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Portugal's Unnecessary Bailout

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PORTUGAL'S plea for help with its debts from the International Monetary Fund and the European Union last week should be a warning to democracies everywhere.

The crisis that began with the bailouts of Greece and Ireland last year has taken an ugly turn. However, this third national request for a bailout is not really about debt. Portugal had strong economic performance in the 1990s and was managing its recovery from the global recession better than several other countries in Europe, but it has come under unfair and arbitrary pressure from bond traders, speculators and credit rating analysts who, for short-sighted or ideological reasons, have now managed to drive out one democratically elected administration and potentially tie the hands of the next one.

If left unregulated, these market forces threaten to eclipse the capacity of democratic governments — perhaps even America's — to make their own choices about taxes and spending.

Portugal's difficulties admittedly resemble those of Greece and Ireland: for all three countries, adoption of the euro a decade ago meant they had to cede control over their monetary policy, and a sudden increase in the risk premiums that bond markets assigned to their sovereign debt was the immediate trigger for the bailout requests.

But in Greece and Ireland the verdict of the markets reflected deep and easily identifiable economic problems. Portugal's crisis is thoroughly different; there was not a genuine underlying crisis. The economic institutions and policies in Portugal that some financial analysts see as hopelessly flawed had achieved notable successes before this Iberian nation of 10 million was subjected to successive waves of attack by bond traders.

Market contagion and rating downgrades, starting when the magnitude of Greece's difficulties surfaced in early 2010, have become a self-fulfilling prophecy: by raising Portugal's borrowing costs to unsustainable levels, the rating agencies forced it to seek a bailout. The bailout has empowered those "rescuing" Portugal to push for unpopular austerity policies affecting recipients of student loans, retirement pensions, poverty relief and public salaries of all kinds.

The crisis is not of Portugal's doing. Its accumulated debt is well below the level of nations like Italy that have not been subject to such devastating assessments. Its budget deficit is lower than that of several other European countries and has been falling quickly as a result of government efforts.

And what of the country's growth prospects, which analysts conventionally assume to be dismal? In the first quarter of 2010, before markets pushed the interest rates on Portuguese bonds upward, the country had one of the best rates of economic recovery in the European Union. On a number of measures — industrial orders, entrepreneurial innovation, high-school achievement and export growth — Portugal has matched or even outpaced its neighbors in Southern and even Western Europe.

Why, then, has Portugal's debt been downgraded and its economy pushed to the brink? There are two possible explanations. One is ideological skepticism of Portugal's mixed-economy model, with its publicly supported loans to small businesses, alongside a few big state-owned companies and a robust welfare state. Market fundamentalists detest the Keynesian-style interventions in areas from Portugal's housing policy — which averted a bubble and preserved the availability of low-cost urban rentals — to its income assistance for the poor.

A lack of historical perspective is another explanation. Portuguese living standards increased greatly in the 25 years after the democratic revolution of April 1974. In the 1990s labor productivity increased rapidly, private enterprises deepened capital investment with help from the government, and parties from both the center-right and center-left supported increases in social spending. By the century's end the country had one of Europe's lowest unemployment rates.

In fairness, the optimism of the 1990s gave rise to economic imbalances and excessive spending; skeptics of Portugal's economic health point to its relative stagnation from 2000 to 2006. Even so, by the onset of the global financial crisis in 2007, the economy was again growing and joblessness was falling. The recession ended that recovery, but growth resumed in the second quarter of 2009, earlier than in other countries.

Domestic politics are not to blame. Prime Minister José Sócrates and the governing Socialists moved to cut the deficit while promoting competitiveness and maintaining social spending; the opposition insisted it could do better and forced out Mr. Sócrates this month, setting the stage for new elections in June. This is the stuff of normal politics, not a sign of disarray or incompetence as some critics of Portugal have portrayed it.

Could Europe have averted this bailout? The European Central Bank could have bought Portuguese bonds aggressively and headed off the latest panic. Regulation by the European Union and the United States of the process used by credit rating agencies to assess the creditworthiness of a country's debt is also essential. By distorting market perceptions of Portugal's stability, the rating agencies — whose role in fostering the subprime mortgage crisis in the United States has been amply documented — have undermined both its economic recovery and its political freedom.

In Portugal's fate there lies a clear warning for other countries, the United States included. Portugal's 1974 revolution inaugurated a wave of democratization that swept the globe. It is quite possible that 2011 will mark the start of a wave of encroachment on democracy by unregulated markets, with Spain, Italy or Belgium as the next potential victims.

Americans wouldn't much like it if international institutions tried to tell New York City, or any other American municipality, to jettison rent-control laws. But that is precisely the sort of interference now befalling Portugal — just as it has Ireland and Greece, though they bore more responsibility for their fate.

Only elected governments and their leaders can ensure that this crisis does not end up undermining democratic processes. So far they seem to have left everything up to the vagaries of bond markets and rating agencies.

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