



Portugal after the Adjustment Program: What's Left to Do?

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Overview

➤ **What's left to do? A macro perspective**

- Challenge #1: Creating jobs to absorb labor slack
- Challenge #2: Breaking Portugal's fiscal deficit "sound barrier" (3%)
- External tail winds (oil, euro, and yields) should help

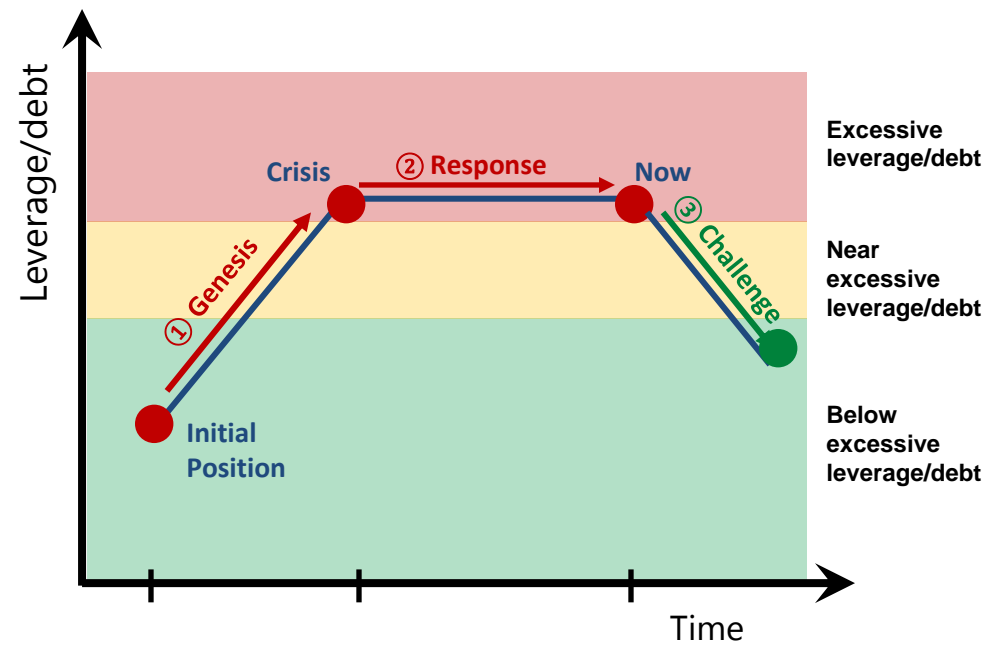
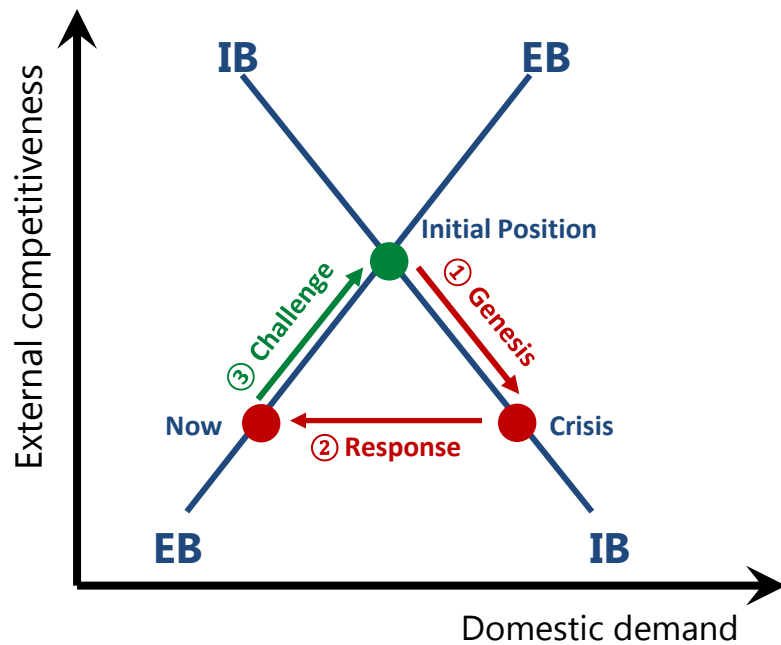
➤ **What's left to do? A firm-level perspective**

- Need more high-performing (\approx exporting) firms
- Effectiveness of structural reforms: What do firms think?
- Managerial skills: The ultimate structural bottleneck?

➤ **Summing up**

Macroeconomic dash board (very stylized)

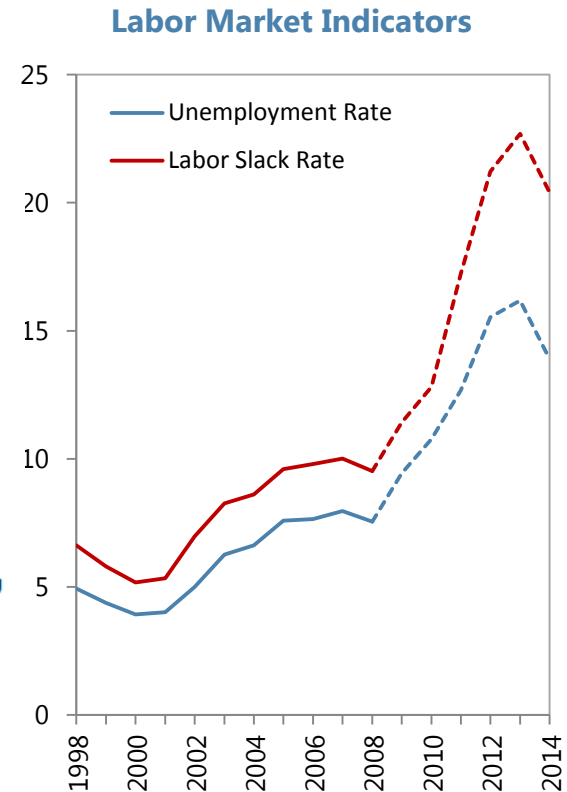
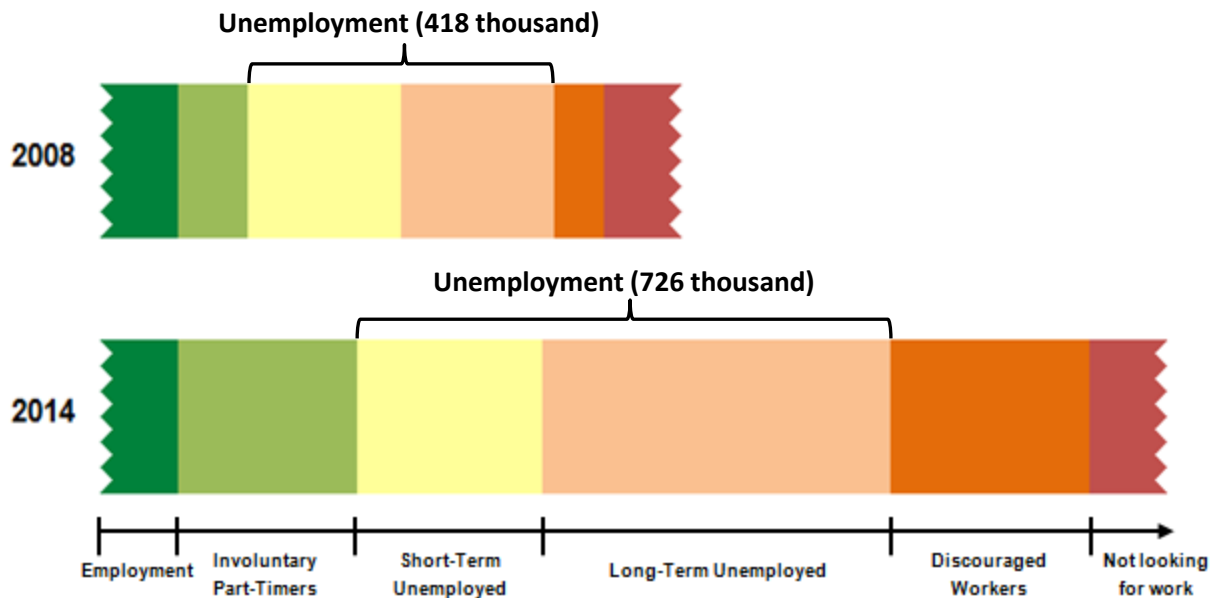
What caused the crisis? What was response? What's left to do?



- Genesis of crisis: Since the mid-1990s, 15 years of very large external deficits (economy off EB curve). Misallocation of foreign savings . Leverage in private sector and public debt rose to excessive levels.
- Crisis response: Adjustment program restored external balance and stabilized leverage/public debt levels at excessive levels. Internal imbalance opened up (economy off IB curve).
- Left to do: Macro challenge #1 is to restore internal balance (= create jobs) without re-opening external imbalance. Macro challenge #2 is to complete fiscal consolidation, bringing fiscal deficit durably below 3%.

Challenge #1: Absorbing labor slack

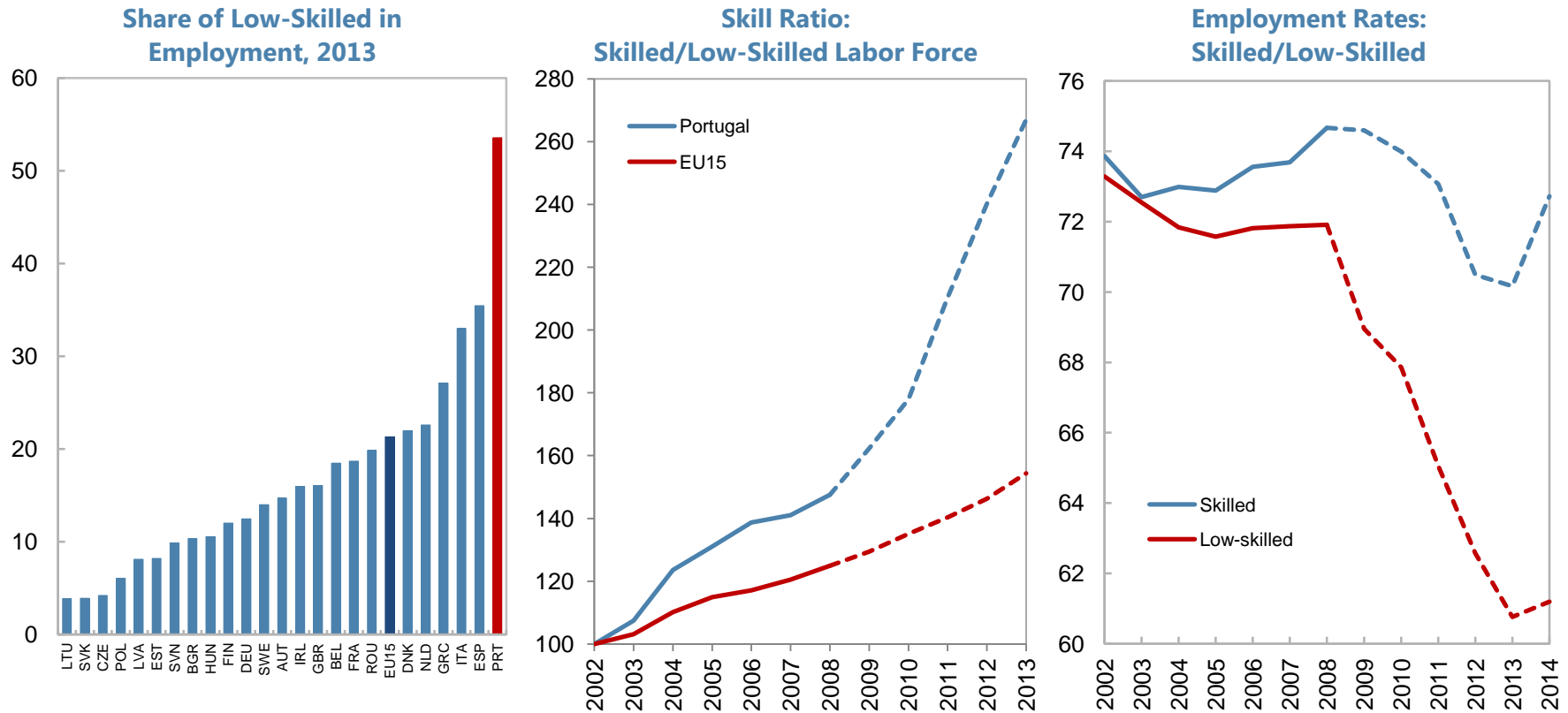
Sizing up Portugal's labor slack problem



- Different degrees of attachment to labor market.
- Since 2010, rise in involuntary part-time and discouraged workers.
- Labor slack rate adjusts unemployment rate to reflect this (chart).
- But labor slack rate ignores outward migration (= more slack).

Challenge #1: Absorbing labor slack

Sizing up Portugal's skilled/low-skilled worker problem



- Share of low-skilled in employment in Portugal still very high.
- But the supply of skilled relative to low-skilled workers is increasing rapidly.
- Employment rate of the low-skilled fell sharply since 2008; little recovery during 2013-14.

Challenge #1: Absorbing labor slack

A four-handed approach

Labor demand

- (1) Need faster-than-projected GDP growth to reduce labor slack
- (2) Need shift of labor demand toward the lower-skilled

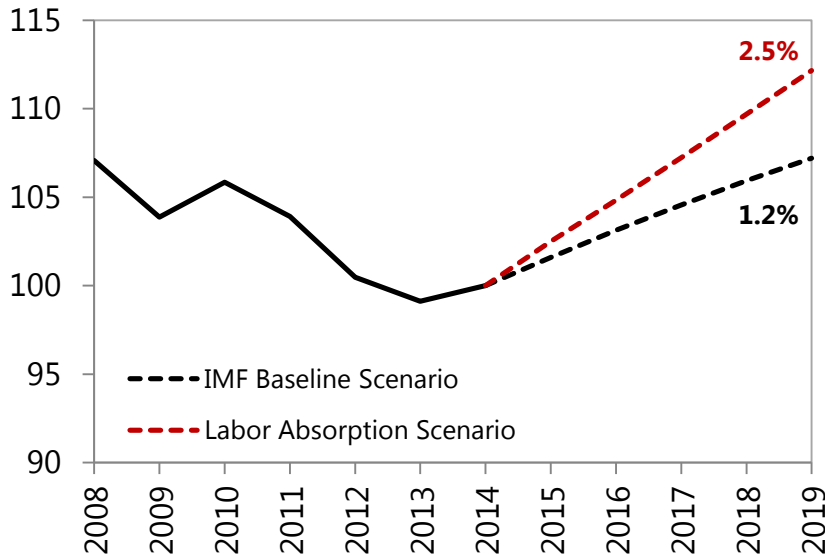
Labor supply

- (3) Need education and training to promote relevant skills
- (4) Need to keep low-skilled workers attached to labor market

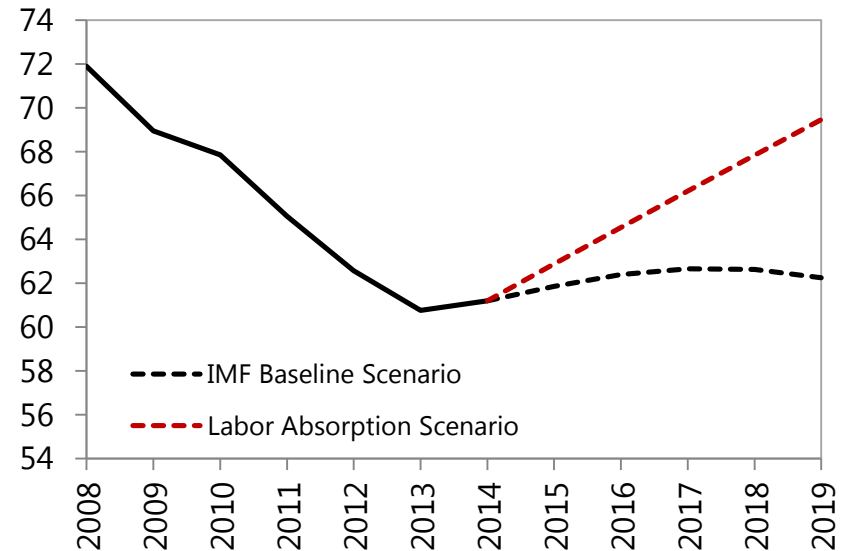
Challenge #1: Absorbing labor slack

Medium-term scenarios

Real GDP (Index 2014 = 100)



Low-Skilled Employment Rate (Percent)

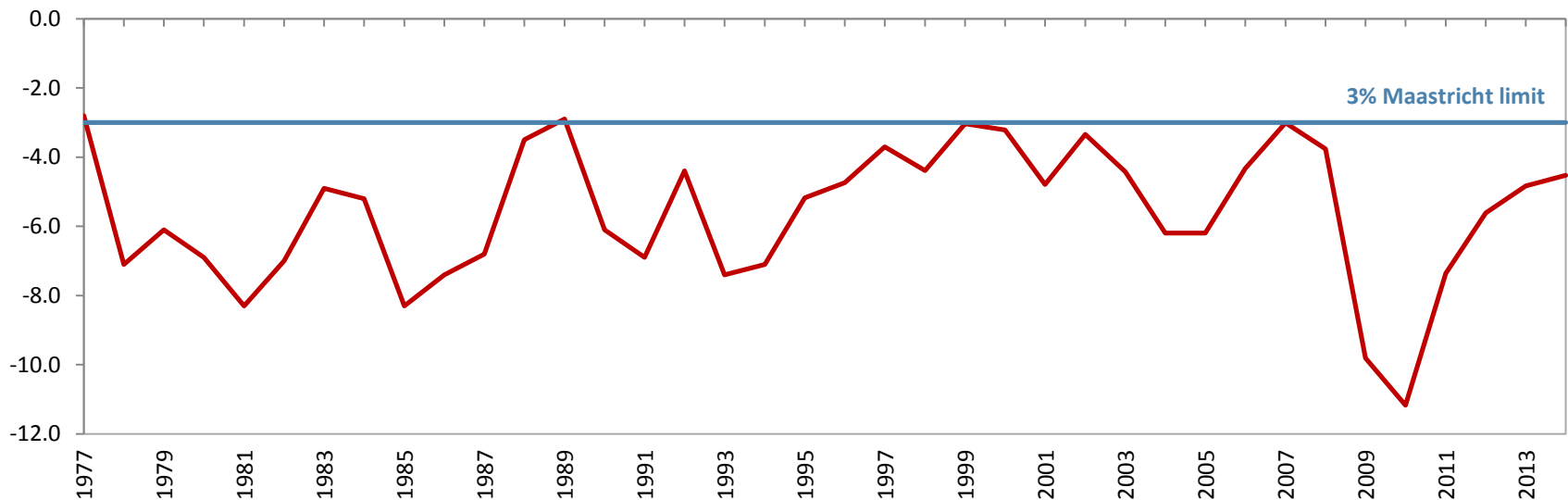


- (1) Labor demand: Faster medium-term GDP growth needed to create jobs.
- (2) Labor demand: Use active labor market policies and caution on minimum wage increases.
- (3) Labor supply: Continue reforms to improve secondary education and vocational training.
- (4) Labor supply: More inclusive unemployment support system that mitigates inactivity traps.

Finding cooperative policy solutions: Special responsibility of social partners; need more inclusive and transparent social dialogue.

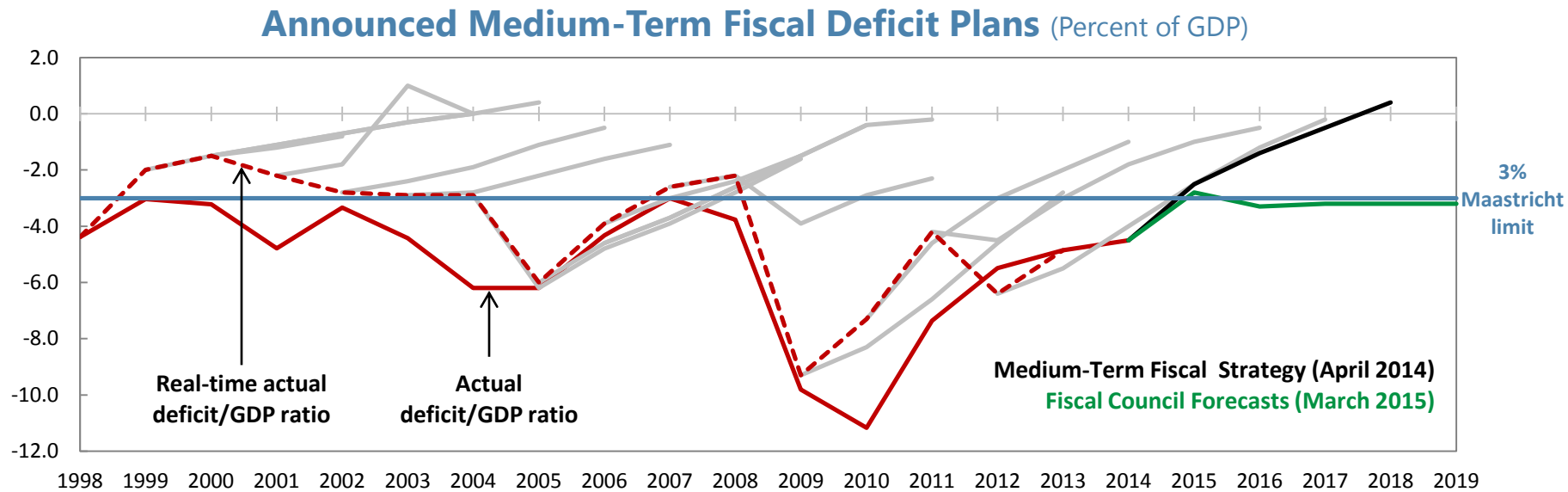
Challenge #2: Breaking Portugal's fiscal deficit "sound barrier"

General Government Balance (percent of GDP)



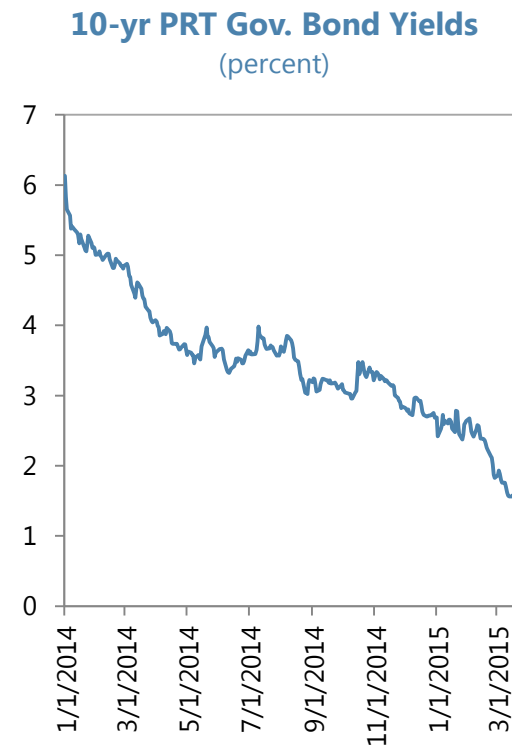
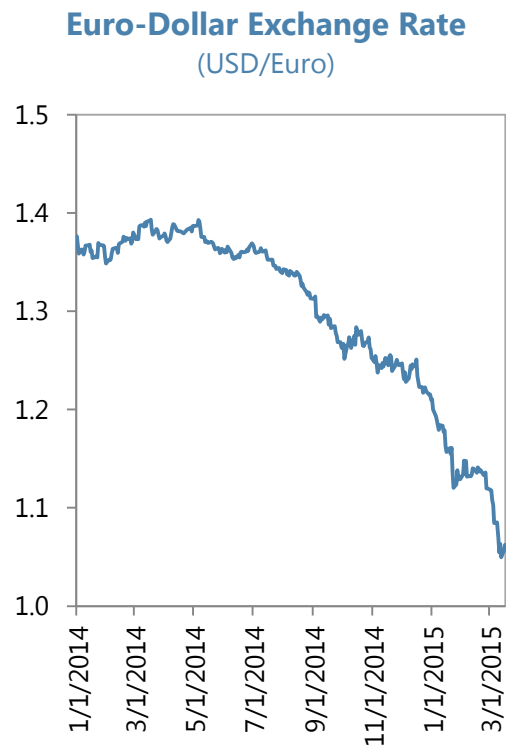
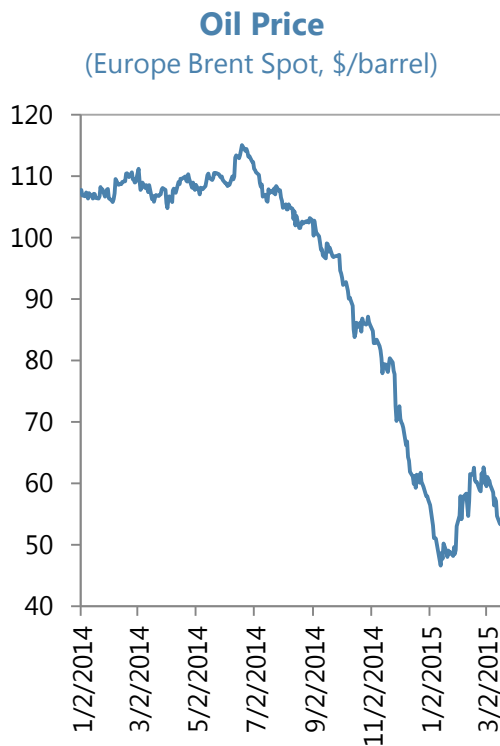
- What's a sound barrier? The point near the speed of sound when airplanes undergo abruptly increasing drag force. Until the 1940s, this drag prevented airplanes from breaking the sound barrier.
- For the last 40 years, Portuguese fiscal policy never managed to break through the 3% fiscal deficit limit established by Maastricht Treaty (chart).
- The adjustment program sought to put in place a more robust fiscal policy apparatus to overcome the "drag forces" once the fiscal deficit approaches 3%.

Challenge #2: Breaking Portugal's fiscal deficit sound barrier



- Since euro adoption, all announced medium-term fiscal plans promised to crack the 3% limit.
- This time should be different. Sustainability of public debt, credibility of fiscal policy, and EU fiscal rules all argue for overcoming political and institutional drag forces.
- But, with no further policy measures, Fiscal Council projects deficits above 3% for 2016-19.
- Dutch lesson on counteracting drag forces: Political parties in the Netherland present transparent and specific fiscal plans before elections, and the consistency and realism of these plans is part of the pre-election debates.

A favorable external setting for addressing these macro challenges: Oil price, euro, and yields



- An unexpected window of opportunity for policy makers.
- Will go some way in addressing the external competitiveness challenge for now.
- But these fair winds may not last and could turn into headwinds.

Firm-level perspective: Who exports?

Tradable sectors vs. high-performing firms

- **Old (sector-based) view:**

Tradable sectors



Exporters

Non-tradable sectors



Non-exporters

To increase exports, policies need to shift resources from non-tradable to tradable sectors (independently of firms).

- **New (firm-based) view:**

High-performing firms



Exporters

Low-performing firms



Non-exporters

To increase exports, policies need to shift resources from low- to high-performing firms (independently of sectors).

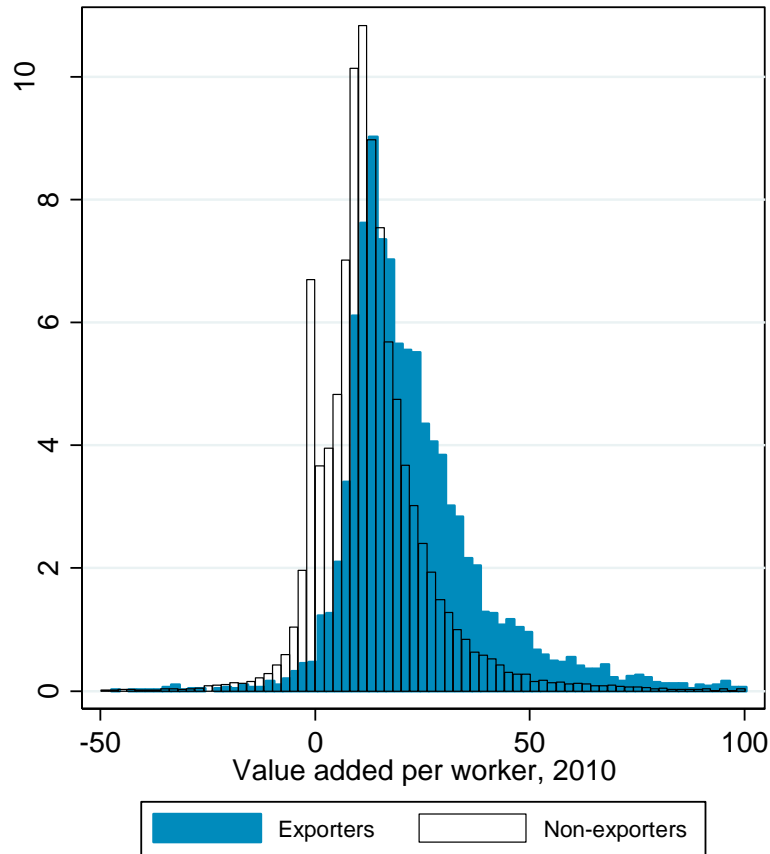
Firm-level perspective: Do non-tradable sectors export?

Austria and Portugal: Exports-to-Total-Supply Ratios (percent)

		Austria 1964	Austria 2011	Portugal 2011
Tradable Sectors	Agriculture	2.8	8.3	7.6
	Mining	20.6	10.8	7.2
	Food	2.3	33.0	15.4
	Textiles	15.8	33.6	40.7
	Wood	25.8	39.2	33.1
	Paper	20.8	48.8	41.8
	Chemicals	14.8	44.3	23.6
	Petroleum	2.0	17.2	17.7
	Non-metalic products	11.3	27.9	27.3
	Basic metals	28.3	42.2	22.9
	Other industry	18.5	44.9	30.1
	Energy	10.6	8.0	1.8
	Total	14.5	35.2	31.8
Non-tradable Sectors	Construction	0.3	1.2	0.0
	Trade	3.0	16.4	4.9
	Accommodation	0.0	9.4	3.8
	Transportation	5.1	25.0	29.7
	Financial services	1.1	14.3	3.3
	Other services	2.6	11.5	7.1
	Public services	0.0	0.5	0.0
	Total	1.7	10.7	5.8
Total all sectors	9.2	20.9	12.4	

- Some 50 years ago, a clear-cut distinction between tradable and non-tradable sectors (example: Austria 1964).
- Nowadays, firms in both tradable and non-tradable sectors tend to export (example: Austria and Portugal 2011).

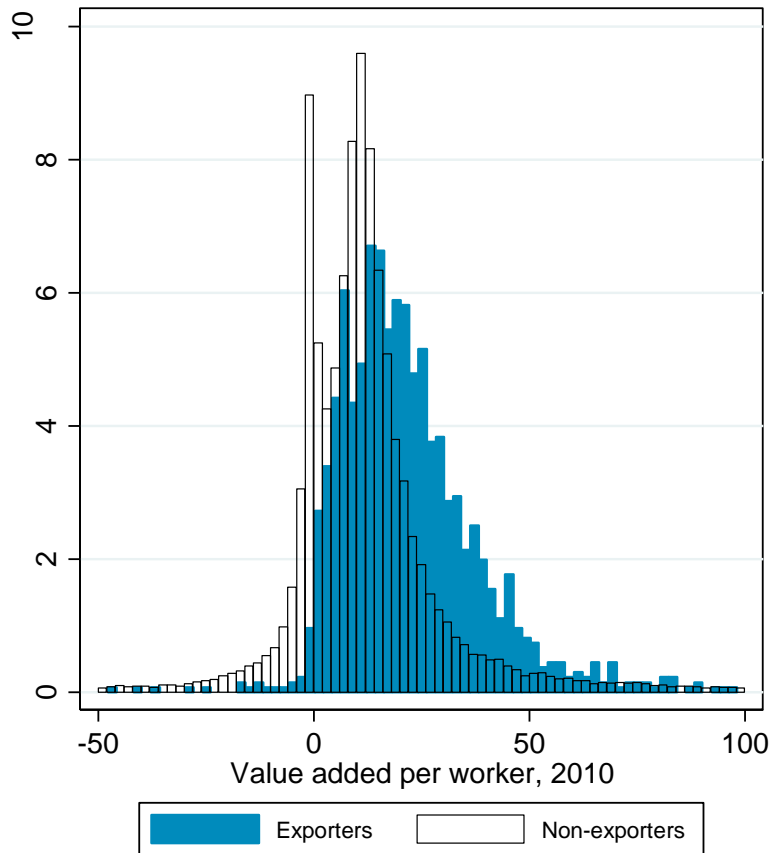
Firm-level perspective: What can we learn from Portuguese manufacturing firms?



	Exporters	Non-exporters
Number of firms	5,010	34,388
Workers per firm	61.2	9.9
Value added per worker	34,584	20,564
ROE	10.2	1.9
Debt/EBITDA	6.7	10.4

- In 2010, only about 13% of all manufacturing firms were exporters (INE definition).
- And firms that exported were bigger, more productive, more profitable, and less leveraged than non-exporting firm. They tended to be “high-performing” firms.

Firm-level perspective: What can we learn from Portuguese construction firms?



	Exporters	Non-exporters
Number of firms	1,376	45,110
Workers per firm	47.0	6.6
Value added per worker	31,698	20,198
ROE	15.0	0.6
Debt/EBITDA	9.2	24.8

- In 2010, while only about 3% of construction firms exported, those firms were also bigger, more productive, and had better financial fundamentals than non-exporters. They also tended to be “high-performing” firms.

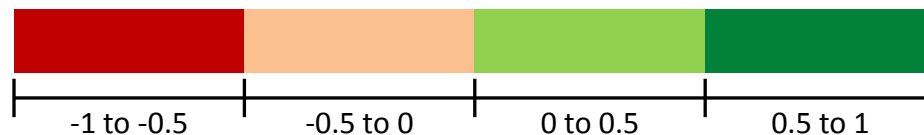
Firm-level perspective: Firms' views about the adjustment program's structural reforms

Design of the survey:

- Sample size: about 500 firms (response rate 17.4%).
- Questions on 34 structural reform areas. For example, regarding reforms of hiring and firing costs:

	Impacto				Necessidade de efetuar mais reformas			
	Nenhum	Pouco	Significativo	N/A	Nenhuma	Importante	Urgente	N/A
	1	2	3		1	2	3	
Custos de admissão e despedimento. Por exemplo: novas regras para despedimento individual; novas regras de compensação por cessação de trabalho. *	●	●	●	●	●	●	●	●

- Scores were normalized to the range -1 to 1, where **-1** means no impact or urgent need; **0** means some impact or need; and **1** means significant impact or no need.
- A color code was assigned based on four uniformly spaced intervals, as follows:



A firm-level perspective: Perceived impact/urgency of product market reforms

Product market reforms	Perceived impact of reforms		Perceived urgency of more reforms	
	Exporters	Non-exporters	Exporters	Non-exporters
Licensing environment	-0.02	0.00	-0.33	-0.05
Energy costs	0.06	-0.14	-0.41	-0.14
Cost of telecommunication and postal services	-0.11	-0.14	-0.06	0.21
Cost of road use	-0.16	0.19	-0.46	-0.23
Cost of using railways	-0.23	-0.50	-0.42	0.00
Cost of using ports	0.06	-0.24	-0.27	-0.29
Cost of professional services	-0.26	-0.30	0.00	0.11
Cost of other services	-0.38	-0.30	0.15	0.00
Enforcement of competition	-0.22	-0.24	-0.38	-0.08

- Product market reforms are generally perceived as having had low impacts on firms' competitiveness (example: cost of railways and costs of services).
- Non-exporting firms generally see little need for more reforms. But exporters see need for significantly more reform efforts (examples: energy, roads, railways, and enforcement of competition).

A firm-level perspective: Perceived impact/urgency of labor market reforms

Labor market reforms	Perceived impact of reforms		Perceived urgency of more reforms	
	Exporters	Non-exporters	Exporters	Non-exporters
Increases in work time	0.24	0.00	0.11	0.45
Increases in work time flexibility	0.54	0.24	-0.31	-0.10
Collective bargaining	0.15	-0.18	-0.30	0.19
Hiring and firing costs	0.38	0.29	-0.42	-0.26
Active labor market policies	0.27	0.19	-0.33	-0.13
Effectiveness of employment agencies	0.13	0.08	-0.37	-0.08

- Labor market reforms are generally seen as having had significantly more impact on firms' competitiveness than product market reforms, especially by exporting firms (example: work time flexibility).
- Non-exporters again see little urgency for more reforms, while exporters express a sense of more urgency (examples: hiring and firing costs and effectiveness of employment agencies).

A firm-level perspective: Perceived impact/urgency of public sector reforms

Public sector reforms	Perceived impact of reforms		Perceived urgency of more reforms	
	Exporters	Non-exporters	Exporters	Non-exporters
Effectiveness of central administration	0.21	0.07	-0.62	-0.50
Effectiveness of local administrations	0.08	0.04	-0.47	-0.56
Cost of paying taxes	0.55	0.50	-0.42	-0.04
Effectiveness of VAT refund	0.28	-0.04	-0.33	0.04
Investment incentives	0.45	0.00	-0.53	-0.26
Payment on time by central administration	0.10	0.15	-0.58	-0.52
Payment on time by local administrations	0.15	-0.04	-0.62	-0.56
Payment on time by SOEs	0.07	0.09	-0.64	-0.75
Quality of services provided by SOEs	0.00	-0.10	-0.54	-0.39
Privatization program	0.11	0.04	-0.13	0.19
Effectiveness of labor courts	-0.08	-0.09	-0.62	-0.41
Effectiveness of tax courts	0.06	-0.14	-0.63	-0.30
Effectiveness of civil and commercial courts	-0.02	0.17	-0.60	-0.35
Effectiveness of alternatives to litigation	0.11	-0.04	-0.63	-0.63

- Most public sector reforms are seen as having had some impact. Exporters are generally more positive on impact of reforms (examples: cost of paying taxes, investment incentives).
- But there is a strong perceived need for much more reform efforts in most areas, a view especially strongly held by exporting firms (examples: increasing the effectiveness of both public administrations and the justice system; paying bills on time).

A firm-level perspective: Perceived impact/urgency of financial sector reforms

Financial sector and insolvency reforms	Perceived impact of reforms		Perceived urgency of more reforms	
	Exporters	Non-exporters	Exporters	Non-exporters
Efficiency of insolvency framework	0.15	-0.04	-0.56	-0.41
Debt restructuring framework (PER)	0.18	-0.17	-0.38	-0.29
Out-of-court debt restructuring framework (SIREVE)	-0.02	-0.27	-0.29	-0.21
Provision of alternative financing options	0.35	0.19	-0.39	-0.42
Efficiency of credit allocation by banks	0.30	0.31	-0.63	-0.54

- Firms generally perceive some positive impacts of reforms, a view more strongly expressed by exporting firms (example: alternative financing options).
- But like in the case of the public sector, firms generally see urgent needs for more reform efforts (examples: efficiency of credit allocation by banks; efficiency of insolvency framework).

A firm-level perspective: Managerial skills

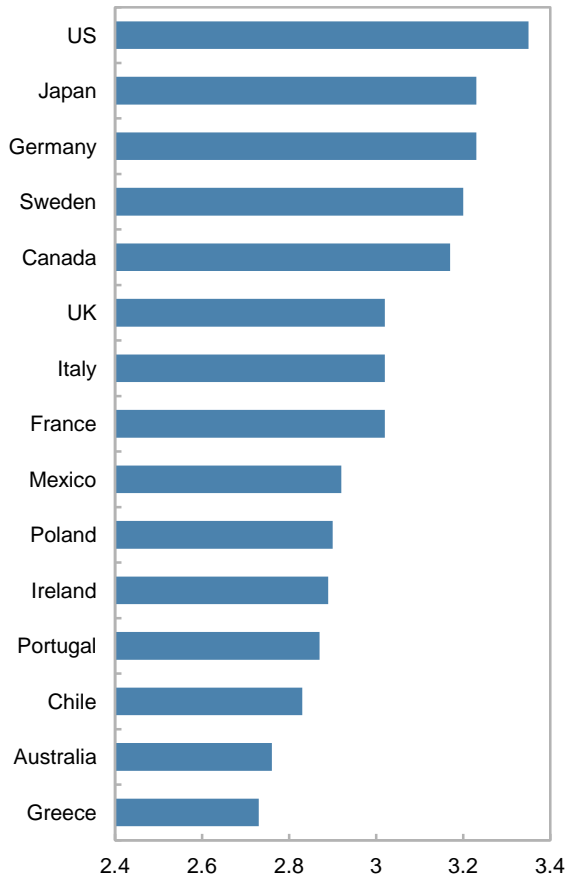
The ultimate structural bottleneck?

- Cross-country data base (Bloom and Van Reenen); includes about 200 Portuguese manufacturing firms (>50 employees).
- Factors explaining low managerial skills across countries:
 - low product market competition;
 - family ownership;
 - regulations restricting management practices;
 - and informational barriers.
- Low managerial skills and structural rigidities: Could they interact?
 - For example, across countries, low human resource management skills in firms associated with restrictive employment protection regulations (see chart next slide).
 - If low managerial skills lead to sub-par economic performance, problem of identifying causality between structural rigidities and economic performance.
- What can Portuguese policy makers do?
 - “Irish solution”: Attract more FDI and expatriate managerial skills
 - “US solution”: Use product-marked competition to eliminate tail of badly managed firms and to push incumbents to improve managerial practices
 - “Back to school solution”: use well-designed training programs (for example “SME MBAs”) to overcome informational barriers.

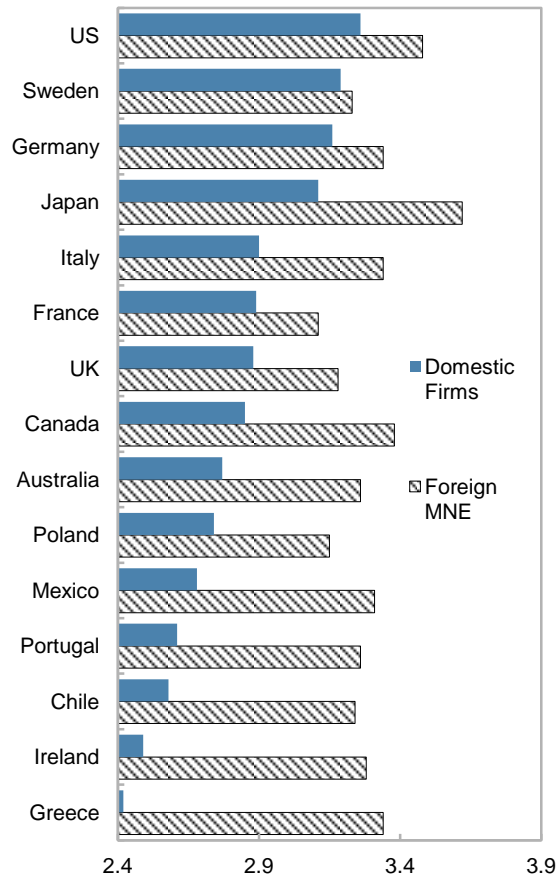
A firm-level perspective: Managerial skills

The ultimate structural bottleneck?

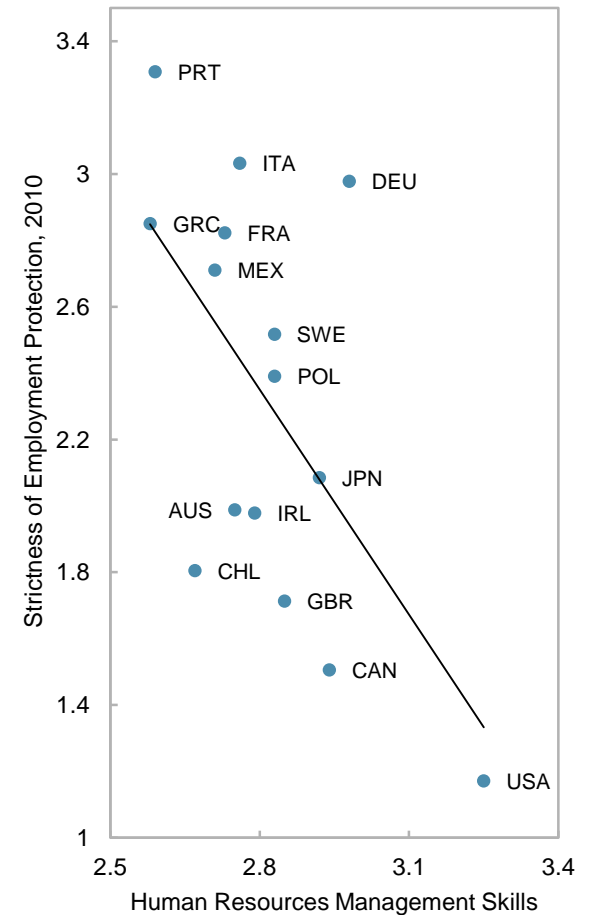
Management Skills Scores



Management Skills Scores of Multinationals and Domestic Firms



Human Resources Management Skills and Strictness of Employment Protection



Summing Up

- The adjustment program managed to stabilize a severely unbalanced economy.
- Macro challenge #1 is to absorb labor slack by creating jobs, especially for the low-skilled.
- Macro challenge #2 is to put public finances on a sustainable basis.
- From a firm-level perspective, the challenge is to create an environment that allows more high-performing (\approx export) firms to emerge.
- Firm survey points in particular to revisit and step up public and financial sector reforms.
- Lack of managerial skills could constitute a key structural bottleneck, particularly among SMEs.

Thank you!