The Ongoing Portuguese Debt Crisis

New year, new crisis. For the beleaguered, once-independent nations of Europe now entangled in the eurozone, the economic drama unfolding in Portugal this week looks woefully familiar. According to the latest speculations in the financial press, the Portuguese government is now under pressure from other European governments to accept a bailout from the EU, much like what happened with Ireland last fall. As with Ireland, Portugal is now denying the need for any bailout, insisting that she can solve her own problems with spending cuts, tax hikes, and other budgetary modifications.

Bond investors were spooked over the weekend by a spike in Portuguese bond yields, which soared briefly to above 7 percent — a rate of return that would certainly force the Portuguese government into default. All eyes are now on this Wednesday's sale of 3- and 9-year Portuguese bonds, for which Lisbon must find buyers if it to finance $26 billion in public accounts this year.

We've seen this dreary pageant already, with Iceland, Greece, and Ireland, as the EU's financial führers continue to kick the can further and further down the road to continental insolvency, hoping that monetary sleight of hand from the European Central Bank (ECB) can postpone the evil day indefinitely. What the Europeans are hoping to avert — yet again — is dreaded "contagion," whereby the problems of smaller economies like those of Greece and Portugal spill over into larger ones, like Spain and Italy. Portugal, after all, only accounts for about 2 percent of the EU's economic output, whereas Spain's economy amounts to a whopping ten percent of the European whole.The truth is that the entire eurozone is insolvent, and that "contagion" is not some perceptual nuance that can be staved off by careful propaganda and a couple of bailouts. It is actually the slowly-unfolding realization that, in the not-so-long run, many of the governments in Europe, including several linked to very large economies (Spain and Italy) simply will not be able to honor their obligations to debt holders, and the rest of the eurozone — indeed, the world — does not have the funds to bail them out. The result will be large scale default on all kinds of debt and a worldwide financial earthquake that will dwarf the panic of fall 2008.

In the meantime, the Portuguese, the Spanish, and the rest of Europe are still desperately hoping that somehow, this time around, the laws of economics will somehow fail to apply, and what has become dizzying downward spiral of more and more debt to finance existing debt will be magically transformed into a miracle of economic growth and solvency. The Chinese government, ever eager to take advantage of fiscal weakness in Western countries, has already purchased Greek and Spanish debt, and may be poised to do the same for Portugal. The ECB has apparently been buying up Portuguese bonds in attempt to drive down the yield.

But in the end, market forces, embodied by the purchasers of European government debt, will determine the fate of the eurozone and the economies that it holds captive. The tipping point will probably be the implosion of an economy, like Spain's, that the rest of the world is unwilling and unable to rescue.

In the near term, Wednesday's bond sale could be a major event, because it could have a significant impact on Thursday, when Spain and Portugal attempt bond sales of their own. Should bond purchasers get cold feet, next week's meeting in Brussels of eurozone finance ministers could be carried out in an economic tempest.

The world's financial elites are well aware what is at stake. As the AP's Barry Hatton and Pan Pylas pointed out Monday, "The prevailing view in the markets is that Europe may be able to support Portugal but that a bailout of Spain would test the limits of the existing bailout fund, potentially putting the euro project itself in jeopardy if governments don't put up more cash."

And looming beyond the potential collapse of the euro and even the European Union itself, there is another, even larger debtor nation caught in the same spiral of heaping new debt upon old, a nation whose government has lived beyond its means for decades while expecting the rest of the world to be its creditor. But will the United States learn from the European debacle, or will we continue unrepentantly robbing Peter to pay Paul, and hoping – as Greece, Ireland, Portugal, Spain, and the rest of Europe have done – that the day of reckoning will never come?

Photo: Bank of Portugal