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Lisbon’s dilemma

Mario Draghi, European Central Bank president, was in Germany on Tuesday to plead for decisive government action to back his bold efforts to stabilise the euro. But a few thousand kilometres away, Portugal serves as a reminder of the severe constraints facing politicians across Europe.

Pedro Passos Coelho, Portugal’s prime minister, was forced into an embarrassing retreat over a plan to shift social security payments from employers to employees. Hundreds of thousands of workers took to the streets last week, many claiming that the government was “robbing workers to pay their bosses”.

The government plan was far from perfect. Since the beginning of the crisis, Portuguese workers have had to swallow significant cuts in their take-home pay. Targeting their wages once again was not only bound to be politically toxic. It also risked depressing consumer spending, worsening the recessionary spiral Portugal has fallen into.

Nevertheless, the government’s attempt to lower employers’ social security payments is a laudable one. Its immediate result would be to make Portugal more competitive on the international market. While unit labour costs have started to fall since the beginning of the crisis, they remain too high. Boosting exports is the only realistic way Portugal has to raise its long-term rate of growth.

Ideally the government will now find a better way to fund this necessary measure. Raising property taxes would have the advantage of not affecting people’s incentives to work. Increasing the top rate of income tax would spread the cost of reform more fairly across society. What Lisbon should not do, however, is scale back the ambition of its plan. Job creation will be boosted only if the social security burden on companies is cut significantly.

The next step should be for the government to push ahead with other growth-enhancing reforms. The measures it has introduced to make its labour market more flexible were among the most effective in the eurozone periphery. However, progress on fostering more competition in its network industries, such as energy and telecoms, has been too slow.

The Portuguese government faces its hardest test so far. As discontent grows among the long-suffering population, it will become increasingly difficult to make the case for economic reform. But finding a way to walk this tightrope is the only way forward for Portugal.

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