "no choice" but to implement austerity measures, putting into practice policies long demanded by their local ruling classes under the pretense of an "external" threat.

The victims of all of this will be the workers of Europe, who will see drastic reductions in their incomes and living standards to satisfy the demands of the financial markets.