Bailout or down and out?

Portugal and Cyprus wrestle with EU rescue conditions

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In April, Portugal's constitutional court decided to strike down four out of nine contested austerity measures approved in the government's budget for 2013. It rejected cuts of about seven per cent in pensioners' and civil servants' holiday bonuses, along with reductions in sick leave and unemployment benefits.

However, the court upheld other measures, such as a reduction in the number of tax brackets. Portugal has to make significant cuts under the terms of a bailout deal agreed with the European Union and the International Monetary Fund (IMF) in 2011.

According to Lino Torgal, Executive Partner at Portuguese law firm Sérvulo & Associados, both decisions came as a surprise. 'In an austerity environment, cuts for public servants and pensioners were expected as unavoidable,' he says. 'Similar measures were approved in other countries under an adjustment programme.'

The court removed a similar measure last year that would have introduced a cut of 14 per cent for pensioners and civil servants, and the perception was that the court would accept a reduction of seven per cent.

'There is an increasingly strong idea that austerity will not bring back the path to growth and the European institutions and partners, chief among which are Germany and other Northern European countries, must change policy to help southern countries grow,' Torgal says.

Luis Pais Antunes, a partner at Portuguese law firm PLMJ and former Secretary of State for Labour, says the immediate practical consequence of the ruling will be to place further limits on the government's freedom to manoeuvre. Lisbon will now be forced to bring forward austerity measures that had been planned for 2014.

Antunes argues that the EU's current strategy is too focused on finance at the expense of employment and investment. 'The financial problem has been brought under control in countries like Portugal and Ireland – our budgets are now much more balanced,' he says. 'However, the price being paid for this in terms of the economy, growth and employment are unsustainable for Portugal, as well as for the eurozone and for Europe as a whole.'

Antunes hopes for some reorientation in the EU's macroeconomic policy after the German elections. 'It does not have be a complete U-turn, just an adjustment to boost growth and employment,' he adds.

Cyprus 'singled out'

While the Portuguese were busy debating their ability to meet the terms of their bailout, Cypriots were struggling to come to terms with their own rescue package. The Cypriot bailout, agreed at a meeting of eurozone finance ministers in April, comes with a novel twist; of the €23bn needed, only €10bn will come from the EU and the IMF. The rest will come from Cyprus itself.

Much of this will come from savers at its ailing banks. Some individuals and organisations with more than €100,000 in their accounts could end up losing as much as 60 per cent of their savings.

Andreas Neocleous, Founder and Managing Partner of Cyprus's largest law firm, Andreas Neocleous & Co, believes northern European countries have singled Cyprus out for special treatment. 'There's been no question of a "solidarity levy" like this in any other bailout,' he says. 'It's not too strong to describe this expropriation of deposits as Orwellian.'

One of the arguments advanced for forcing Cyprus to partially fund its own bailout is the widespread belief that many account holders are Russian depositors engaged in money laundering. Neocleous believes that national interests are at play here, as Cyprus is not the only major EU portal for investment to and from Russia. There are several others, such as the Netherlands.

Institutions in that country, along with others in Germany, Malta and Switzerland, are now advertising themselves as a 'safe haven' for Russian funds, Neocleous says.

'The argument seems to be that all the money is dirty, therefore we are fair game,' he adds. 'Cyprus is a very small economy, and it didn't get the support it expected from the EU. This bailout is an extremely blunt instrument that tars every credit holder with the same brush.'

Leaving aside the rights and wrongs of the bailout deal, forcing a country of 850,000 people to come up with €13bn is going to be a major challenge. Rough estimates suggest this could amount to about €40,000 per household.

Lode van der Hende, a partner in the Brussels office of Herbert Smith Freehills, emphasises that EU problem-solving processes have always been 'unhappy' and 'clumsy'. The financial crisis has exposed the EU's 'less than ideal' institutional arrangements in recent years, he says.

One can't help wondering what the founding fathers of the European Union would have made of it all. The 1951 Treaty of Paris, which created the European Coal and Steel Community, spoke of 'the development of employment and the improvement of the standard of living in the participating countries' and 'avoiding the creation of fundamental and persistent disturbances in the economies of the Member States'. Many Europeans must feel this is the exact opposite of what the EU is doing right now.