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OPINION | COMMENTARY

A European Bailout That Worked?

Portugal's election campaign has lacked the fireworks of Greece or Spain, but also the noisy debates about the future of reforms.

By JOSEPH C. STERNBERG

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Lisbon

Entering into this weekend's parliamentary election, Portugal must look like a pretty dreamy place to many eurozone officials. Four years after suffering a sovereign-debt crisis and accepting a bailout, Lisbon has brought its budget under control and returned the economy to growth in accordance with the terms of its adjustment program.

Overall, it's been a smooth process. Not for the Portuguese the radical anti-austerity fireworks of Greece's Syriza or Spain's Podemos, or even the smoldering discontent of Ireland's Sinn Fein. Both of Portugal's major parties, the ruling center-right Social Democratic Party and the center-left Socialist Party, are committed to staying the course.

In many ways, Portugal is the perfect example of a eurozone bailout plan gone right—enough reform to stimulate growth but not enough to trigger anti-Europe political movements.

And that turns out to be Portugal's, and Europe's, problem. Witnessing a successful bailout program in action, it becomes clear that this is a plan designed to create an averagely dysfunctional eurozone economy, not some sort of Iberian tiger. After four years of bailout reforms, Portugal's reward is that it resembles France—not Greece, but also not Singapore or Chile—with the next crisis not averted, only punted off to the next political generation.

Which isn't to say the achievements of the bailout haven't been impressive. The centerpiece, a labor-reform bill passed in 2011, brought Portuguese rules into closer alignment with the rest of Europe, offering employers more flexibility to set working hours and to lay off workers. Lisbon has also steadily privatized in whole or in part a long list of entities including the postal service, an electric

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utility, a state-owned insurer and the flag carrier TAP Portugal.

The revenue from these sales, coupled with increases in the value-added tax and surcharges on the personal income tax, has reduced the government's deficit to 2.8% of gross domestic product by next year from 7.4% in 2011. In 2013, the government announced a plan to cut the corporate tax rate to 17% by next year from 25%.

These reforms exceed anything most other nonbailout European economies have managed in recent years. That helps to account for the economy's return to growth, which hit 1.5% year-on-year in the second quarter, ahead of the eurozone average of 1.2%.

Yet despite its bolder measures, Lisbon also has shown the political limits to reform even in the midst of a crisis. That marquee labor reform was achieved via consensus with the country's major unions, which reduced protests but also precluded any attempt to liberalize the workforce beyond Europe's heavily regulated norm.

Fiscal sanity has been achieved mainly via tax increases, not spending cuts. This has shifted most of the burden of fiscal adjustment to the productive private economy while shielding what remains a bloated public sector. Attempts to restrain spending through pension reductions and pay cuts for civil servants were rebuffed by the constitutional court in 2013.

Other reform efforts are stalling, particularly judicial reforms that would shorten the length of legal proceedings. Protracted lawsuits add uncertainty and weigh on Portugal's competitiveness rankings.

By sidestepping many of the reforms that typically inflame political passions, Lisbon gets to enjoy a quiet election this weekend. But the price of this peace is the perpetuation of a two-track economy. Exporters, who have always faced competitive pressures abroad and, as a result, have long been forced to be more efficient and better prepared to cope with a downturn, continue to prosper. Domestic-facing firms, having only been partially freed from suffocating

regulatory burdens, continue to struggle.

So a quiet election isn't such a good thing. Portugal needs a noisy debate on how it's going to attract significant investment to boost the lagging parts of its economy. That would require a new round of policy reforms, especially on matters such as excessive business-licensure requirements at the local level.

It's also going to require deeper fiscal reforms that finally get a grip on spending to stave off the next crisis. The public debt still is 130% of GDP, the government still is running a deficit, and the current growth rate won't be sufficient to improve the debt ratio on its own. And this is before accounting for the fiscal drag of a largely unreformed public pension system in a country with a rapidly aging population and with millions of its young people fleeing to Britain, Germany and elsewhere in search of job opportunities.

The politicians have generally avoided such topics in this campaign. Prime Minister Pedro Passos Coelho implemented the reforms and recognizes the need for more. He did, after all, push for pay and pension revamps. But voters are exhausted with reform, and the politicians aren't eager to ask the electorate to countenance more.

That's not to diminish the political victory of having persuaded voters that the program has been necessary. The two main signs of Mr. Coehlo's success here are that he's likely to be re-elected, with recent polls putting his party at between 38% and 41% support compared to 28% to 34% for the Socialists. And his opponent, Antonio Costa, isn't threatening to overturn the reforms, instead suggesting only small, albeit fiscally unsustainable, tweaks to spending and taxes.

Portuguese politicians and voters alike are showing a lot more intelligence in this regard than many Greek and some Spanish voters. But one can't help but wish this election were offering a more substantial—and exciting—debate about Portugal's next steps.

Mr. Sternberg is editorial-page editor of The Wall Street Journal Europe.

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