OECD

OECD ECONOMIC SURVEYS

PORTUGAL

1996

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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BASIC STATISTICS OF PORTUGAL

THE LAND

Area (thousand sq. km)	92.0	Major cities, resident population in thousands (1992):	
		Greater Lisbon	2 048
		Greater Porto	1 652

THE PEOPLE

Population (1995, thousands)	9 900	Civilian employment (1995, thousands)	4 225
Number of inhabitants per sq. km	107	As a percentage of total:	
Civilian labour force (1995, thousands)	4 551	Agriculture	11.8
		Industry	32.1
		Services	56.1

PRODUCTION

Gross domestic production in 1995 (million of US$[1])	127 126	Gross domestic product at factor cost by origin (1993, per cent of total)	
Gross domestic product per head in 1995 (US$[1])	12 841	Agriculture	5.8
Gross fixed asset formation in 1995:		Industry	37.8
Per head of GDP	25.7	Services	56.4
Per head (US$[1])	3 300		

THE GOVERNMENT

Public consumption 1995, per cent of GDP	17.7	Composition of Parliament (number of seats):	
Public investment 1995, per cent of GDP	4.8	Social Democrats (PSD)	88
(Per cent of total investment)	18.6	Socialists (PS)	112
General Government current revenue, 1995, per cent of GDP	38.1	Communist Party (PCP)	15
		Centre Social Democrats (CDS)	15

FOREIGN TRADE

Exports of goods and services 1994, per cent of GDP	21.1	Imports of goods and services 1994, per cent of GDP	28.9
Main exports as a percentage of commodities exports, 1993 (SITC):		Main imports as a percentage of commodities exports, 1993 (SITC):	
Food, beverages and tobacco (0, 1)	6.8	Food, beverages and tobacco (0, 1)	12.3
Basic and semi-finished materials (2, 3, 4)	9.6	Basic and semi-finished materials (2, 3, 4)	13.6
Manufactured goods (5, 6, 7, 8)	83.5	Manufactured goods (5, 6, 7, 8)	74.1
of which:		*of which*:	
Chemicals (5)	4.4	Chemicals (5)	9.7
Machinery and transport equipment (7)	21.1	Machinery and transport equipment (7)	35.8

THE CURRENCY

Monetary unit: Escudo	Currency units per US$, average of daily figures:	
	Year 1995	149.9
	April 1996	154.4

1. Data converted to US$ using PPPs.

This Survey is based on the Secretariat's study prepared for the annual review of Portugal by the Economic and Development Review Committee on 28th May 1996.

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After revisions in the light of discussions during the review, final approval of the Survey for publication was given by the Committee on 13th June 1996.

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The previous Survey of Portugal was issued in June 1995.

Introduction

The past year has seen further progress with respect to reduction of inflation and interest rates, but a less satisfactory performance of growth and employment. A combination of wage moderation and productivity gains has helped to contain unit labour costs, allowing the inflation differential relative to the EU average to shrink to a historical low of 0.5 points in the spring of 1996. Progress on the inflation front, assisted by a trend towards lower budget deficits, has resulted in a narrowing of Portuguese interest rate differentials *vis-à-vis* the core European economies, with the prospects for further convergence being relatively good. But GDP growth was a rather moderate 2.5 per cent for 1995 as a whole. Having gathered strength early in the year, as elsewhere in Europe, activity fell off in the second half and is estimated to have remained weak in the first part of 1996. While the slowdown has involved the domestic components of demand, particularly investment, the original source of the weakness seems to have been lower export demand. A recovery in this sector should allow real GDP to pick up later in the year, to a rate of around 2¾ per cent in 1997. But this rate of expansion is unlikely to reduce the unemployment rate, which has risen to over 7 per cent.

Following several years in which the growth of the economy was rapid enough to narrow the gap in living standards with the rest of Europe, the real-income convergence process appears to have stalled. Since the onset of the recession the gap between Portuguese and EU unemployment, although remaining considerable, has narrowed, while economic growth has been slower. The combination of macro-economic and structural policy responses needed to deal with this predicament poses important challenges to policy-makers. On the one hand, the effects of macroeconomic policy consistency are beginning to come through in greater financial market credibility and lower interest rates, reinforcing the traditional strength of wage flexibility. In this sense, given further consolidation, many of the fundamentals required for sustainable recovery remain in place.

But the economy is operating in a structurally different and internationally more competitive environment, and its traditional wage flexibility may be insufficient on its own to bring unemployment down while also meeting distributional goals. To achieve real income convergence and prevent the increase in unemployment from becoming structural, policy initiatives need to be considered across a wide field, including, in particular, taxation, education policy and product-market competition.

The *Survey* begins with a description of recent trends, with particular reference to the reasons for the growth pause and the prospects for a resumption of the expansion. Chapter II analyses the convergence process from the point of view of interest rate trends and the fiscal consolidation needed to achieve the Maastricht criteria. Chapter III discusses the need for reform of social security, especially the public pension system, both from the point of view of containing the expansion of public debt, and reducing the future burden of non-wage labour costs on the working population. Impediments to employment growth and the policy response to prevent unemployment becoming structural are analysed in Chapter IV, which elaborates a broad programme of reforms for Portugal in the light of the requirements of the OECD *Jobs Study*. This covers not just the labour market *per se* but also initiatives to improve human capital, enhance competition and reduce the burden of taxation. The *Survey* closes with conclusions presenting key points together with policy recommendations.

I. Recent Developments and Prospects

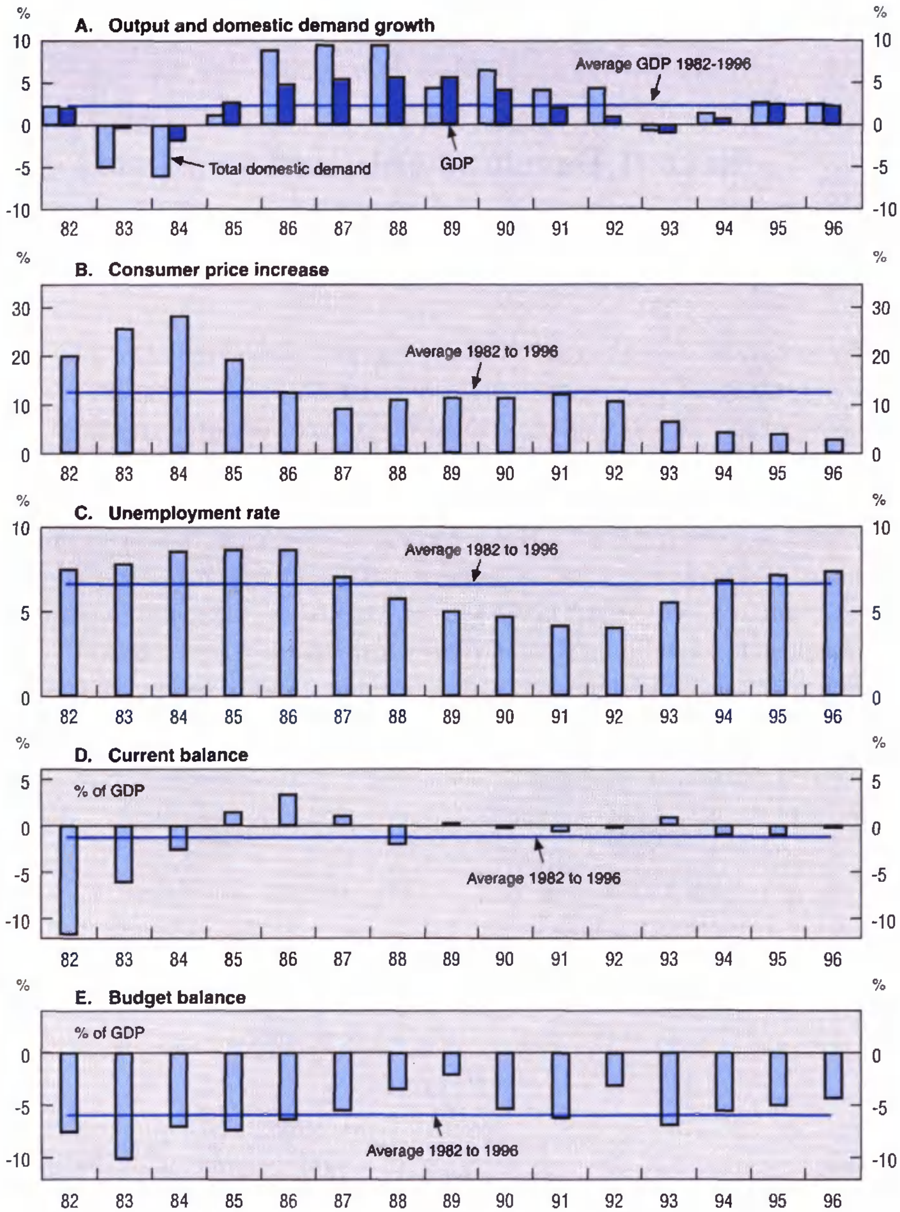
A setback to the recovery

The recovery, which began in the first quarter of 1994, initially followed the traditional pattern of lagging the upturn in other European countries, while the weakening in the second half of 1995 seems to have occurred in step with the deceleration in Europe.[1] For the year as a whole, real GDP is estimated by the OECD to have expanded at an average rate of 2.5 per cent, following growth of 0.8 per cent in 1994 (Figure 1). But according to coincident indicators of aggregate output from both the Bank of Portugal and the Statistical Institute (Figure 2, panel A), output growth eased in the second semester on account of weaker fixed investment and a levelling-off in private consumption (panels B and C). The process seems to have commenced with weakening exports, foreign orders trending down throughout the year (panel D).

Industrial production figures, which unlike the coincident indicators include the output of the newly operational *AutoEuropa* plant,[2] point to greater buoyancy, higher production of investment goods more than offsetting lower output of consumer goods in the second half of 1995 (Figure 3). However, business surveys for manufacturing indicate an involuntary build-up of stocks of finished goods, as manufacturing orders weakened from the end of 1994 (Figure 4). Both retail and wholesale trade surveys show a deceleration of orders and activity from the middle of 1995. Only in construction has a consistent upward trend in orders been evident since mid-1994 (panel B).

Taking 1995 on average, gross fixed investment is estimated to have expanded by around 6 per cent, keeping it roughly in line with the pace of previous recoveries (Figure 5). The expansion has been particularly strong for construction investment, in particular public, but has also extended to machinery and equipment.[3] On the consumption side, the volume of sales in large retail

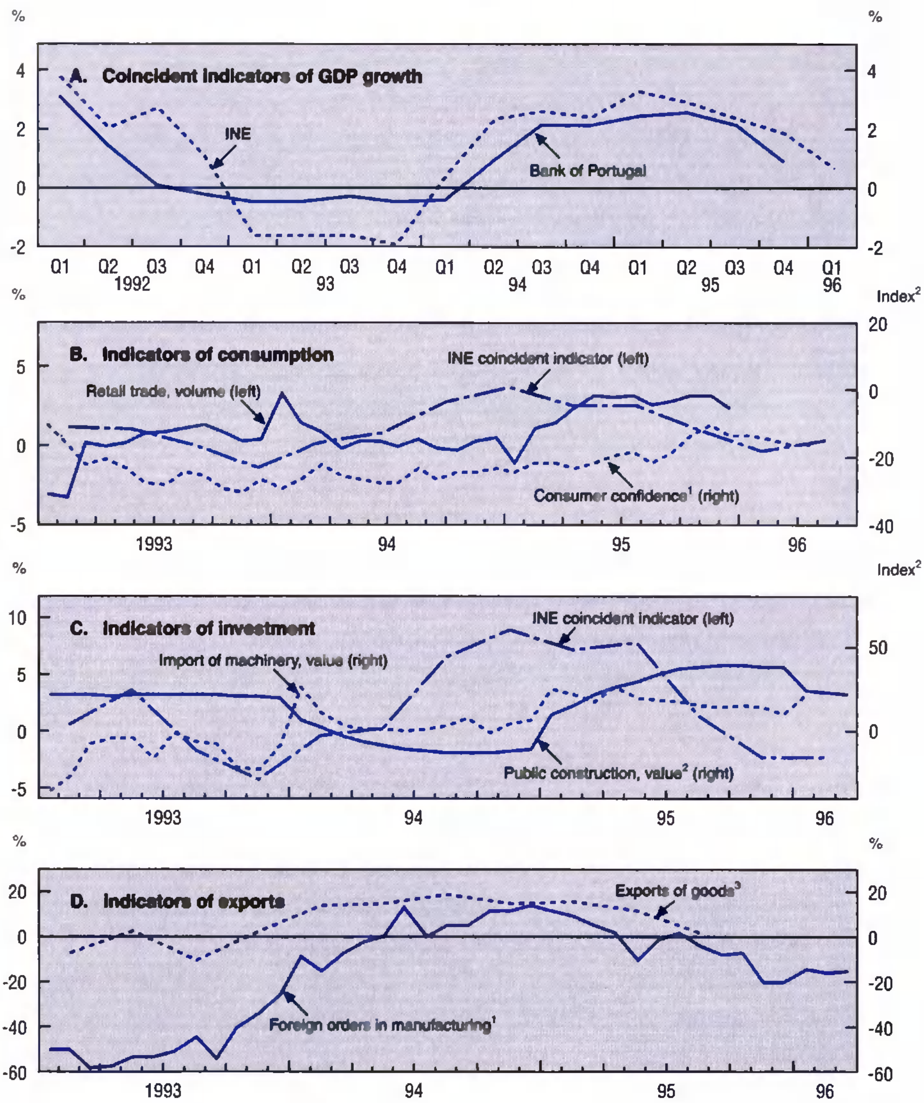
Figure 1. **MACROECONOMIC PERFORMANCE**



Source: OECD.

Figure 2. **INDICATORS OF DEMAND**

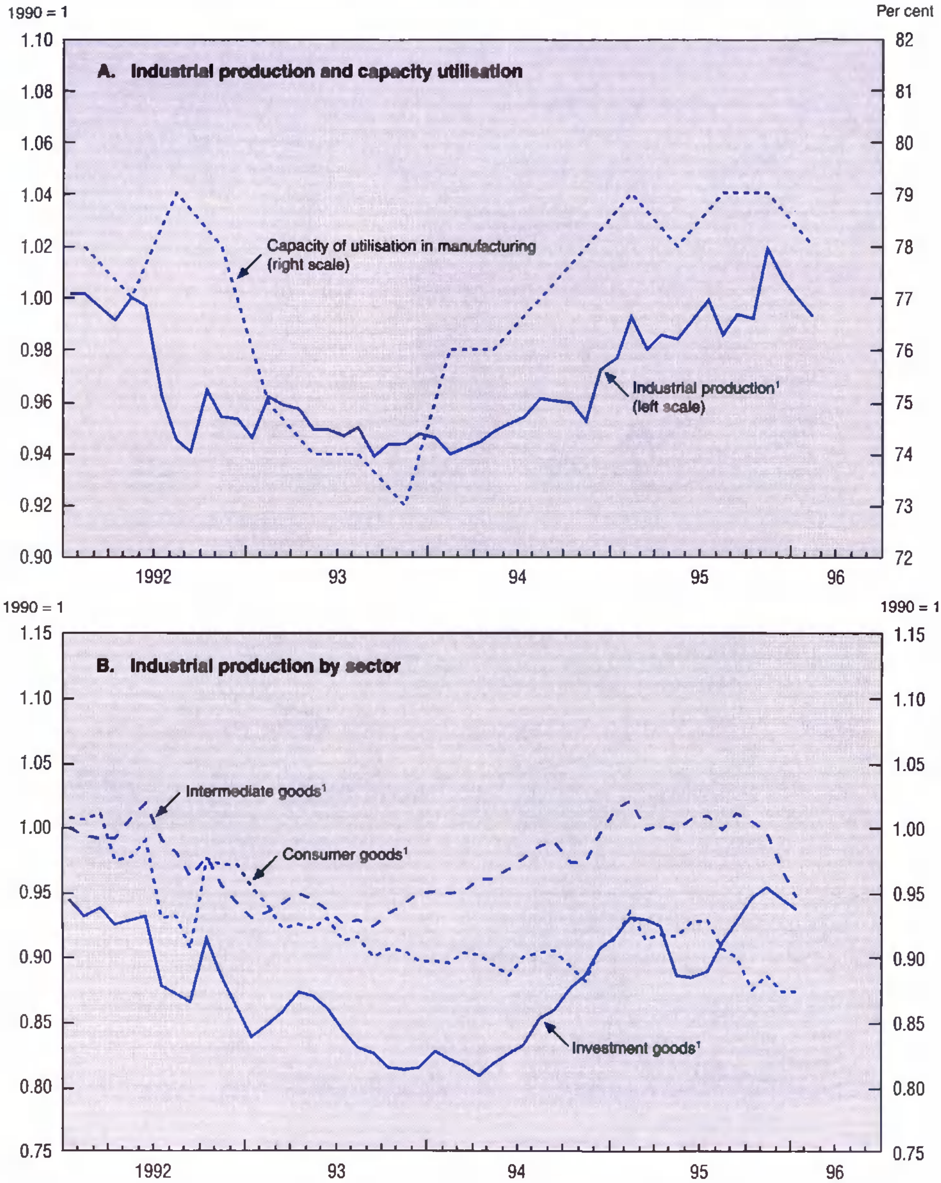
Year-on-year percentage changes



1. Balance of positive and negative opinions.
2. Buildings completed.
3. Export volume.

Source: Ministry of Finance; INE; Bank of Portugal.

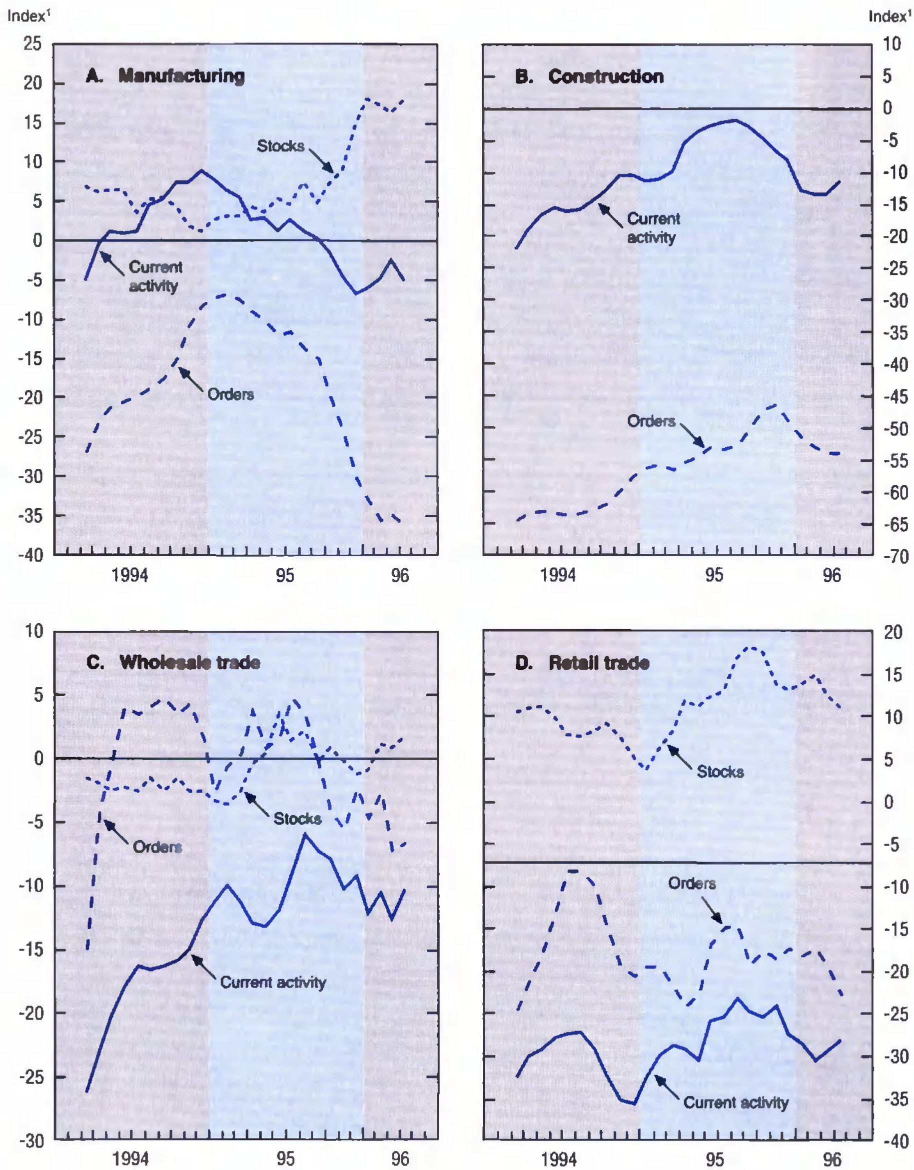
Figure 3. **INDICATORS OF ACTIVITY**



1. Three-month moving average.

Source: Ministry of Finance; INE; OECD, *Main Economic Indicators*.

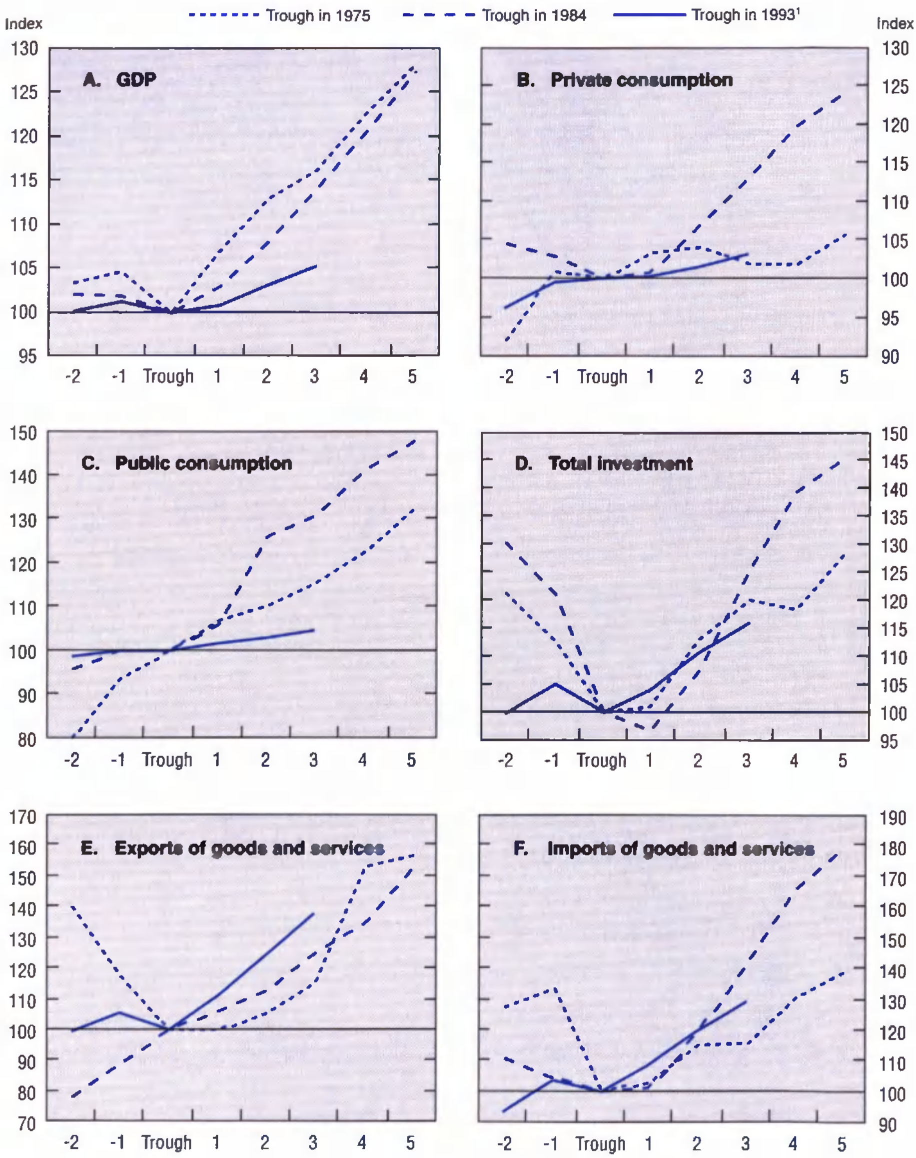
Figure 4. **BUSINESS SURVEYS**[1]



1. Balance of positive and negative answers. Three-month moving average.
Source: Ministry of Finance.

Figure 5. **CURRENT AND PREVIOUS RECOVERIES COMPARED**

Volume indices, trough = 100



1. Annual data for 1996 are OECD projections.

Source: OECD.

outlets expanded by 2.2 per cent in 1995, while import volumes of consumer goods increased by around 6 per cent. Overall, private consumption is estimated to have picked up to 1.7 per cent, sustained in 1995 by an increase in real disposable income and a small drop in the household saving ratio. Public consumption continued to record weak growth in volume terms in 1995. On the external side, the growth of exports of goods and services reached an estimated 11.4 per cent, as gains in market shares due to additional capacity outweighed the effect of weaker market growth. Export growth has compared rather favourably with that in the two previous upturns, the negative contribution of the foreign balance to economic growth falling as a result in 1995 to 0.8 points of GDP.

Output growth appears to have remained subdued in early 1996. Although business surveys in manufacturing indicate a slight reduction in pessimism about production levels, with some improvement in foreign orders, firms in the trade and construction sectors reported a further deterioration in activity. Overall, available information on the business climate would seem to suggest that activity decelerated further in the first quarter of 1996, with only exporters expecting a revival of demand. Rising output pessimism was reflected in a curtailment of investment plans for 1996 (see below). On the other hand, other indicators relating to consumer spending and investment in machinery and equipment point to greater buoyancy, offsetting continued weakness in construction.

Continued labour shedding and higher unemployment

Employment fell by 0.6 per cent in 1995, with large contractions in agriculture and the industrial sector. The shake-out was limited to dependent employees, although job losses for employees with permanent contracts were partly offset by gains for those with fixed term contracts (Table 1). Overall, the cumulative employment fall since 1992 has been close to 3 per cent, and around 6 per cent for employees. The behaviour of employment has been erratic in the current recovery, a temporary increase in the first half of 1994 being followed by renewed labour shedding in the second half of the year and broad stability thereafter. Average working hours increased until the third quarter of 1995, but fell again in the final quarter of the year. For 1995 as a whole, however, total hours worked in the economy contracted by 0.3 per cent and by 3.3 per cent in industry , pointing to a fall in labour inputs and to significant productivity gains (Figure 6).

Table 1. **Sectoral trends in employment**

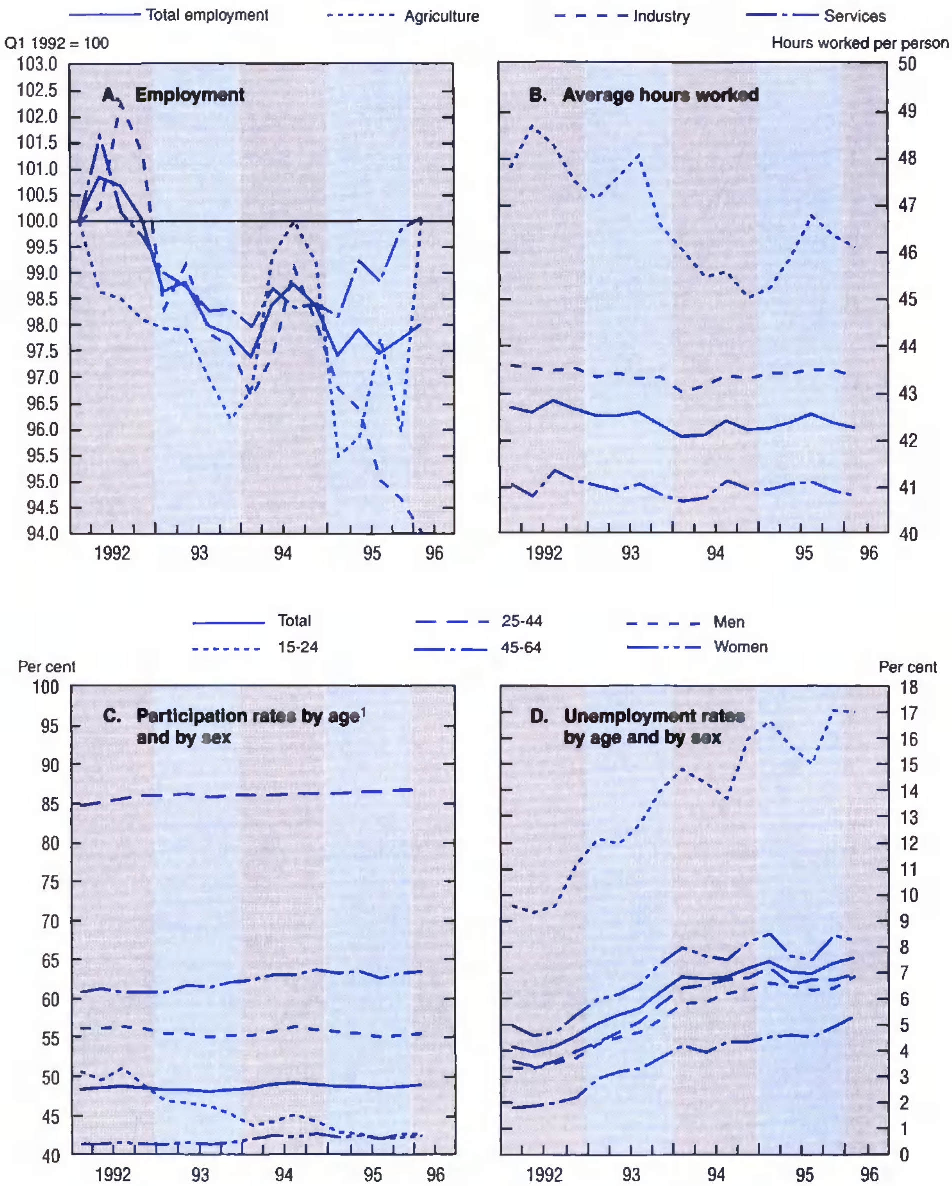
Percentage change

	Total			Employees		
	1993	1994	1995	1993	1994	1995
Agriculture	–1.6	1.6	–2.6	–12.9	–9.8	–6.7
Industry	–2.7	–0.4	–2.1	–3.2	–1.5	–2.7
of which: Textiles	*–6.6*	*2.5*	*–7.0*	*–6.6*	*2.1*	*–6.5*
Services	–1.6	–0.2	0.7	–2.2	–1.9	0.3
Permanent contracts	–	–	–	–1.6	–1.6	–1.5
Fixed-term contracts	–	–	–	–13.1	–4.2	3.3
Full-time	–2.2	–0.5	–0.5	–	–	–
Part-time	1.0	5.5	–2.6	–	–	–
Total	**–2.0**	**–0.1**	**–0.6**	**–3.0**	**–1.9**	**–0.9**

Source: Data provided by the Portuguese authorities.

While cyclical factors have been important, employment shedding may, in part, reflect the structural adjustment of Portuguese firms to new technologies and increased competition from abroad.[4] As shown in Figure 7, despite a widening of the output gap similar to that of other European countries, the decline in employment in Portugal over the past five years has been sharper than that observed in the early 1980s when, confronted with a more severe recession, firms protected jobs by deferring wage payments. The high concentration of employment losses suggests the importance of sector-specific factors. Job reductions in the textile, clothing and shoe-producing sectors (25 000 in 1995) accounted for almost the totality of the employment fall in 1995 (26 000 persons). Such a reduction may be linked to the phasing out of special factors which had contributed to employment gains in the second half of the 1980s, when Portugal's free access to the protected European markets contributed to a 26 per cent employment growth in the textile and clothing industry, to around one-third of manufacturing employment and of exports.[5] This employment expansion has been almost completely reversed since 1990. Employment shedding in the textile sector is likely to continue with the phasing out of the MFA agreement reached under the Uruguay Round.[6]

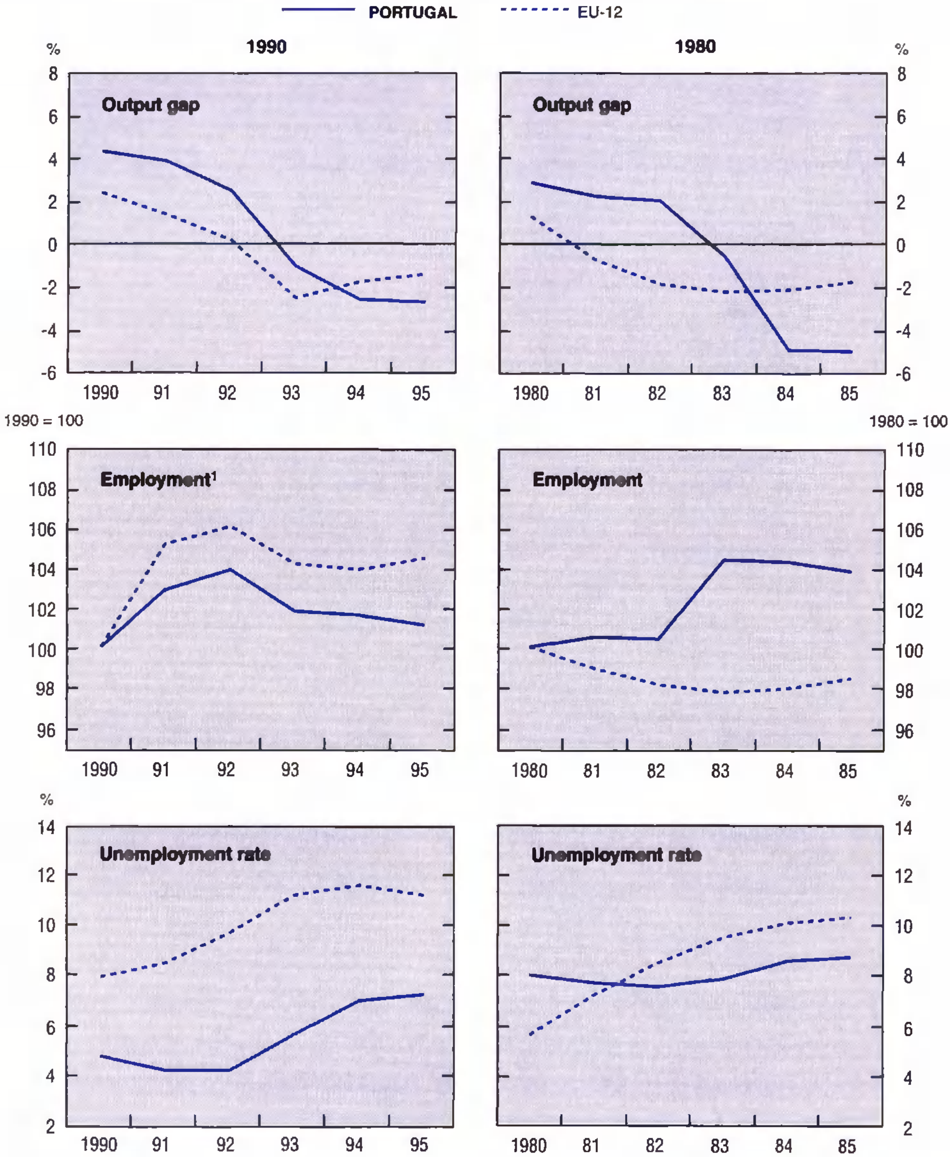
Figure 6. **RECENT DEVELOPMENTS IN THE LABOUR MARKET**



1. Per cent of the corresponding total working-age population.

Source: INE, quarterly labour force survey.

Figure 7. **OUTPUT GAPS, EMPLOYMENT AND UNEMPLOYMENT**



1. Employment growth in 1992, affected by a statistical break, is estimated on the basis of answers to the *Quarterly Employment Survey*, relative to the employment situation one year earlier.

Source: OECD

Labour shedding, in a context of stable participation rates, translated into a further rise in the unemployment rate to 7.2 per cent in 1995 as against 6.8 per cent in 1994. By the first quarter of 1996, the unemployment rate, at 7.5 per cent, was 3.6 points higher than the low reached in the second half of 1992, with 40 per cent of the unemployed having been out of work for more than one year. The increase in unemployment, which affected both men and women, was particularly steep for young persons (15 to 24 years of age), where the rate reached 17 per cent by early 1996, from below 10 per cent in early 1992, despite a sharp drop in participation rates. Tentative evidence of increased labour mismatches is to be seen in parallel movements for vacancies and unemployed in 1995 (see Chapter IV); however, despite a 37 per cent increase in the number of vacancies recorded in job centres in 1995, more than 56 registered unemployed were available for each registered vacancy.

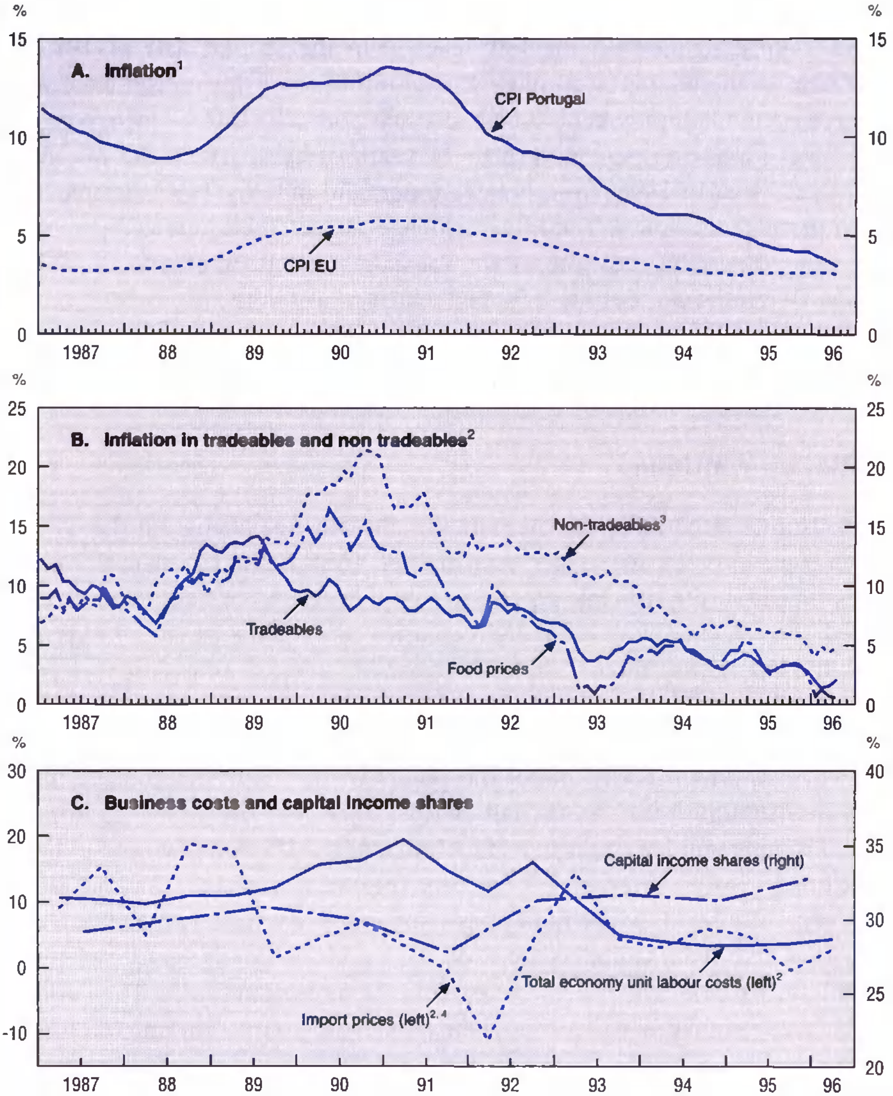
Disinflation continues

Consumer price inflation, measured by the average change in the CPI index excluding rents, eased to 4.1 per cent in 1995 from 5.2 per cent in the previous year, well within the official target range of 3.5 to 4.5 per cent. The process of nominal convergence with other EU countries in evidence since 1990 thus continued, the inflation-differential relative to the EU average subsiding to 1 point by year-end (Figure 8, panel A). The fall in inflation in 1995 occurred despite an increase in indirect taxes, including a 1 point increase in the standard VAT rate in January 1995, which added about 0.6 points to the CPI. Disinflation gathered further momentum in the second half of 1995, thanks to favourable external price trends. The appreciation of the escudo relative to the US dollar served to limit the rise in import prices to around 2 per cent (Figure 8, panel C) for the year as a whole, with absolute falls for food prices. Indeed, in contrast to the previous year, disinflation in 1995 was underpinned by the tradeable goods sector, where inflation fell to 3.3 per cent from 4.5 per cent in 1994 (panel B). The process of disinflation continued in early 1996, when the average inflation rate fell to 3.4 per cent in the twelve months to April; the year-on-year inflation rate in the same month was 2.9 per cent.[7]

Disinflation has also been sustained by continued moderate growth of unit labour costs (Figure 8, panel C), as a result of both wage moderation and robust productivity growth. In the face of rising unemployment, contractual wages rose

Figure 8. **INFLATION DEVELOPMENTS**

Percentage changes



1. Average rate.
2. Year-on-year rate.
3. Including services and construction.
4. Implicit price deflator for imports of goods and non-factor services.

Source: Bank of Portugal; OECD.

at a rate of around 5 per cent in 1995, broadly unchanged from the previous year, with slightly higher increases for minimum wages and average earnings (Table 2). However, this has to be seen in the context of a sharp increase in labour productivity growth, to 2.9 per cent for the economy as a whole. Moreover, with unemployment rising and inflation declining, the year-on-year growth of contractual earnings eased from the second half of 1995, falling to a low of 4.4 per cent in April 1996. Business profits increased significantly in 1995, pushing the capital income share above the level observed at the previous cyclical peak.

Table 2. **Indicators of wage inflation**

Percentage change

	1990	1991	1992	1993	1994	1995
Average earnings[1]	17.0	16.0	13.7	6.5	6.0	6.7
Contractual wage[2]	14.1	14.2	10.9	7.9	5.1	4.8
Minimum wages[3]	13.8	14.6	11.0	6.5	4.0	5.5
Labour costs per unit of output[4]	16.6	18.1	13.0	5.3	4.3	..
Memorandum item:						
CPI	13.4	11.3	8.9	6.5	5.2	4.1

1. Excludes public administration and non-market services. The data is based on a survey conducted in April and October; data for 1995 refer to the increase in the twelve months to April.
2. Contractual wage rates in the non-agricultural sector.
3. Minimum wages for workers 18 and over in the non-agricultural sector.
4. All economy.

Source: Data provided by the Portuguese authorities.

Against this background, the income policy agreement of January 1996, signed by the new government, the employers' associations and one of the largest unions, sets guidelines for wage negotiations in 1996. These guidelines recommend wage increases of 4.5 per cent in 1996, based on an inflation target of 3.5 per cent and projected productivity gains of 2 per cent in 1996,[8] with larger increases (5 per cent) for minimum wages. The agreement also establishes that the wage norm will be automatically adjusted in the case of a monthly change in CPI inflation deviating by more than 0.2 points from the envisaged path. In application of this norm, more rapid disinflation than originally foreseen led to a reduction of the wage guidelines to 4.2 per cent, effective from the end of

April 1996. The pact also commits the government and the social partners to reform employment and labour legislation, as well as the tax and social security systems.

The external sector

Exchange rate

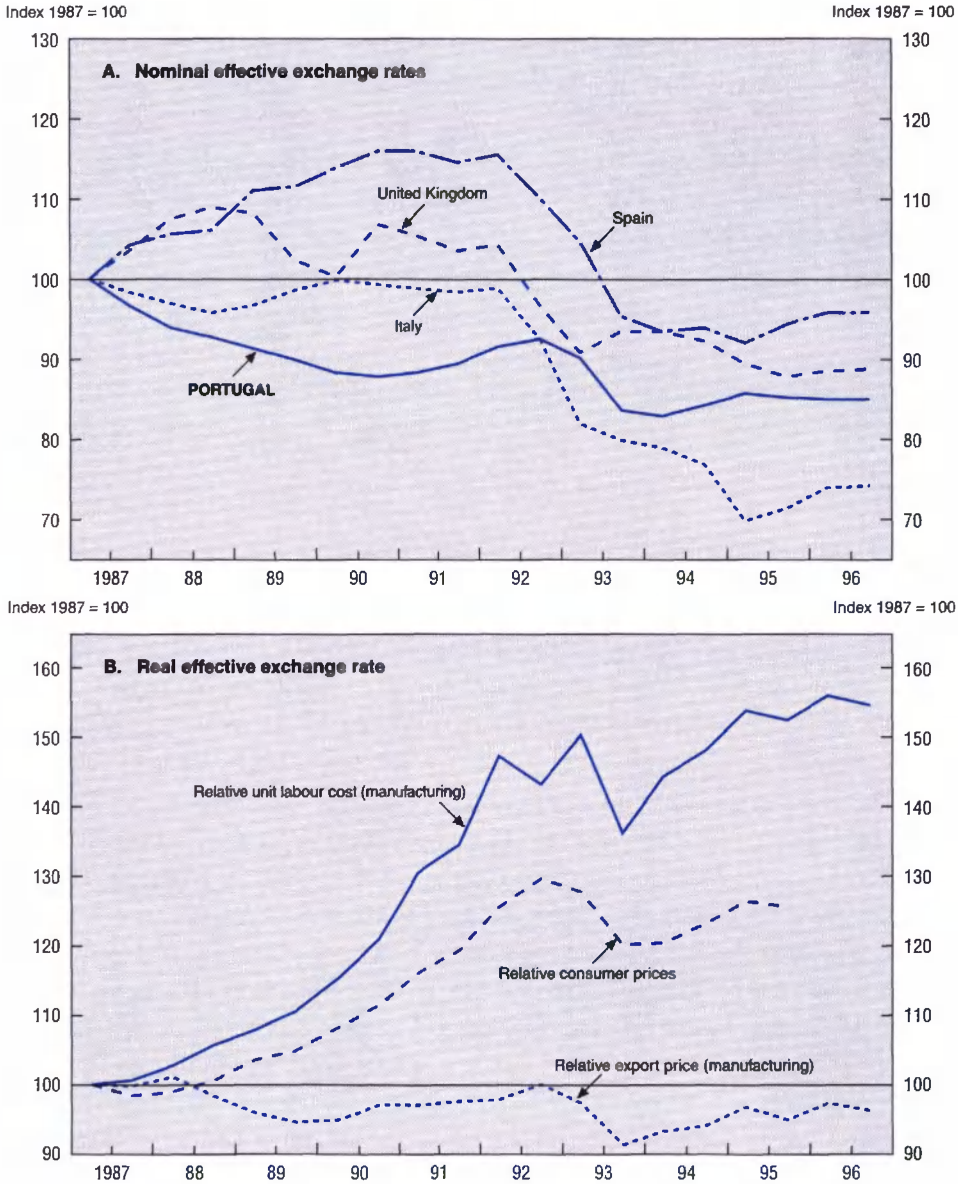
The nominal effective exchange rate strengthened by 2.1 per cent in 1995 after depreciating by around 4 per cent in 1994 (Figure 9, panel A). This reflected an appreciation relative to non-EMS currencies and the Spanish peseta. Both relative unit labour costs and relative manufacturing export prices show a real appreciation in 1995, amounting respectively to around 5 per cent and 2.6 per cent (panel B). Since 1988, the combination of a rise in relative unit labour costs in manufacturing and the stability of manufacturing export prices suggests a squeeze of profit margins in this sector, which was partly reversed in 1995.[9] However, despite this increase in labour costs, the absolute level of hourly compensation of Portuguese workers remains far below that of major partner countries (26 per cent of the EU average in 1995, Table 3).

Trade and current account balances

The year-on-year growth of merchandise export volumes, at around 12 per cent, was slightly weaker in 1995 than that recorded in the previous year, with exports of investment goods registering particularly strong gains. While export market growth slowed, from rates above 10 per cent in 1994 to around 8 per cent in 1995, the momentum of export volumes was maintained by strong gains in market shares. New capacity in the export sector contributed to this, more than offsetting the further reduction in export competitiveness already noted (Figure 10). Exports from the new car company, *AutoEuropa,* are estimated to have totalled Esc 138 billion in 1995 and are projected to increase to Esc 350 billion in 1996, an amount equivalent to around 9 per cent of total merchandise exports.[10] Growth of merchandise import volumes is estimated to have fallen slightly, to around 10 per cent in 1995, despite the recovery in domestic demand and an improvement in the price competitiveness of imported products. Import growth was relatively weak for consumer goods. A further improvement in the coverage ratio (the ratio of merchandise export volumes to

Figure 9. **NOMINAL AND REAL EXCHANGE RATES**

1987 = 100



Source: OECD.

Table 3. **Levels of hourly compensation costs for production workers in manufacturing**

Index, United States = 100

	1980	1985	1990	1992	1993	1994	1995[1]
United States	100	100	100	100	100	100	100
Portugal	**21**	**12**	**25**	**32**	**27**	**27**	**29**
Japan	56	49	86	101	114	125	114
Germany[2]	125	74	147	157	154	160	154
France	91	58	102	105	97	100	97
Italy	83	59	119	121	96	95	96
United Kingdom	77	48	85	89	76	80	79
Canada	88	84	106	105	98	92	96
Spain	60	36	76	83	69	67	71
EU	99	60	114	120	109	115	111
Asian NIEs	12	13	25	30	31	34	..

1. Estimate.
2. West Germany.

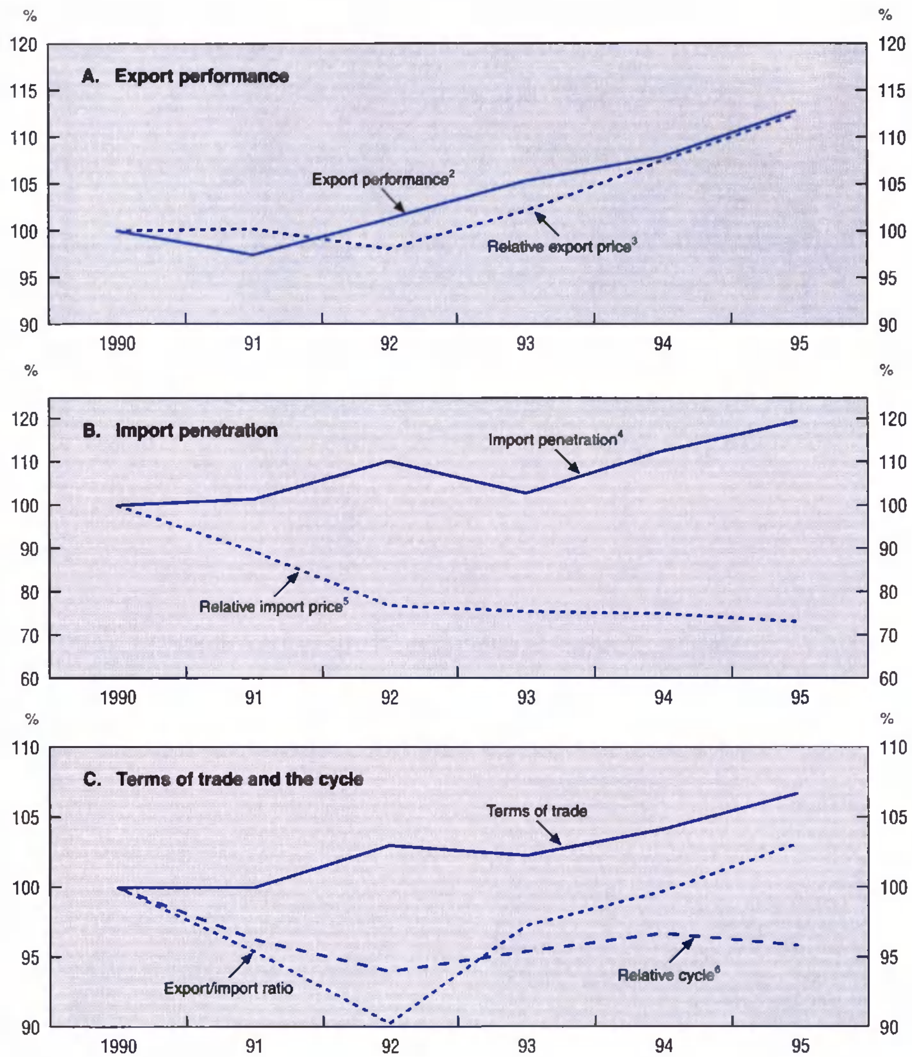
Source: BLS (1995), "International Comparisons of Hourly Compensation Costs for Production Workers in Manufacturing, 1994", June, Report 893.

imports) occurred although growth of Portugal's domestic demand was similar to that of partner countries. Rising terms of trade also contributed to the reduction in the trade deficit from 7.9 per cent of GDP in 1994 to 6.7 per cent in 1995, a lower deficit with the EU more than offsetting a larger one with non EU countries.

The current account (on a transactions basis) is estimated to have moved close to balance in 1995 (Figure 11), the estimated deficit shrinking from Esc 253 billion in 1994 to Esc 37 billion in 1995 (Table 4). Higher net public transfers in 1995 reflected an increase in EU transfers received and a fall in transfers paid to the EU from exceptionally high levels reached in 1994, which had been boosted by the regularisation of overdue obligations and higher contributions to the EU based on new GDP data. The increase in net public transfers was partly offset by lower private transfers, mainly emigrant remittances, reflecting the deterioration of labour markets in host countries and a trend to lower migration from Portugal. The deficit on factor income increased relative to 1994, partly on account of interest payments on the higher stock of public debt held by non-residents. This was, however, offset by a larger surplus on non-factor services boosting the surplus of invisibles to around 8 per cent of GDP.

Figure 10. **INDICATORS OF MERCHANDISE TRADE**[1]

1990 = 100

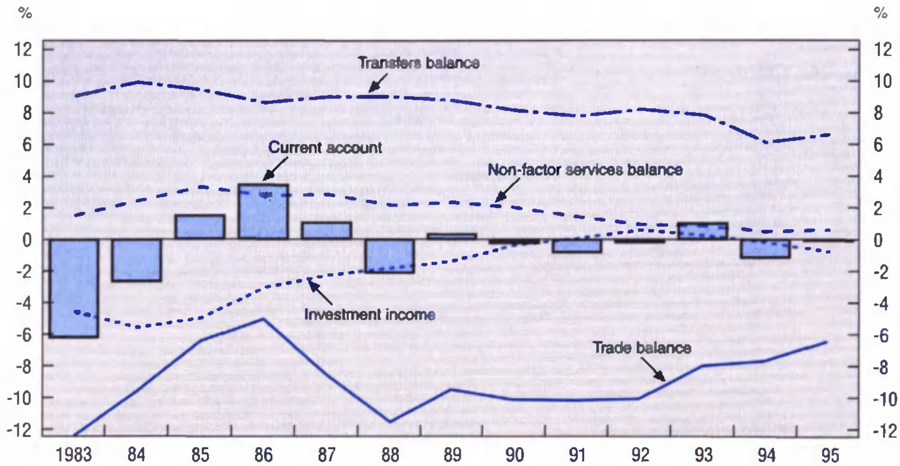


1. Total goods.
2. Volume index of Portugal's exports divided by volume index of Portugal's export market.
3. Index of Portugal's export unit values divided by index of export unit values in partner countries.
4. Volume index of Portugal's imports divided by index of Portugal's Total domestic demand.
5. Index of Portugal's import unit values divided by the delator of total domestic demand.
6. Volume index of domestic demand of OECD countries divided by volume index of Portugal's domestic demand.

Source: OECD.

Figure 11. **CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS**

Per cent of GDP



Source: OECD.

Table 4. **Current account of the balance of payments**[1]

Billions of escudos

	1993	1994	1995[2]
Trade balance	**1 282.2**	**–1 336.6**	**–1 281.4**
Imports (f.o.b.)	3 839.4	4 418.9	4 897.0
Exports (f.o.b.)	2 557.2	3 082.3	3 615.6
Invisible balance	**1 335.2**	**1 084.0**	**1 243.9**
Services	247.8	238.9	274.5
Transport	–26.4	–66.1	–32.5
Travel and tourism	348.9	399.8	408.7
Other private services	–47.1	–65.5	–71.9
Government services	–27.6	–29.3	–29.8
Factor income	13.2	–51.5	–107.7
Labour income	13.5	11.6	10.0
Investment income	22.0	–33.8	–87.9
Other income	–22.3	–29.3	–29.8
Transfers	1 074.2	896.6	1 077.1
Official	459.1	322.2	566.9
Private	615.1	574.4	510.2
Current account	**53.0**	**–252.6**	**–37.5**
In per cent of GDP	0.4	–1.8	–0.2

1. Data on a transaction basis.
2. Provisional.

Source: Bank of Portugal.

Capital transactions

The balance of non-monetary capital flows recorded a deficit of Esc 479 billion in 1995 (Table 5), with particularly large net inflows from mid-year. For the year as a whole, portfolio investment recorded a deficit of around Esc 350 billion, with large net outflows from residents outweighing inflows from non-residents. Portfolio investment from non-residents was entirely concentrated in government bonds denominated in foreign currencies, with net disinvestment in holdings of both shares and government bonds denominated in escudos. A recovery in international bond markets sustained higher portfolio investment abroad by residents, mainly banks.[11] The balance of direct investment also showed a small deficit, a fall in foreign investment in the financial sector more than offsetting small increases elsewhere. Portuguese direct investment abroad continued rising relative to 1994 on account of investments by Portuguese banks

Table 5. **Net capital movements**[1]

Billions of escudos

	1993	1994	1995
Non-monetary financial accounts	**309.9**	**–188.6**	**–479.0**
Direct investment, net[2]	226.6	161.2	–3.7
Portuguese investment abroad, net	–22.6	–47.0	–103.0
Foreign investment in Portugal, net	249.2	208.2	99.3
Portfolio investment, net	189.7	189.6	–349.3
Portuguese investment abroad, net	–421.4	–96.8	–409.5
Foreign investment in Portugal, net	611.1	286.4	60.2
External credits, net	40.7	–152.6	–52.4
Granted	–28.4	–9.1	–46.8
Received	69.1	–143.5	–5.6
Other operations, net	–147.1	–386.8	–73.6
Change in the short-term position of banks	**–794.1**	**222.4**	**979.9**
Errors and omissions[3]	**3.1**	**–90.7**	**–498.1**
Change in official reserves[4]	**428.1**	**309.5**	**34.7**

1. Data for 1995 are not comparable with those of previous years, as they include portfolio investment in international clearing centres.
2. Includes investment in real estate.
3. Includes operations which have not yet been classified.
4. Minus sign indicates an increase in reserves.

Source: Bank of Portugal.

in other EU countries. Overall, outflows of non-monetary capital including "errors and omissions" was broadly matched by an increase in the short-term position of banks, making for a small rise in official reserves in 1995. At more than 20 per cent of GDP, the stock of international reserves at the end of 1995 was relatively high. This, together with Portugal's net creditor position *vis-à-vis* the rest of the world, should continue to underpin market confidence on the stability of the escudo.

Short-term outlook

The most recent business surveys in industry and trade suggest a further weakening in economic activity in the first part of 1996. On the consumption side, although consumer confidence had stabilised at the relatively high levels reached at end-1995, producers of consumer goods and retail outlets expect a deceleration of demand and domestic orders, only partly offset by a pick-up in foreign orders. On the investment side, business surveys have revealed expectations of depressed demand in construction and lower investment plans for industry for 1996. The INE survey of end-1995 (conducted between October 1995 and January 1996) showing a fall in planned industrial investment of 3.5 per cent in nominal terms. Large declines planned by private firms contrast with a small improvement for public enterprises.

Activity should pick up in the second half of 1996, in line with a projected recovery in other European countries. Despite a negative carryover effect stemming from weak growth in the second half of 1995, the stimulus to exports provided by new industrial capacity is expected to support real GDP growth of 2¼ per cent in 1996, strengthening to 2¾ per cent in 1997 (Table 6). The increase in real GDP growth in 1997 will partly reflect the impact of the 1998 *Expo,* which, according to estimates from the Department of Planning, could boost real GDP by around ¾ per cent by 1998. Private consumption is expected to strengthen moderately in line with higher real disposable income, leaving the household saving ratio broadly unchanged. Continued buoyancy in public infrastructure works will sustain gross fixed investment. On the external side, the coming on-stream of additional capacity in the automobile sector will contribute to further gains in Portugal's aggregate export market share in 1996, while a pick-up in foreign demand will help to sustain merchandise export growth in 1997, as the growth momentum from the automotive sector fades. Despite a slight deterioration of the trade balance, the current account is projected to remain close to balance in both 1996 and 1997.

Table 6. **Short-term projections**

Percentage change

	1993	1994	1995	1996	1997
Demand and output[1]					
Private consumption	0.4	0.2	1.7	1.8	2.4
Public consumption	0.0	1.4	1.6	1.4	1.4
Gross fixed investment	–4.8	3.9	5.4	5.0	6.2
Final domestic demand	–1.0	1.3	2.6	2.6	3.3
Stockbuilding[2]	0.2	0.2	0.2	–0.1	0.0
Total domestic demand	–0.9	1.5	2.7	2.5	3.2
Exports of goods and services	–5.1	10.7	11.4	9.7	7.5
Imports of goods and services	–3.2	8.5	8.6	7.5	6.8
Foreign balance[2]	–0.1	–1.0	–0.8	–0.7	–1.3
GDP at market prices	–1.2	0.8	2.5	2.3	2.7
Prices					
GDP deflator	7.6	5.6	5.8	4.2	3.7
Private consumption deflator	7.0	4.8	4.1	3.2	2.7
Unemployment rate[3]	5.6	6.9	7.2	7.4	7.5

1. At 1985 prices.
2. As a percentage of GDP in the previous period.
3. Percentage of total labour force.

Source: OECD (1996), *Economic Outlook* No. 59.

The rebound in activity is expected to result in only a moderate increase in jobs, as productivity gains are likely to remain substantial as a result of international competition. With unemployment well above its estimated structural level nominal wage growth is projected to diminish further, unit labour cost increases easing to around 3 per cent in 1997. Together with a moderate increase in import prices, this could reduce consumer-price inflation to below 3 per cent in 1997.

The principal uncertainty attached to the projections concerns the pick-up in foreign demand, especially in other European economies. Portuguese export market growth is projected to increase from a rate of 5 per cent in the first half of

1996 to 7 per cent next year. Its failure to do so would significantly affect industrial investment, although the risks on the external side would seem to be evenly balanced. On the domestic side the main risk attaches to the danger of fiscal slippage, which could have critical influence on the stability of the escudo within the ERM and hence on interest rates. Here too the possibility of a better outturn exists, especially given recent gains in exchange-rate credibility.

II. Macroeconomic Policy

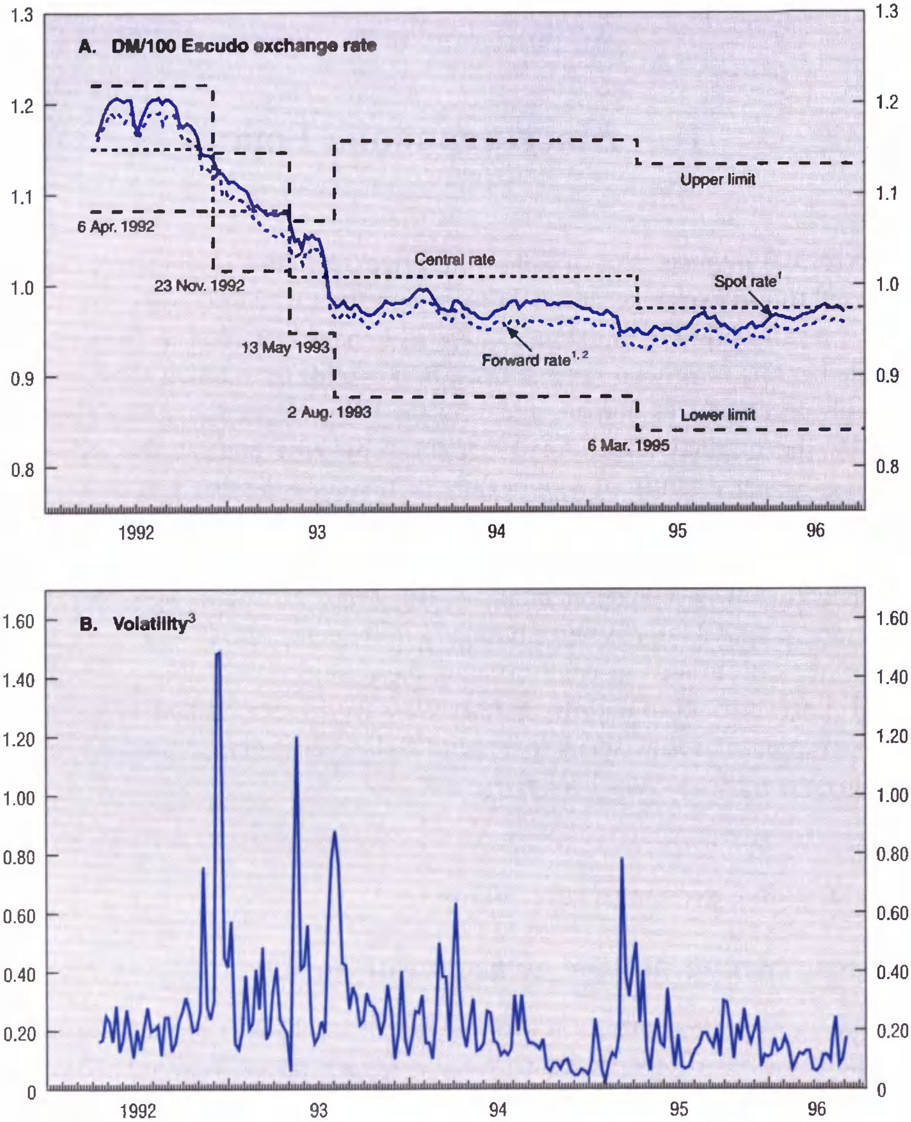
With the ultimate aim of achieving price stability,[12] monetary policy has continued to use exchange-rate stability within the ERM as the key intermediate target. The credibility of this strategy appears to have increased in 1995, allowing a gradual easing of official interest rates. Bond yields have fallen substantially in line with developments abroad, and with the budget deficit significantly undershooting the original target for 1995, the long-term interest rate differential *vis-à-vis* Germany narrowed significantly in 1995 and the first half of 1996. The new minority government which took office in October 1995 has reaffirmed Portugal's commitment to the attainment of the 3 per cent deficit limit by 1997 and to full participation in Phase III of the European Monetary Union. Budgetary proposals for 1996 envisage a fall in the fiscal deficit by around 1 point of GDP, to 4.2 per cent, bringing these objectives within reach. Fundamentals thus seem set to improve further. However,achieving budget and interest rate convergence would seem to require tighter controls of public spending, overruns having frequently occurred in the past.

Monetary and exchange rate policy

Economic convergence and exchange rate stability

Until mid-1993, Portugal's membership of the ERM was accompanied by periodic pressures on the exchange rate, as evidenced by high volatility of the spot exchange rate and, occasionally, by forward exchange rates approaching the lower bound of the fluctuation band (Figure 12). These pressures, linked to wider European turbulence affecting foreign exchange markets as well as to the weakness of the Spanish currency, were countered by the Portuguese authorities through a combination of official interventions in foreign exchange markets,

Figure 12. **EXCHANGE RATE LEVELS AND VOLATILITY**



1. Weekly average.
2. Three-month forward rate.
3. Weekly average of the standard deviation of the daily quotes of the five preceding days.

Source: OECD.

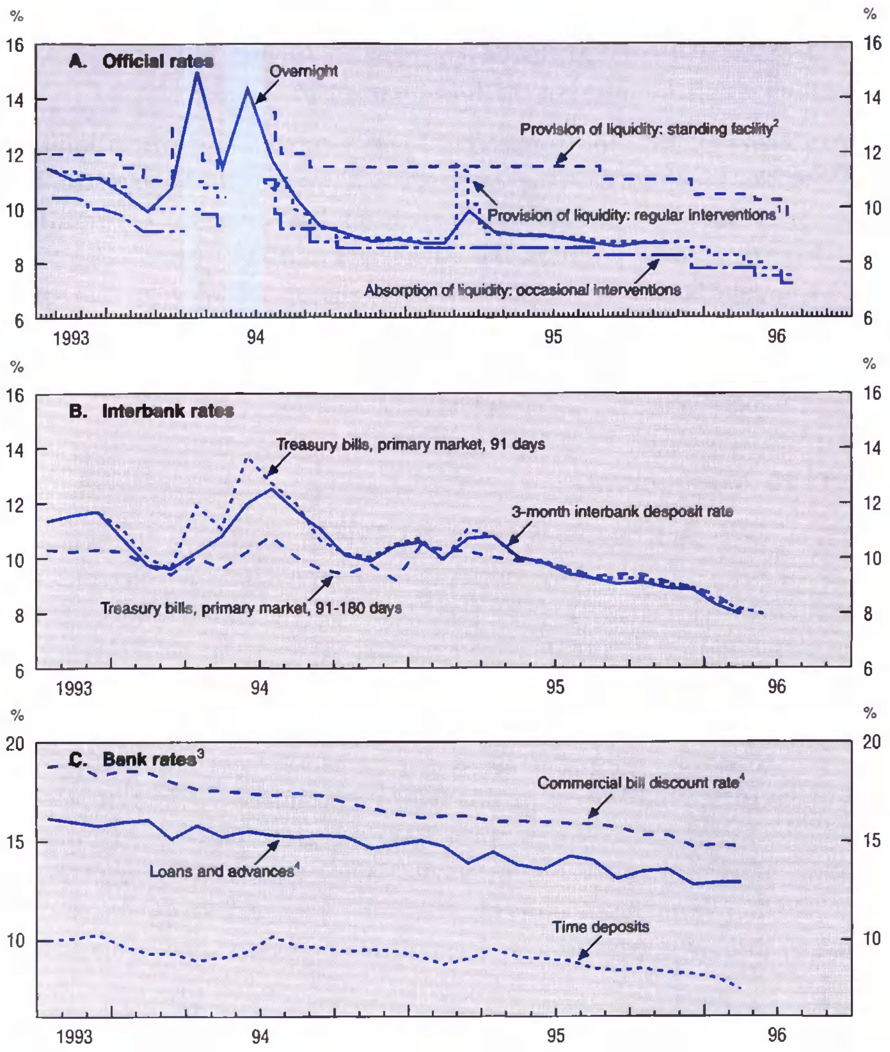
increases in the central bank intervention rates and realignments of the escudo parity in the ERM (in November 1992 and May 1993). Following the widening to ± 15 per cent of the ERM fluctuation band in August 1993, the escudo has traded within a narrow range in the lower part of the band.

With sustained inflation convergence and a correction of fiscal imbalances since 1994, the credibility of the exchange rate appears to have risen, as evidenced, *inter alia,* by the sharp decline in exchange rate volatility. In March 1995, the central parity of the escudo within the ERM was devalued by 3.5 per cent, half the size of the devaluation of the Spanish peseta, bringing it in line with market rates prevailing since August 1993. This realignment was not preceded by significant market pressure on the escudo, but was aimed at limiting losses in competitiveness relative to partner countries.

Interest rate developments

Following a short period in early 1995 when the Bank of Portugal was forced to tighten monetary conditions, official intervention rates have been on a downward trend (Figure 13). [See Box 1 for a description of techniques of monetary control used by the Bank of Portugal]. Starting in mid-February 1995, turbulence in foreign exchange markets, affecting most European currencies, was countered by interventions of the Bank of Portugal, while official rates were kept unchanged. However, following the re-alignment of the central parity of the escudo in the ERM on 6 March, market pressure prompted a 2.7 point increase in the repo-rate, to a level of 11.6 per cent by mid-March. This was slightly above the ceiling of the official band for money market rates. With exchange rate tensions abating from April onwards, the repo rate was progressively eased, returning by the end of May to a level below that prevailing before the March re-alignment. Official interest rate reductions continued in the second half of 1995 and into 1996. Following a small decline in the repo rate in early August, the authorities modified the official corridor, first on 28 August, when they reduced its ceiling by 0.5 points, to 11 per cent, and its floor by 0.25 points, to 8.25 per cent, then on 19 December, when both rates were cut by 50 basis points. Nevertheless, the need to maintain exchange rate stability implied an easing in the Bank of Portugal's repo rate of only half the size of the cut in the German repo rate. In mid-March 1996, helped by previous easing of Germany's repo rates, the Bank of Portugal again lowered both the ceiling and the floor of the

Figure 13. **INTEREST RATES**



Shaded areas correspond to periods of suspension of interventions by the Bank of Portugal.

1. Regular operations for liquidity injection are contracted on the first working day of each reserve maintenance period and mature in the first working day of the subsequent period. From May 1994 variable rate on repurchase-agreements.
2. Standing facility, based on pre-announced rate liquidity provision operations maturing on the next working day following the transaction. Use of this facility is automatic.
3. 91-180 days.
4. Non-financial private enterprises.

Source: Bank of Portugal.

Box 1. **Monetary control by the Bank of Portugal**

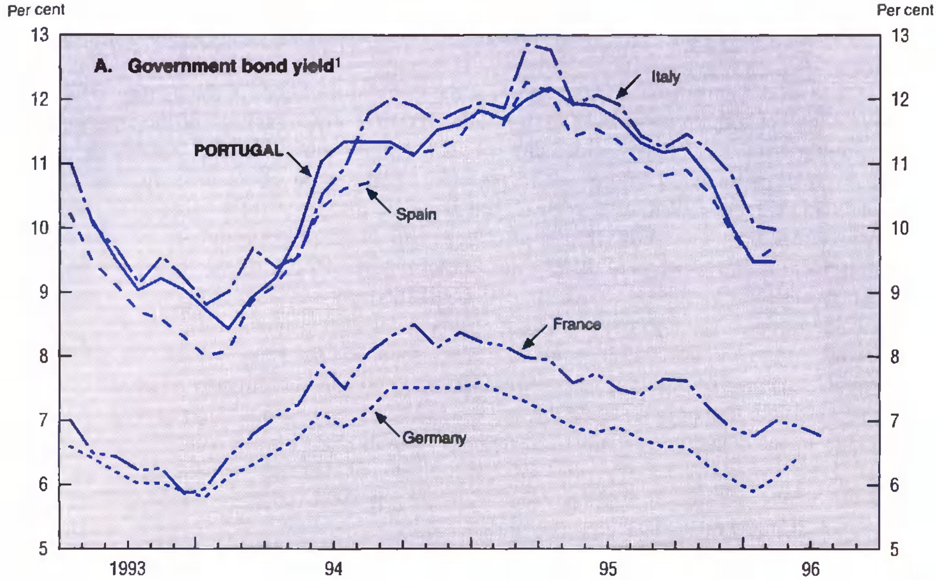
The set of instruments at the disposal of the Bank of Portugal for the management of money market conditions include an overnight credit facility, a facility for the absorption of liquidity and repurchase agreements (repos). Under normal market conditions, the interest rates on the two facilities set, respectively a ceiling and a floor for very short-term money market rates. Within this band, the Bank of Portugal steers short-term money market rates through repos. Repos are conducted at the beginning of each reserve requirement maintenance period and expire either on the first day of the following period (regular repos) or within the reserve period. Until July 1994, regular repos were issued at pre-announced rates subject to a quantity ceiling, with suspensions in periods of extreme pressure in the foreign exchange market. Since then, regular repos have been effected through auctions of liquidity at variable rates, although occasionally (February and April 1995) the Bank has resumed the announcement of repo rates when intending to give a clear signal concerning changes in monetary conditions. Use of variable repos has provided the Bank of Portugal with a better indicator of demand pressure in the money market, while avoiding disruptions which were previously associated with the suspension of repos at times of exchange market turbulence.

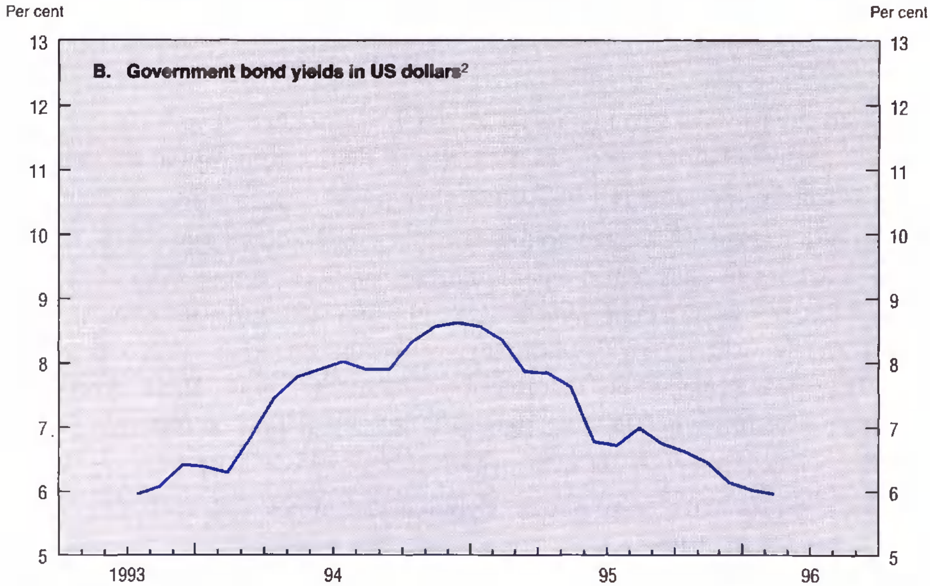
official corridor by 0.25 points, to 10.25 and 7.5 per cent respectively, while the repo rate declined below 8 per cent. Key official rates were lowered again in mid-April, when the repo rate fell to 7.6 per cent.[13]

Money market rates have followed official rates down since March 1995, sharper declines in rates with longer maturities implying a flattening of the yield curve. The easing of money market rates in 1995 was fully reflected in lower commercial bank loan rates, while smaller declines were recorded in deposit rates. Banks' intermediation margins thus shrank in 1995. Bank profitability nevertheless stabilised, reflecting increased intermediation activity, while non-performing loans fell to 6 per cent in December 1995.

Bond yields have also posted significant declines falling by more than 3 points from April 1995 to May 1996 (Figure 14). In the process, the differential relative to German bonds narrowed from around 5 points in April 1995 to 2.5 points in May 1996 (Figure 15), with Portuguese yields below Italian and Spanish rates. Interest rate spreads on Portuguese bonds denominated in dollars, having narrowed by around 0.2 points since early 1995, are now lower than

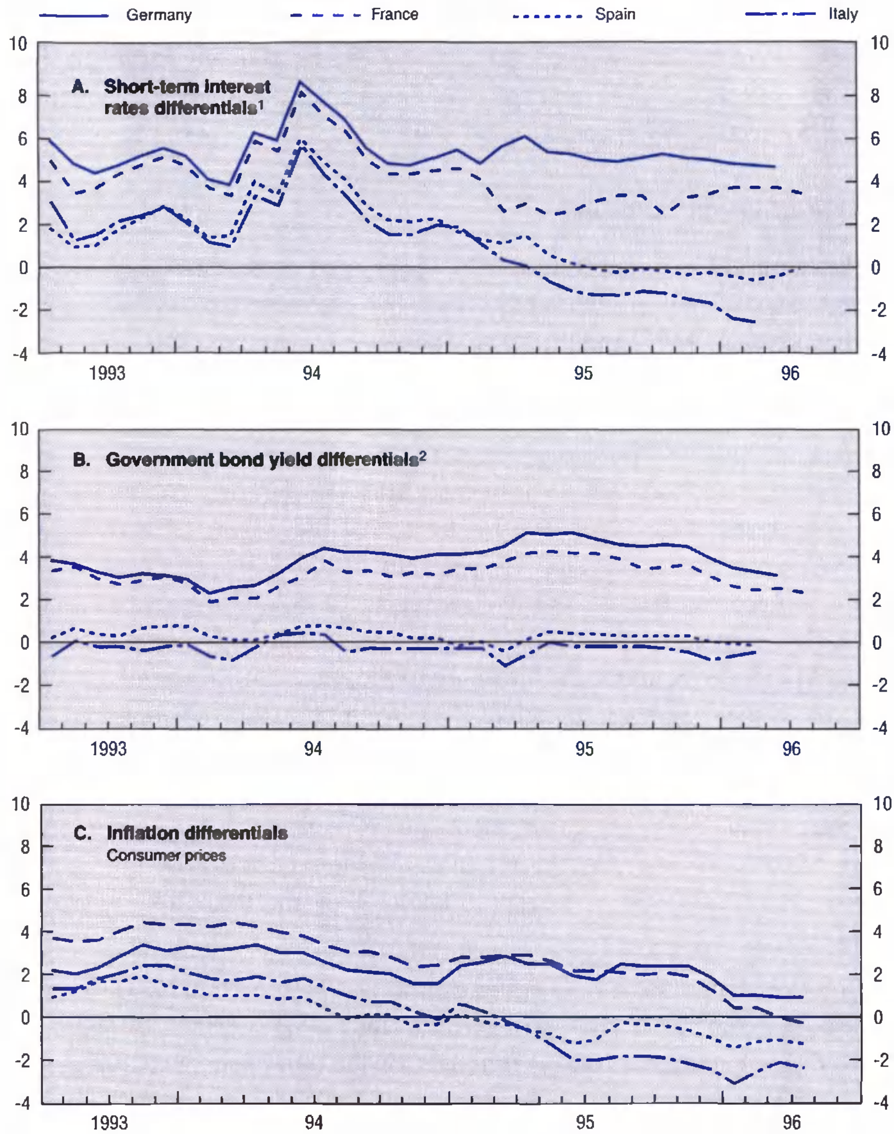
Figure 14. **LONG-TERM INTEREST RATES**





1. 10-year government bonds.
2. 10-year government bond at 5¾ per cent, 1993.
Source: OECD.

Figure 15. **INTEREST RATE AND INFLATION DIFFERENTIALS**



1. Portugal: 3-month Interbank money market rate; Germany: 3-month FIBOR; Spain: 3-month interbank loans; France: 3-month PIBOR; Italy: 3-month interbank rate.
2. Portugal, Italy and Spain: 10-year government bonds; Germany: 7-15 year public sector bonds; France: public and semi-public sector bonds.

Source: OECD.

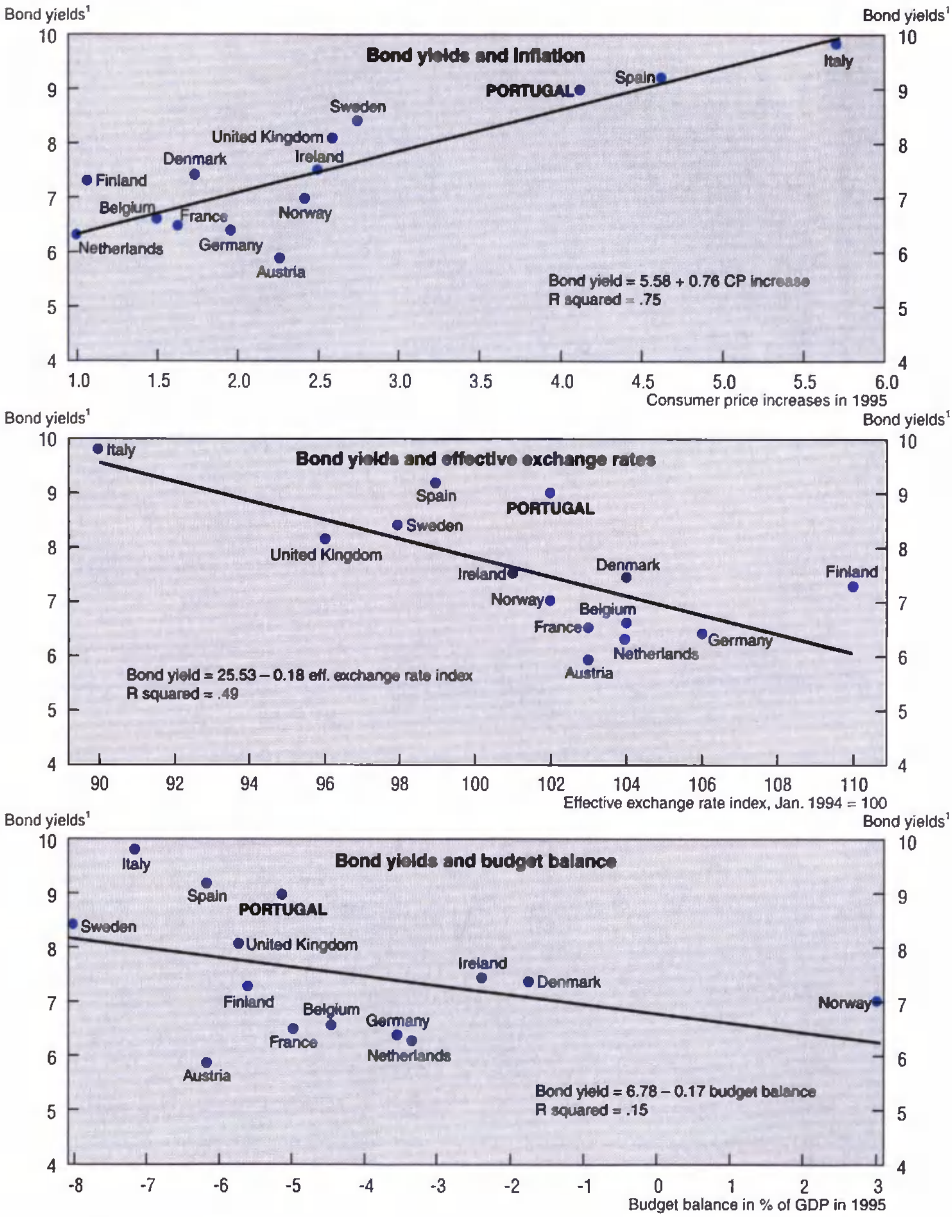
Italian and Irish spreads and are less than a tenth of the interest differentials in national currency assets. Nevertheless, the interest rate spread between escudo and Deutschemark-denominated government bonds remains large and seems mainly to reflect the slow process of adjusting expectations to an improving inflation and budgetary record (Figure 16).

Money and credit aggregates

Having accelerated until mid-1995, money and credit aggregates have since recorded a significant deceleration, which has extended into 1996 (Figure 17). Both the aggregate M2–, and the larger aggregate L– (liquid assets of the resident non-financial sector) have been growing at a similar pace, with the different evolution over the two halves of 1995 reflecting both the pace of the recovery in economic activity and portfolio shifts associated with changes in the relative yields of different financial instruments. After decelerating continuously from early 1992 to less than 5 per cent in early 1994 the growth of both aggregates gathered momentum, to around 13 per cent in the first quarter of 1995. The subsequent deceleration of monetary aggregates started in the second quarter of 1995, with the growth of L– falling to a year-on-year growth rate of around 5 per cent by March 1996, associated with portfolio shifts in favour of government bonds. Investment flows into public debt securities from the non-bank sector were positive in 1995, a movement which was sustained in the second half of the year by expectations of capital gains on government bonds and by the higher yield differential between government saving certificates and time deposits. Growth of the narrow aggregate M1 over the same period was subject to more variability and exhibited a weaker relation with the evolution of aggregate activity.[14]

Domestic bank credit followed a similar accelerating trend up to mid-1995, decelerating thereafter as growth of credit to the public sector eased. Bank credit to non-financial companies and individuals, on the other hand, expanded strongly (in year-on-year terms) throughout 1995, partly reflecting the impact of financial liberalisation, *i.e.* the removal of restrictions on consumer credit and increased bank competition in the mortgage market, and the suspension of the stamp tax on consumer credit. Bank credit granted to other financial institutions, for the purpose of purchasing shares of privatized firms, accellerated sharply in the second half of 1995 (Figure 17).[15]

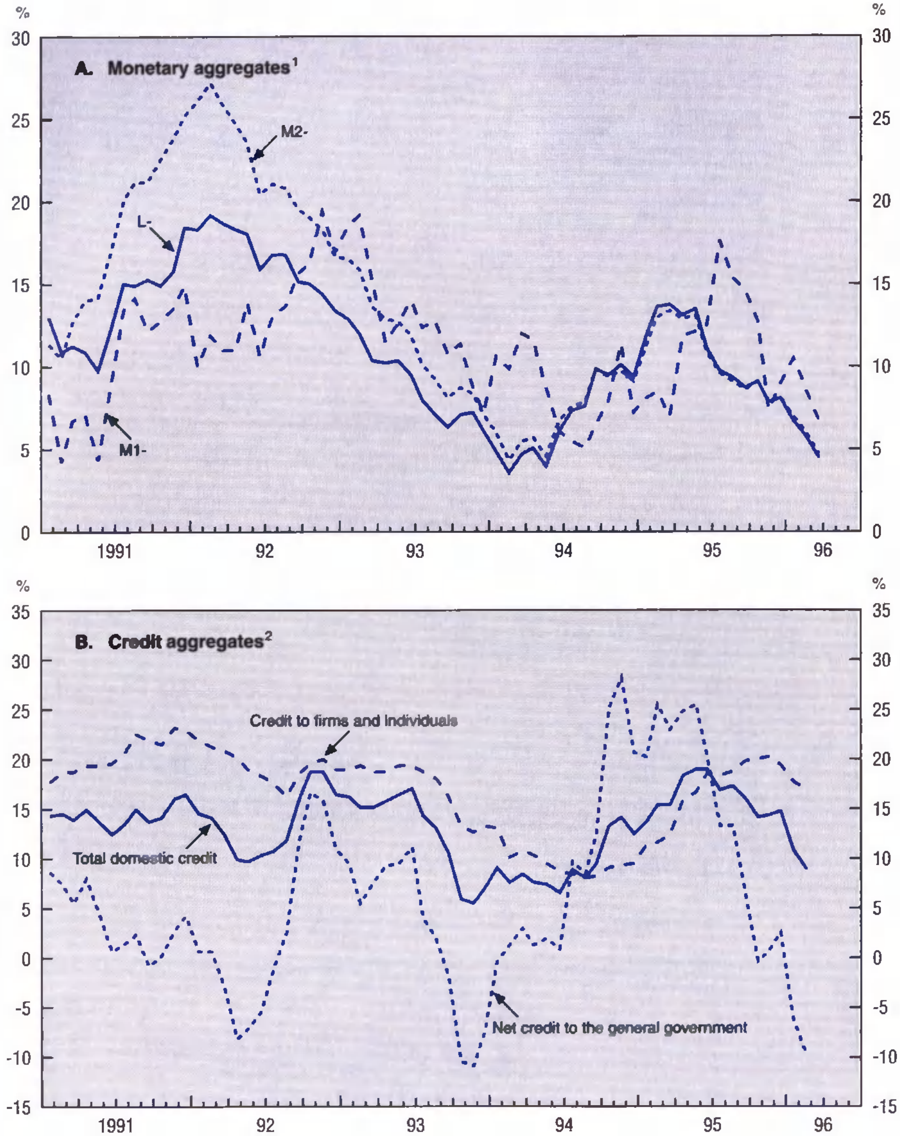
Figure 16. **BOND YIELDS, INFLATION, EXCHANGE RATES AND PUBLIC FINANCE**



1. The yield for May 1996.
Source: OECD.

Figure 17. **MONETARY AND CREDIT AGGREGATES**

Year-on-year percentage changes



1. End of month figures.
2. Weekly average figures.

Source: Bank of Portugal.

Fiscal policy

Following a large deficit increase in 1993, fiscal policy has become progressively tighter. The 1996 budget is based on the need to achieve the budgetary convergence criteria by 1997 and thereby qualify for the third stage of EMU. In budgetary terms this requires a reduction in the general government deficit of 2.2 per cent of GDP and a cut in the debt ratio of around 10 per cent from 1995 levels. The 1996 Budget is ambitious in this respect, but there is pressure on certain segments of government spending and budgetary execution could be hampered, as in the past, by a lack of expenditure control. Achieving the goals set down in the budget thus depends on elements, such as greater administrative efficiency and improved spending control, the effects of which are difficult to estimate.

Developments in 1995

General government net lending, having declined from 7.3 per cent of GDP in 1993 to 5.7 per cent in 1994, eased to 5.2 per cent in 1995, significantly undershooting the level foreseen in the 1995 budget (Table 7 and Figure 18).[16] The improvement in 1995 mainly reflected a deficit reduction at the State level (the largest component of the central administration) of 1.2 per cent of GDP, which more than compensated for the higher deficit of the social security institutions and the elimination of the surplus of other autonomous central services (Table 8). The unfavourable cyclical impact on budget consolidation over the past two years has been more than offset by discretionary measures, resulting in an improvement in the cyclically-adjusted deficit of around three quarters of a point more than that of the actual deficit. The primary surplus, though remaining well below its 1992 level, rose to 0.6 per cent of GDP in 1995, a level which resulted in an increase in the debt-to-GDP ratio of 1.4 points.

Budgetary consolidation in 1995 reflected a further increase in the share of current receipts in GDP, which rose by 1.3 points, significantly more than originally budgeted (Table 7). Taxes on income and wealth, in particular, increased at three times the rate expected on account of higher collections of personal income taxes (which exceeded their budgeted value by 6 per cent) and of taxes on corporate income (for which the difference is close to 20 per cent). In addition to the favourable evolution of the tax base, taxes on income were

Table 7. **General government income statement**[1]

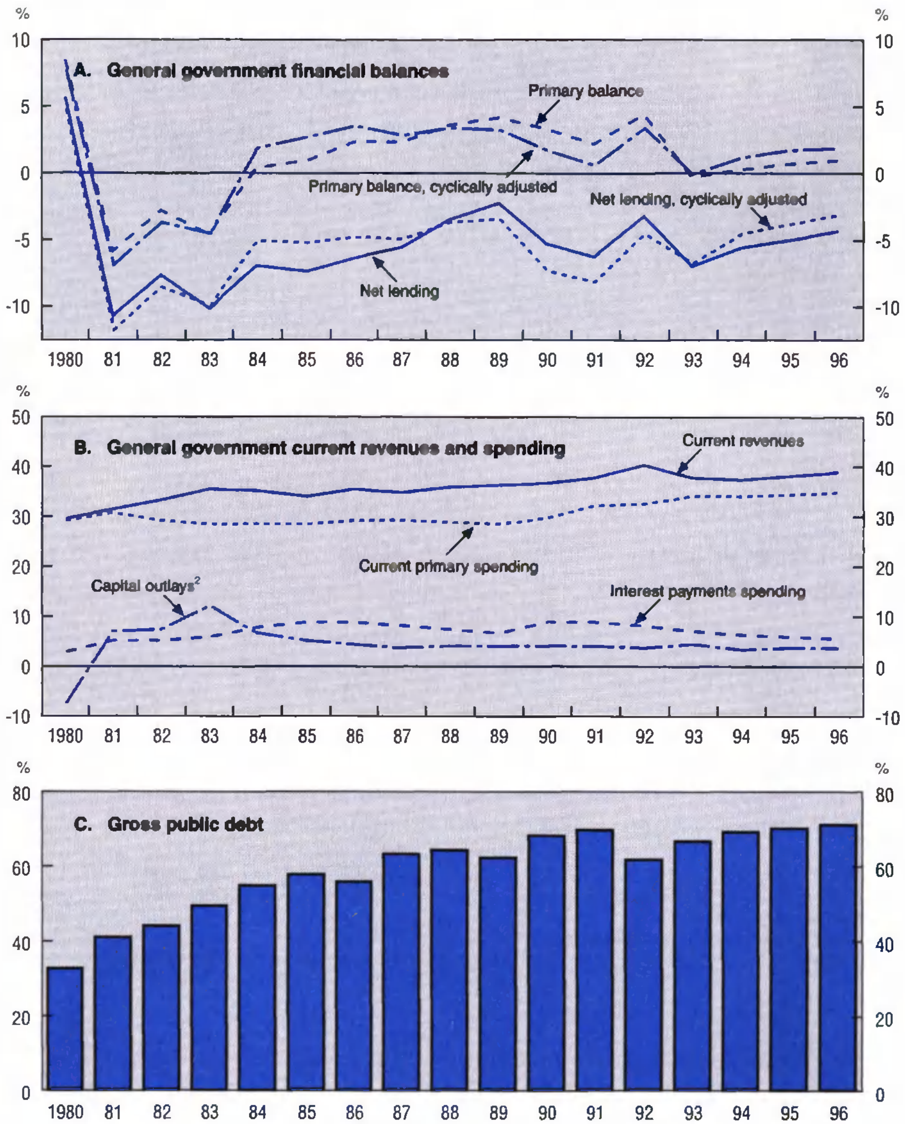
	1994	1995 Budget	1995 Estimate	1996 Budget	1995 Budget	1995 Estimate	1996 Budget
	Billions of escudos				Per cent change		
Current receipts	**5 474.2**	**5 941.0**	**6 110.6**	**6 677.4**	**8.5**	**11.6**	**9.3**
(per cent of GDP)	38.0	37.8	39.3	40.2	–	–	–
Taxes on income and wealth	1 315.8	1 365.2	1 480.0	1 615.0	3.8	12.5	9.1
Social security contributions	1 598.1	1 734.9	1 773.5	1 928.3	8.6	11.0	8.7
Indirect taxes	2 019.2	2 227.8	2 244.3	2 448.9	10.9	11.1	9.1
Other current receipts	541.1	601.9	612.8	685.2	11.2	13.3	11.8
Current expenditures	**5 809.3**	**6 236.3**	**6 332.9**	**6 781.0**	**7.4**	**9.0**	**7.1**
(per cent of GDP)	40.3	39.6	40.7	40.9	–	–	–
Public consumption	2 547.9	2 753.7	2 777.1	3 010.3	8.1	9.0	8.4
Wages and salaries	1 982.5	2 161.9	2 136.3	2 372.1	9.0	7.8	11.0
Other goods and services	565.4	591.8	640.8	638.2	4.7	13.3	–0.4
Subsidies	121.8	134.8	139.2	138.8	10.7	14.3	–0.3
Interest payments	842.0	868.4	899.2	857.3	3.1	6.8	–4.7
Transfers	2 297.6	2 479.4	2 517.4	2 774.6	7.9	9.6	10.2
Current balance	**–335.1**	**–295.3**	**–222.3**	**–103.6**	**–11.9**	**–33.7**	**–53.4**
(per cent of GDP)	–2.3	–1.9	–1.4	–0.6	–	–	–
Capital receipts	**335.9**	**523.1**	**427.1**	**503.0**	**57.4**	**27.2**	**17.8**
Capital expenditures	**818.8**	**1 152.6**	**1 008.5**	**1 099.2**	**40.8**	**23.2**	**9.0**
Gross capital formation	556.9	745.8	654.1	739.7	33.9	17.5	13.1
Capital transfers	261.9	406.9	354.4	359.5	55.4	35.3	1.4
Overall balance	**–818.0**	**–924.8**	**–803.7**	**–699.8**	**13.1**	**–1.7**	**–12.9**
(per cent of GDP)	–5.7	–5.9	–5.2	–4.2	..	..	..
Primary balance	**24.0**	**–56.4**	**95.5**	**157.5**	**–335.0**	**297.9**	**64.9**
(per cent of GDP)	0.2	–0.4	0.6	0.9	–	–	–
Net financial assets	**26.0**	**38.2**	**70.2**	**36.9**	**46.9**	**83.8**	**–47.4**
Net borrowing requirements	**–844.0**	**–963.0**	**–873.9**	**–736.7**	**14.1**	**3.5**	**–15.7**
(per cent of GDP)	–5.9	–6.1	–5.6	–4.4	–	–	–
Memorandum item:							
Overall balance, cash basis	–752.4	–909.5	–733.5	–703.8	..	..	..
(per cent of GDP)	–5.2	–5.8	–4.7	–4.3	..	..	..

1. Data on a national accounts basis.
Source: Data provided by the national authorities.

affected by measures to shorten collection lags, improvements in tax administration and reduced tax evasion, in response to the 1994 legal provisions, which criminalised tax non-compliance. Measures to reduce the arrears owed to the tax and social security institutions, which at end-1993 totalled Esc 685 billion,

Figure 18. **FISCAL INDICATORS**[1]

Per cent of GDP



1. Figures for 1996 are projections.
2. Defined as the sum of fixed investment, net capital transfers received by the government and other capital transactions.

Source: OECD.

Table 8. **Revenues and expenditures at different levels of the general government**[1]

	1994	1995	1996	1994	1995	1996	1995	1996
	Estimate		Budget	Estimate		Budget	Estimate	Budget
	Billions of escudos			Per cent of GDP			Percentage change	
State								
Total receipts	3 281.0	3 637.6	3 973.4	22.8	23.4	23.9	10.9	9.2
Total expenditures	4 062.1	4 283.6	4 722.5	28.2	27.5	28.5	5.5	10.2
Overall balance	–781.1	–646.0	–749.1	–5.4	–4.2	–4.5	–	–
Primary balance	18.6	191.9	46.3	0.1	1.2	0.3	–	–
Borrowing requirements	–792.2	–855.0	–757.2	–5.5	–5.5	–4.6	–	–
Autonomous services								
Total receipts	1 411.6	1 584.2	1 684.4	9.8	10.2	10.2	12.2	6.5
Total expenditures	1 371.0	1 588.6	1 676.3	9.5	10.2	10.1	15.9	5.5
Overall balance	40.6	–4.3	10.1	0.3	0.0	0.1	–	–
Primary balance	46.5	2.5	16.6	0.3	0.0	0.1	–	–
Borrowing requirements	28.4	–43.1	–16.4	0.2	–0.3	–0.1	–	–
Central government								
Total receipts	3 754.2	4 176.6	4 574.3	26.1	26.8	27.6	11.3	9.5
Total expenditures	4 494.7	4 826.9	5 313.3	31.2	31.0	32.0	7.4	10.1
Overall balance	–740.5	–650.3	–739.0	–5.1	–4.2	–4.5	–	–
Primary balance	65.1	194.4	62.9	0.5	1.2	0.4	–	–
Borrowing requirements	–763.8	–898.1	–773.6	–5.3	–5.8	–4.7	–	–
Local government								
Total receipts	702.0	761.4	851.5	4.9	4.9	5.1	8.5	11.8
Total expenditures	737.3	800.2	865.0	5.1	5.1	5.2	8.5	8.1
Overall balance	–35.3	–38.7	–13.5	–0.2	–0.2	–0.1	–	–
Primary balance	–0.5	–0.4	37.5	0.0	0.0	0.2	–	–
Borrowing requirements	–38.0	–41.1	–15.9	–0.3	–0.3	–0.1	–	–
Social security institutions								
Total receipts	1 929.4	2 144.6	2 530.2	13.4	13.8	15.2	11.2	18.0
Total expenditures	1 971.7	2 259.3	2 477.4	13.7	14.5	14.9	14.6	9.7
Overall balance	–42.3	–114.7	53.0	–0.3	–0.7	0.3	–	–
Primary balance	–40.7	–98.5	57.1	–0.3	–0.6	0.3	–	–
Borrowing requirements	–42.3	65.2	52.9	–0.3	0.4	0.3	–	–

1. Data on a national accounts basis.
Source: Data provided by the national authorities.

(around 12 per cent of current receipts or 5 per cent of GDP) and which have since increased to Esc 1 000 billion, succeeded in generating Esc 40 billion of additional receipts in 1994 alone, with further instalments due over a six year period of Esc 219 billion. Transfers received from the EU also increased significantly in 1995, reaching the equivalent of 3.2 per cent of GDP, well above levels reached in the previous year (Table 9).

Table 9. **Public transfers between Portugal and the European Union**

Billions of escudos

	1992	1993	1994	1995 Estimate	1996 Budget
From Portugal to the EU	145.4	163.1	247.5	170.4	223.6
Financial contributions[1]	109.4	127.9	207.2	130.1	181.1
Customs and levelling duties	36.7	35.4	40.0	40.3	42.5
Reimbursement of contributions	–0.7	–0.2	0.3	0.0	0.0
From the EU to Portugal	**461.3**	**619.7**	**507.9**	**669.5**	**738.4**
Agricultural fund (EAGGF)-guarantee[2]	74.4	86.4	139.7	138.9	173.9
Structural funds	359.6	500.9	321.4	449.7	477.0
Agricultural fund (EAGGF)-guidance[2]	49.9	62.1	49.6	55.0	63.2
Regional fund (ERDF)[3]	222.5	286.0	218.1	315.7	291.2
Social fund (ESF)[4]	87.2	152.8	53.7	79.0	122.6
PEDIP[5]	21.2	10.8	5.6	–	–
Cohesion fund	–	15.7	33.7	79.5	85.0
Others	6.2	5.9	7.5	1.4	2.5
Net transfers received by Portugal	**315.9**	**456.6**	**260.4**	**499.1**	**514.8**
Memorandum items:					
Net EU transfers as per cent of GDP	2.5	3.4	1.8	3.2	3.1

1. Contributions based on GNP, VAT resources and contributions to the European Investment Bank (EIB).
2. European Agricultural Guidance and Guarantee Fund.
3. European Regional Development Fund.
4. European Social Fund.
5. Specific Programme for the Development of Portuguese Industry.

Source: Ministério das Finanças (1996), Orçamento do Estado.

On the expenditure side, current outlays of the general government rose marginally as a share of GDP, increasing by 9 per cent as compared with a budgetary provision for a 7.4 percentage rise. The strongest growth was recorded by subsidies and by purchases of goods and services, which in both cases exceeded the initial appropriations. Expenditure on wages and salaries increased by around 8 per cent, which was lower than budgeted, while current transfers expanded faster than initially targeted, by almost 10 per cent. Growth of capital spending, at over 20 per cent in 1995, was boosted by increases of both public investment and by capital transfers to the private sector, but remained well below original appropriations, mainly due to under-execution at the level of local government.

Confronted with significant expenditure overruns, the new government presented a supplementary budget in December 1995, which increased current expenditure limits by over 3 per cent, mainly for health, education and road maintenance. However because of the unexpected revenue gains and lower disbursements in capital spending, the effects of overruns in current expenditure were neutralised at the level of the global deficit.

The 1996 budget[17]

The 1996 budget envisages a contraction in the general government deficit of 1 point to 4.2 per cent of GDP in 1996, a 1.3 point increase in tax pressure offsetting a rise, as a share of GDP, in both current and capital outlays.[18] Budget measures are targeted to widen the tax base, while keeping basic tax rates unchanged, and to redistribute expenditure to human and infrastructure capital and to low-income households (Table 10). The budgetary provisions are based upon assumptions of inflation falling to between 3 and 3.5 per cent in 1996 and output rising by 2.7 per cent. Lower interest expenditures account for the greater part of the deficit cut, but around one-third of the projected deficit reduction at the general government level is expected to stem from an improvement in the primary surplus, to close to 1 per cent of GDP, due largely to an improvement in the balance of the social security institutions.

On the spending side, general government current disbursements are budgeted to increase at a significantly slower rate than in 1995 (Table 7). A strong increase is foreseen in public wages, (11 per cent) reflecting higher budgetary contributions to the public pension scheme. Current transfers (mainly to households) are also budgeted to increase at double digit rates, with budgetary resources being earmarked to finance minimum-income transfers to around 8 000 households below the poverty line. Nominal declines are scheduled for the remaining items of current expenditure, with legislation recently introduced enforcing stricter expenditure controls at all levels of the public administration.[19] Budgeted levels of interest payments assume a fall of around 1 percentage point in the implicit cost of public debt, which is broadly consistent with market rates observed in early 1996. Curbs in capital transfers are also expected to lead to a significant deceleration in the growth of capital expenditures, although general government investment will continue to increase at a strong rate (13 per cent), mainly reflecting investment in transport infrastructure.

On the revenue side, the government's objective is to increase the current revenues of the general government by around 9 per cent. Corporate income tax receipts are expected to rise by close to 20 per cent (Table 11), mainly as a result

Table 10. **State expenditure**[1]

	1995 Budget	1995 Estimate	1996 Budget	1995 Budget	1995 Estimate	1996 Budget
	Billions of escudos			Per cent change		
	Economic classification					
Current expenditure	**3 869.2**	**3 940.9**	**4 284.6**	**4.1**	**6.0**	**8.7**
Wage bill	1 335.8	1 338.2	1 486.1	10.4	10.6	11.1
Purchase of goods and services	204.1	219.3	219.2	12.9	21.3	0.0
Interest payments	782.9	791.8	774.4	1.8	3.0	–2.2
Transfers	1 383.6	1 432.0	1 680.3	–2.2	1.2	17.3
to other public bodies	1 094.9	1 151.0	1 362.7	–0.6	4.5	18.4
to other	288.7	281.0	317.6	–7.9	–10.3	13.0
Subsidies	102.8	98.9	89.1	5.7	1.6	–9.9
Other	60.0	60.7	35.5	29.3	30.8	–41.5
Capital expenditure	**537.2**	**506.7**	**567.4**	**19.0**	**12.2**	**12.0**
Investments	172.5	138.9	171.5	49.6	20.5	23.5
Capital transfers	353.9	365.9	393.4	5.7	9.3	7.5
to other public bodies	335.0	341.5	372.3	7.8	9.9	9.0
to other	18.9	24.4	21.1	–21.6	1.2	–13.5
Other	10.8	19.0	2.5	671.4	35.7	31.6
Financial transactions[2]	**193.3**	**189.4**	**20.1**	**51.0**	**48.0**	**–89.4**
Total	**4 599.7**	**4 637.0**	**4 872.1**	**7.0**	**7.9**	**5.1**
	Functional classification					
Defence and security	**725.3**	**772.1**	**717.1**	**5.1**	**11.9**	**–7.1**
Social functions	**2 041.2**	**2 282.5**	**2 421.4**	**–0.8**	**10.9**	**6.1**
Education	787.8	805.0	876.1	8.6	11.0	8.8
Health	616.7	697.8	654.2	–4.2	8.4	–6.2
Others	636.7	779.7	891.1	–7.5	13.3	14.3
Economic functions	**363.1**	**418.0**	**382.5**	**3.2**	**11.4**	**–8.5**
Other	**1 276.8**	**975.0**	**1 331.0**	**21.9**	**–6.9**	**36.5**

1. Public accounts basis.
2. Includes "Cláusola de Convergência/Reserva".

Source: Ministério des Finanças (1996), Orçamento do Estado.

of higher profits from public enterprises, with smaller gains for indirect and personal income taxes. To a significant extent, revenue increases are also expected to follow from the better enforcement of existing laws and a curb on tax evasion and avoidance. Widespread evasion of personal income taxes is evidenced, *inter alia,* by low average values of declared income of self-employed, particularly in the retail and construction sectors, and of most professional categories, such as doctors, lawyers and accountants. As far as evasion of corporate

Table 11. **State tax receipts**[1]

	1994	1995 Budget	1995 Estimate	1996 Budget	1995 Budget	1995 Estimate	1996 Budget
	Billions of escudos				Per cent change		
Direct Taxation	**1 191.3**	**1 222.0**	**1 334.8**	**1 459.0**	**2.7**	**12.1**	**9.3**
Personal income tax (IRS)	865.7	895.0	950.9	997.4	3.5	9.9	4.9
Corporate income tax (IRC)	310.5	311.0	372.4	446.0	0.2	20.0	19.8
Other direct	15.1	16.0	11.5	15.6	7.4	–22.8	35.7
Indirect Taxation	**1 961.2**	**2 062.7**	**2 074.2**	**2 206.2**	**4.7**	**5.3**	**6.4**
Value added tax (IVA)	1 038.8	1 123.9	1 125.9	1 207.7	8.2	8.4	7.3
Fuel tax (ISP)	399.1	433.0	433.7	466.0	8.5	8.7	7.4
Car tax (IA)	121.1	140.0	133.6	151.8	15.6	10.3	13.6
Tobacco tax	140.5	150.0	150.9	167.3	6.0	6.6	10.9
Stamp tax	213.5	166.5	167.3	159.0	–22.5	–22.1	–5.0
Other	48.2	49.3	63.0	54.4	–9.9	15.2	–13.7
Total	**3 152.5**	**3 284.7**	**3 409.2**	**3 665.2**	**3.9**	**7.9**	**7.5**

1. Public accounts basis.
Source: Ministério des Finanças (1996), Orçamento do Estado.

income taxes is concerned, around half of small firms appear to have declared continual losses over the past 20 years. Evasion of the VAT might also be substantial. The increased efficiency of the tax administration is to be achieved through the allocation of greater resources, the redeployment of tax officials and decentralisation. Legislation is to be introduced to the effect that corporate income for those firms declaring abnormally low profits in three consecutive years will be based on the presumptive income of similar-sized firms in the same sector. At the same time, computerised controls are to be introduced, facilitating the creation of a system for the identification of taxpayers. Combined with the reform of the judicial system, new means for the settlements of tax liabilities and the introduction of indirect methods for the determination of taxable income for some categories of tax payers, these measures are projected to contribute to around one third of the total increase of State tax revenues.

At the same time, special tax provisions are targeted to favour low-income earners and to stimulate investment and competition:

– In the first area, measures include a higher indexation factor for lower incomes; increased (real) tax deductions for low-income pensioners and for low-income employees and increased benefits for couples with only one income-earner.

- In the second area, the system of tax credit for additional investment introduced in 1995 is maintained, with preferential treatment for small firms and backward regions, while taxes have been cut on car purchases.
- The stamp-tax on financial transactions has been reduced by 1 point and an intermediate VAT rate of 12 per cent introduced for certain categories of food products and services which had suffered from tax competition with Spain.

In the context of the presentation of the budget, the authorities also announced plans to give further impetus to the privatisation programme, with the objective of raising more than Esc 380 billion, or 2.3 per cent of GDP in 1996, through the sale of financial and industrial enterprises, with Esc 290 billion earmarked for debt reduction. Privatisations in the financial sector are expected to include *Banco Fomento e Exterior,* one of Portugal's largest financial groups, and *Banco Totta e Açores*; and, in the industrial sector, *Electricidade de Portugal,* the national power company, a second tranche of *Portugal Telecom,* as well as cement, tobacco and paper pulp companies.

Debt management

General government gross debt increased to 71.4 per cent of GDP in 1995, continuing the upward trend in evidence since 1993, as the liabilities of both the central government and other public bodies increased (Table 12). In addition to the impact of the deficit, other transactions recorded "below the line" contributed to a rise in public debt of around Esc 230 billion (Table 13): an increase in the stock of government deposits, linked to a policy of over-funding, together with interest accruals on saving certificates more than offset the favourable impact on foreign debt of the escudo appreciation and of privatisation receipts earmarked for debt reduction, which reached Esc 118 billion in 1995, from Esc 30 billion in the previous year.[20]

Debt management in 1995 continued to be geared towards increasing the maturity and diversity of public debt while reducing its cost. To this end, the liquidity and transparency of the domestic market was increased and household savings attracted through the issue of saving certificates. Throughout the year, the Treasury assured its regular presence in all segments of domestic markets, with issues continuing even in periods characterised by high financing costs. Debt

Table 12. **Outstanding public debt**

Billions of escudos

	1991	1992	1993	1994	1995
	Amount outstanding				
General government debt	7 846.2	8 001.8	9 162.7	10 078.0	11 110.3
(per cent of GDP)	70.2	64.4	67.2	70.0	71.4
Central government debt	7 629.7	7 766.3	8 871.4	9 753.0	10 700.9
(per cent of GDP)	68.2	62.5	65.1	67.7	68.7
Other public bodies	216.5	235.5	291.3	325.0	409.4
(per cent of GDP)	1.9	1.9	2.1	2.3	2.6
	Composition of direct public debt				
Domestic debt	92.0	92.5	88.3	85.5	82.5
Fixed rate	28.7	23.3	27.2	31.4	33.0
Short-term	20.0	14.7	10.6	13.0	11.9
Medium- and long-term	8.7	8.6	16.6	18.4	21.1
Floating rate	63.3	69.2	61.0	54.1	49.5
Short-term	–	–	–	–	–
Medium- and long-term	63.3	69.2	61.0	54.1	49.5
Foreign debt	8.0	7.5	11.8	14.5	17.5
	Implicit cost of direct public debt				
Total	14.9	16.8	13.6	10.3	9.8
Domestic debt	15.4	17.8	14.8	11.4	10.6
Foreign debt	11.5	6.5	4.0	5.1	6.0
	Maturity of direct public debt[1]				
Total	..	..	..	3.3	3.5
Domestic debt	..	..	..	2.7	2.9
Short-term	..	..	..	0.4	0.3
Medium- and long-term	..	..	..	3.1	3.3
Foreign debt	..	..	..	6.6	6.6

1. Years to maturity. End of period.

Source: Data provided by national authorities.

financing in 1995 mainly relied on fixed rate bonds (with issues worth Esc 733 billion) and floating rate bonds (Esc 511 billion), with a residual role attributed to Treasury bills. To increase the predictability of debt operations, the Treasury published in early 1995 a yearly calendar of issues for bonds with maturities of three, five and ten years and of their indicative amounts. In 1995,

Table 13. **General government deficit and other transactions**[1]

Billions of escudos

	1991	1992	1993	1994	1995
A. Overall deficit	736.0	451.8	934.8	818.1	803.7
B. Other transactions	535.3	–296.2	226.1	97.2	228.6
Privatisation receipts for debt redemption	–86.8	–199.9	–51.6	–30.0	–117.8
Financial assets net of reimbursements	–12.6	24.5	33.8	26.0	70.2
Change in government deposits	368.8	–329.6	–35.9	–62.5	361.9
Interest paid on saving certificates	110.0	117.8	140.4	114.2	118.5
Adjustment for exchange rate changes	10.6	10.2	141.1	–15.7	–40.5
Adjustment for complementary period	21.8	0.4	–35.8	–81.1	–152.5
Other adjustments[2]	123.5	80.4	34.1	146.3	–11.2
C. Total change in general government gross financial liabilities (A + B)	**1 271.3**	**1 55.6**	**1 160.9**	**915.3**	**1 032.3**
Memorandum item:					
General government gross financial liabilities	7 846.2	8 001.8	9 162.7	10 078.0	11 110.3

1. Data on a national account basis.
2. Includes debt settlements.

Source: Data provided by the Portuguese authorities.

the Portuguese Treasury also increased significantly its presence in foreign markets:

- A multicurrency credit facility was signed in March worth DM 3 billion (around Esc 320 billion), enabling prompt recourse to short-term external financing in the event of unfavourable domestic conditions.
- In the Eurobond market, there were Portuguese issues in yen (a 7-year issue worth Y 70 billion, or Esc 115 billion) and in French francs (a 10-year issue worth FF 6 billion, or Esc 180 billion).
- The government used the Global Medium Term Notes Programme, through several small placements in various currencies (worth Esc 100 billion), and made other medium and long-term operations (loans from banks with limited fungibility, worth Esc 64 billion).
- The Portugese government signed in November a new Euro Commercial Paper Programme (worth $2 billion, or Esc 297 billion), aimed at providing short-term financing at conditions more advantageous than those prevailing in the domestic and foreign markets. Issues in several currencies made under this programme in 1995 totalled Esc 95 billion.

Stronger recourse to foreign markets translated into an increase in the weight of foreign debt to more than 17 per cent in 1995, a level more than twice as high as that recorded three years earlier, but which is still low by international standards.

The debt management strategy followed by authorities yielded results in terms of both maturity and costs of public debt. The residual maturity of Portuguese direct debt lengthened to 3.5 years by end-1995. The cost of direct debt fell below 10 per cent in 1995, on account of both greater reliance on foreign debt, which has a markedly lower cost but carries a higher risk, and of lower costs for domestic debt. Treasury bill rates remained for most of 1995 slightly below bid rates on the money market, while exhibiting lower volatility.

For 1996, despite a reduction in the cash borrowing requirement of the State (net of privatisation receipts and including other financial operations), the budget envisages an increase in the anticipated reimbursements of high-interest debt instruments (FIP), resulting in the need for gross issues equivalent to around 22 per cent of GDP. In addition to assuring an orderly financing of the state borrowing requirement, debt management in 1996 will continue to pursue the aim of greater efficiency and liquidity in domestic financial markets. The number of maturities will be reduced and the size of instruments transacted increased, so as to facilitate the development of capital and derivative markets and reduce distortions which currently contribute to high interest rates. In the authorities' view, the pursuit of an active approach to debt management dictates flexibility as to the choice of instruments of financing. Plans have also been announced for a revision of legislation on the fiscal treatment of public debt, and for creating a specialised management agency responsible for the public debt portfolio.

III. Reform of the Social Security System

In Portugal, as in other OECD countries, the gap between social security expenditure and contributions is set to widen over the medium run, enlarged by deteriorating demographic trends. While corrective measures have recently been taken, these may not be adequate to restore financial equilibrium. Reforms to the social security system may thus be needed to ensure its viability in the medium term, and, to this end, the new government has appointed a special commission in 1996 to prepare a White Paper on social security not later than June 1997. Two broad sets of issues are involved. The first is one of financial sustainability, insofar as steps need to be taken to ensure that the funding of pension commitments does not result in an unacceptable increase in taxation or borrowing. This has particular relevance for the development of non-wage labour costs, with implications for labour-market performance (see Chapter IV). The second relates to the structure of benefits and contributions, which may need to be redesigned in order to reduce any adverse effects on efficiency and equity deriving from current institutional arrangements.

The chapter begins with a broad overview of Portugal's social security system, describing its institutional set-up and financing mechanisms. It then proceeds to present the main features of the two principal regimes, the private-sector general system and the public-sector scheme. While the discussion covers the entire spectrum of Portugal's extensive social security system, including both pensions and welfare programmes, the focus is on the pension schemes. Options for policy reform, based upon an assessment of long-term financial prospects, are laid out in the final section of the chapter.

Main features of the social security system

Portugal's pay-as-you-go system evolved in stages, a variety of limited regimes having been introduced since the beginning of the century. The first major pension plan was established in 1929 with the creation of the *Caixa Geral de Aposentações* for public-sector employees. A general scheme for private-sector workers was instituted in 1935, covering wage-earners in industry and services. Transfer payments included old-age and invalidity pensions, work injuries and sickness benefits, with contributions based upon earnings. This scheme was restructured in 1962 and 1969 to create special regimes for different categories of dependent workers, including those in agriculture. In the 1970s, social security schemes underwent further changes, extending the coverage to include self-employed persons and raising benefit levels. Pension rights were generalised in the public sector, extending them to all employees in central, local and regional administrations in 1972.

A fundamental reform, following the 1974 revolution, made welfare benefits universal with the creation of the "social pension" for persons not covered by the general scheme. Throughout the 1980s, the coverage of benefits was expanded and harmonised across certain categories of workers. In 1980, programmes of social protection for low-income persons were extended and incorporated into the non-contributory scheme, while agricultural workers were shifted to the general regime in 1987. Subsequent reforms in the late 1980s harmonised the system further, while maintaining the differentiation between the private and the public sector. In 1993-95, the government introduced a number of policy reforms, including a rise in the retirement age for women and a change in the pension formula.

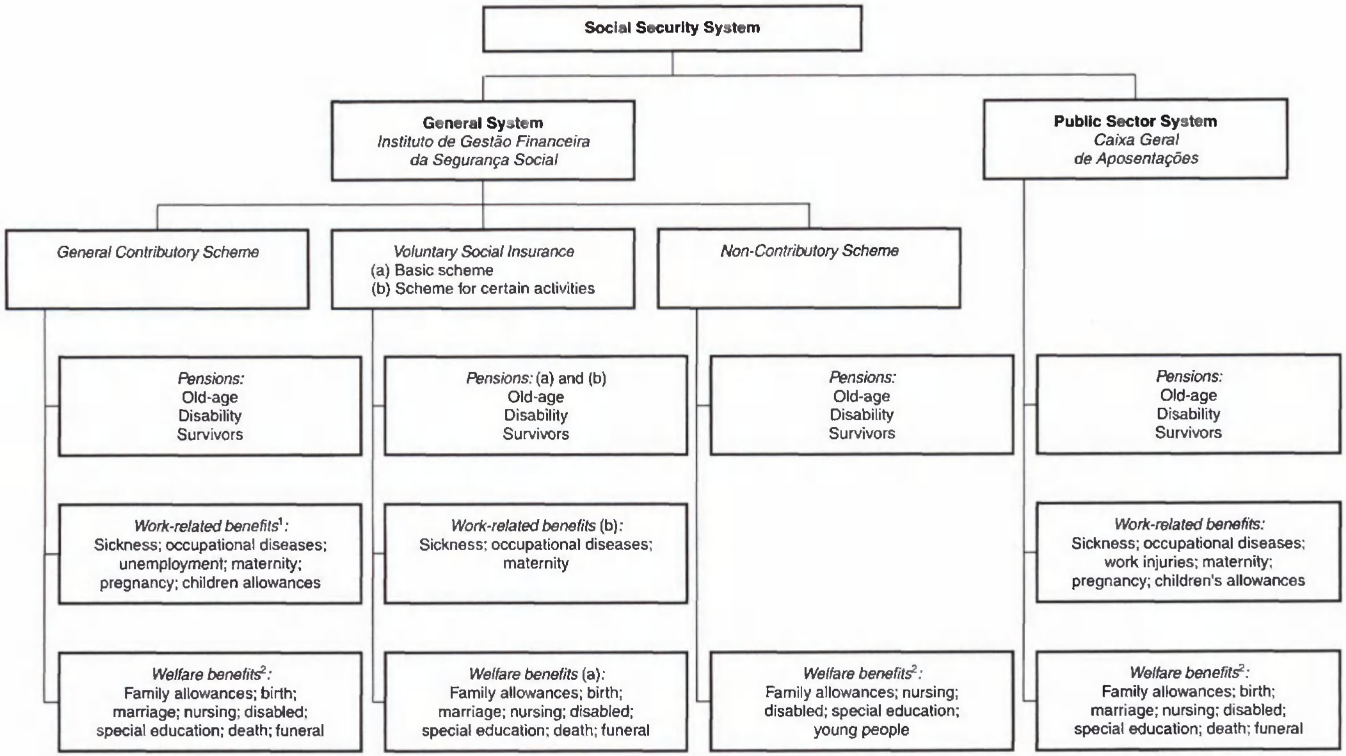
The current institutional set-up

The social security system comprises two main regimes: the general system, covering private-sector workers, and the system for public-sector employees (Figure 19). A special regime applies to the banking sector.

Of the two main regimes, the **general system,** with 2.3 million pension beneficiaries and 4.3 million contributors, is by far the more important. Managed by the *Instituto de Gestão Financeira da Segurança Social* (IGFSS), it comprises three basic schemes:

- The *general contributory scheme* covering dependent and self-employed workers outside the public sector (3.8 million in 1994).[21] Payments made

Figure 19. **SOCIAL SECURITY ORGANISATION**



1. The protection in the event of sickness and occupational diseases is voluntary for the self-employed.
2. Welfare benefits are not incomes-tested, with the exception of special education benefits and death grants.

Source: Portuguese authorities.

by this regime include pensions for old-age, invalidity and survivors; insurance against a temporary loss of income due to sickness, occupational diseases, maternity and unemployment; and other welfare benefits. The latter are, for the most part, not income-tested and consist of family allowances, birth grants, benefits for the disabled, funeral grants, etc. Pension beneficiaries amounted to 1.6 million in 1994. Outlays under the general contributory scheme are fully covered by social security contributions.

- The *voluntary social insurance scheme,* providing protection to persons not compulsorily covered by the general contributory scheme (*e.g.,* housewives, national citizens with occupational activity abroad). Benefits comprise old-age, invalidity and survivors' pensions, death grants and other welfare benefits. Special conditions govern the entitlement to additional benefits.
- The *non-contributory scheme,* providing minimum protection to persons not covered by any of the previous schemes, whose monthly income is below a certain limit and who are suffering economic and social hardship.[22] In addition to the "social pension" for old-age and invalidity, the other benefits provided by the non-contributory scheme include family and children allowances, subsidies to young people and benefits for the disabled. Pensioners numbered 156 000 in 1994, while family allowances beneficiaries totalled 21 000. The non-contributory scheme is funded by central government transfers.

There is also a special regime for agriculture, providing old-age and invalidity pensions, survivors' benefits and family allowances. This regime covers a closed pool of agricultural workers.

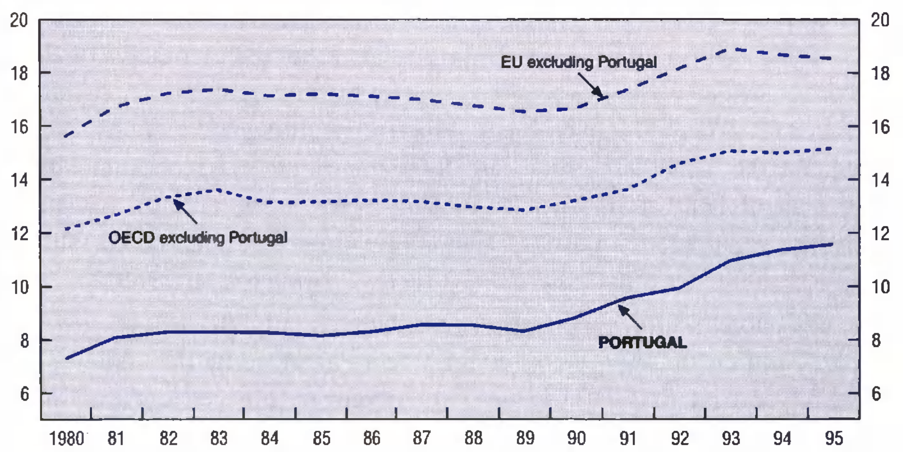
The **system for public sector employees** is managed by the *Caixa Geral de Aposentações* (CGA) and covers around 360 000 pension beneficiaries and 640 000 contributors.[23] Pension benefits are higher than those disbursed under the general contributory scheme, although employee contribution rates are similar. The government funds the difference between contributions and pension expenditure. Non-income-related welfare benefits are similar to those provided under the general contributory scheme. The *Assistência na Doença aos Servidores Civis do Estado* (ADSE) ensures medical assistance through revenues based upon a contribution rate of 1 per cent of the gross wage.

The **banking-sector scheme** is a private capitalised system, covering an estimated 135 000 beneficiaries, most of whom are excluded from the general system except for family allowances and risks of unemployment and occupational diseases. There are several private pension funds, managed by authorised life insurance and pension fund management companies, which provide pensions for old-age, disability and survivors as well as death grants, health and maternity benefits.

The financing of the social security system

In line with trends observed in other countries, Portugal's social security outlays have steadily increased relative to GDP, reaching an estimated 11.6 per cent in 1994, compared with 8.4 per cent in 1986 (Figure 20). The greater part of this rise (1.8 points) mirrored higher spending under the private-sector general system, which climbed to 9.2 per cent of GDP in 1994 in response to both rising numbers of beneficiaries and improved benefits (Table 14). Within the general

Figure 20. **SOCIAL SECURITY OUTLAYS**
Per cent of GDP



Source: OECD.

Table 14. **Private-sector general system**

Per cent of GDP

	1983	1986	1990	1991	1992	1993	1994
Current revenues	**7.1**	**8.4**	**8.5**	**8.7**	**8.7**	**9.5**	**9.3**
Contributions	6.3	7.3	7.5	7.8	7.6	7.5	7.4
Budget transfers[1]	0.3	0.7	0.6	0.6	0.6	1.5	1.5
Other revenues	0.5	0.4	0.4	0.3	0.5	0.5	0.4
Current expenditures	**7.3**	**7.4**	**7.8**	**8.3**	**8.6**	**9.0**	**9.2**
Pensions	4.9	4.9	5.5	5.7	5.8	6.0	6.1
Unemployment benefits	0.2	0.4	0.3	0.4	0.5	0.8	0.9
Sickness benefits	0.6	0.5	0.6	0.6	0.6	0.5	0.5
Other welfare programmes[2]	0.3	0.4	0.4	0.5	0.5	0.5	0.5
Other	1.2	1.3	1.0	1.1	1.1	1.1	1.0
Current transfers[3]	0.0	0.2	0.4	0.4	0.3	0.2	0.3
Current balance	–0.2	0.8	0.3	0.0	–0.2	0.3	–0.2
Capital balance	0.0	–0.3	–0.3	–0.2	0.0	–0.3	–0.4
Overall balance	**–0.2**	**0.4**	**0.0**	**–0.2**	**–0.1**	**0.0**	**–0.6**

1. Includes only transfers from Ministry of Employment and Social Security.
2. Social Action.
3. Excludes transfers from the Fundo de Estabilização Financeira da Segurança Social.

Source: Ministry of Employment and Social Security, Ministry of Finance, and National Institute of Statistics (INE).

system, cash contributions have been sufficient to cover outlays under the contributory scheme, while expenditures under the non-contributory regime have been funded by central government transfers, totalling 1.5 per cent of GDP in 1994. At the same time, there are large contribution arrears, amounting to 2.6 per cent of GDP in 1994, and financial reserves are still far too small to protect the system against growing spending pressure, despite the establishment of a reserve fund (the *Fundo de Estabilização Financeira*) in 1989.

In the public sector, employees' contributions only covered 45 per cent of social expenditure in 1995, the remainder being financed by the central government (1.5 per cent of GDP, Table 15). Moreover, the gap between pension payments per beneficiary in the public sector and the private-sector equivalent widened with the public pay reform in 1989, which boosted public pay and hence earnings-related pensions (see below).

Table 15. **The public sector scheme**

Per cent of GDP

	1992	1993	1994	1995
Revenues	**1.9**	**2.1**	**2.4**	**2.8**
Employees' contributions	1.0	1.0	1.3	1.2
Budget support	0.8	1.0	1.1	1.5
Other	0.0	0.0	0.0	0.0
Expenditures	**1.8**	**2.0**	**2.4**	**2.8**
Pensions	1.7	2.0	2.3	2.7
Other	0.1	0.1	0.0	0.0

Source: Caixa Geral de Aposentações, Relatório e Contas.

Benefits and contributions

The general system

Old-age, invalidity and survivors' pensions account for two-thirds of current expenditure under the general system. Pension payments grew from 4.9 per cent of GDP in 1986 to over 6 per cent in 1994 (Table 14). Three main factors were responsible for the rise in spending:

- Population ageing, which raised the number of pension beneficiaries by more than 2 per cent a year.
- Nominal pension adjustments, which increased real expenditure by 1.8 per cent per year. A fourteenth month of pension payment was introduced in 1990.
- Rising pension levels for new retirees, which, replacing lower pensions for those who died, increased real expenditure by 4 per cent per year.

Pension benefits in the general contributory scheme are earnings-related. They are calculated on the basis of a fixed accrual rate, the assessed income (income of the contributor over a specified period of time prior to retirement) and the number of years of contributions. At present, the reference income to compute pensions is the highest 10-year average income of the last 15 years. The accrual rate is a flat 2 per cent, which is high by international comparison. Overall, pensions cannot exceed 80 per cent of assessed income (Table 16). In 1996, the minimum pension in the general contributory scheme (Esc 29 000 per month) amounts to 49 per cent of the national minimum wage.

Table 16. **Pension provisions of the general system**

General contributory scheme	
Coverage	Employed and self-employed persons
Contribution rate	
Employed persons	Employees 11%[1] Employers 23.75%[1]
Self-employed persons	23% to 28%[2]
A. Old age pension	
Eligibility conditions	
Age	Women 63[3] Men 65
Minimum qualified period	15 years of recorded earnings[4]
Contribution period for full pension	40 years
Monthly amount	2% of reference income for each calendar year of recorded earnings
Reference income	Highest 10-year average income of the last 15 years
Minimum pension	30% of reference income[5]
Maximum pension	80% of reference income
Inflation adjustment	*Ad hoc*
B. Invalidity pension	
Eligibility conditions	
Definition of contingency	Medical assessment of permanent incapacity
Minimum qualified period	5 years of recorded earnings[4]
Contribution period for full pension	As old-age pension
Monthly amount	As old-age pension
Reference income	As old-age pension
Minimum pension	As old-age pension
Maximum pension	As old-age pension
Inflation adjustment	*Ad hoc*
C. Survivor's pension	
Eligibility conditions	
Definition of contingency	Death of a beneficiary and subsequent loss of earnings
Minimum qualifying period	36 months of recorded earnings
Monthly amount	60% of old-age or invalidity pension for spouse and 20-40% for children depending on their number[6]
Maximum amount	100% of old-age or invalidity pension
Non-contributory scheme	
Coverage	Persons not covered by a protection scheme, under income conditions
A. Old-age social pension	
Eligibility conditions	
Age	Women and men 65 years
Monthly amount	Esc 20 000
B. Invalidity social pension	
Eligibility conditions	
Definitions of the contingency	Medical assessment
Monthly amount	As old-age social pension

Table 16. **Pension provisions of the general system** *(cont.)*

C. Survivor's pension	
Monthly amount	Same percentages of survivor's pension of the general contributory scheme calculated over the social old-age or invalidity pension

1. Including contributions for work-related benefits and welfare payments. Employees 2.1 per cent for invalidity and 5.6 per cent for old-age and survivor's pensions. Employers 4.8 per cent for invalidity and 12.4 per cent for old-age and survivor's pensions.
2. Depending on the protection scheme: compulsory or voluntary.
3. To be increased to 65 years between 1995 and 1999.
4. For this purpose a year is defined as having at least 120 days of recorded earnings.
5. Every year the government establishes a minimum value for old-age and invalidity pensions (Esc 29 000 for 1996). When the minimum amount calculated (30 per cent of reference income) does not reach this minimum value fixed yearly, a social supplement is added for that purpose.
6. 40-80 per cent for orphans if both parents were beneficiaries.

Source: Data provided by the Portuguese authorities.

The current retirement age is 65 years for men and 63 years for women.[24] A minimum of fifteen years of contributions are required to qualify for an old-age pension at retirement age. Forty years of contributions are required for the maximum pension. No formal indexation mechanism governs the annual pension adjustment, which is based upon *ad hoc* government decisions. Pensions have been subject to taxation from 1989, but benefit from preferential treatment, the average tax rate being about 7 per cent lower than that on earned income and the degree of progressivity being milder.

Persons in the non-contributory scheme are entitled to a social pension, provided their income is 30 per cent or less of the national minimum wage (50 per cent if married). Currently, the social pension (Esc 20 000 per month) corresponds to 34 per cent of the minimum wage and is only payable from the age of 65. Benefits are revalued once a year by government decree.

Insurance against a temporary loss of income due to sickness, occupational diseases, maternity and unemployment is provided by the general contributory scheme. Benefits are earnings-related and not subject to taxation (Table 17). Among these, unemployment benefits, included in the general system in 1985, are the most important, amounting to 0.9 per cent of GDP in 1994. The unemployment insurance scheme requires that claimants should have held a job for at least 540 days in the preceding 24 months, while the maximum duration of the benefit is related to the worker's age. In 1995, the average benefit period was

Table 17. **General contributory scheme: work-related benefits for employees**

	Sickness benefit	Maternity benefit	Unemployment insurance benefit	Unemployment social benefit	Occupational diseases benefit[1]
Eligibility	Recorded earnings for at least 6 months and 12 continuous days during the 4 months prior to the one preceding the day of incapacity	Recorded earnings for at least six months	• To be capable of and available for work. • To be registered at the employment office. • Recorded earnings for a least 540 days during the 24 months preceding job loss.	• To have exhausted entitlement to unemployment insurance benefit. • Recorded earnings for at least 180 days during the 12 months preceding job loss. • To have an average monthly income not exceeding 80% of the minimum wage in the relevant sector.	List of occupational diseases
Benefits	• 65% of the average salary for the 6 months preceding the 2 months in which the illness began. • 70% of this average wage after a period of incapacity of more than 365 days without interruption. • In the event of tuberculosis: 80% of average salary or 100% if insured has 2 or more dependants. Minimum amount: 30% of salary in the relevant sector	100% of the average salary on same conditions as for sickness benefit. Minimum amount: 50% of the minimum salary in the relevant sector	65% of the average salary for 12 months preceding the 2 months prior to the date of unemployment. The monthly amount cannot be higher than 3 times the minimum guaranteed salary and cannot be lower than that salary	70% to 100% of minimum salary in line with number of dependants	Temporary incapacity: • Partial incapacity: two-thirds of the reduction of general earnings capacity. • Total incapacity: two-thirds of the salary at the day of medical evaluation.

Table 17. **General contributory scheme: work-related benefits for employees** *(cont.)*

	Sickness benefit	Maternity benefit	Unemployment insurance benefit	Unemployment social benefit	Occupational diseases benefit[1]
Duration	Maximum 1 095 days	98 days (60 of which after confinement). 14 to 30 days after miscarriage. 60 days in case of adoption	General benefits proportional to age: < 25 years 10 months 25-30 years 12 months 30-35 years 15 months 35-40 years 18 months 40-45 years 21 months 45-50 years 24 months 50-55 years 27 months > 55 years 30 months	• Same periods established for the unemployment insurance benefit. • Extended benefits: 50% of these periods. • If the person is aged over 55, the benefit continues to be awarded up to age 60, anticipating the entitlement to an old-age pension.	All the contingency period
Waiting period	3 days	None	None	None	None
Number of beneficiaries (1994)	686 000	61 000	113 000	68 000	

1. Insurance against work injuries is compulsory. It is the responsibility of employers to transfer it to insurance companies.
Source: Eurostat and Portuguese authorities.

17 months. The unemployment compensation is subject to a ceiling, the level of which depends on the minimum national wage. The average monthly benefit corresponded to 136 per cent of this minimum wage in 1994. When entitlements are exhausted or not applicable, job seekers qualify for the unemployment social benefit, provided their income does not exceed 80 per cent of the minimum wage. The benefit varies between 70 and 100 per cent of the minimum wage, in line with the number of dependants. Unemployed persons aged over 55 are entitled to the unemployment social benefit until the age of 60, after which they qualify for an old-age pension. Accepting a part-time job triggers the suspension of unemployment compensation.

Contributions, totalling 7.4 per cent of GDP in 1994, are the main source of finance. The total contribution rate is currently 34.75 per cent of the gross wage, of which 23.75 per cent is paid by employers and 11 per cent by employees. This global rate covers contributions for pensions, work-related benefits and welfare payments, with no differentiation being made for different insurance categories. Contribution rates for the self-employed and special categories of dependent labour are lower (Table 18). The average period over which people pay contributions is relatively short, 14 years in 1995.

In order to narrow the gap between contributions and outlays in the private sector, the government in 1993-95 introduced a number of reforms, including:

- A change in the pension formula, lengthening from 10 to 15 years the period which determines the reference income, and lowering the accrual rate from 2.2 per cent to 2 per cent.

Table 18. **Contribution rates in the general system in 1996**

Per cent

	Worker	Employer	Combined
Dependent workers			
General rates	11.0	23.75	34.75
Agricultural workers	8.0-9.5	21.0-23.0	29.0-32.5
Domestic services	8.0	21.0	29.0
Clergy	4.0	8.0	12.0
Soccer professionals	11.0	17.5	28.5
Self-employed	23.0-28.0[1]	–	23-28.0[1]

1. These rates are being increased gradually to reach 25.4 and 32.0 per cent by the year 1999.
Source: Ministry of Employment and Social Security.

- A gradual rise in the retirement age for women from 62 in 1993 to 65 years by 1999.
- An increase in the contribution period required for full pension.
- A reduction in the contribution rate paid by employers of 0.75 percentage points, offset by a rise in VAT rates of 1 point, receipts of which are earmarked for social security.
- Tighter eligibility controls on invalidity and sickness benefits.
- Payment facilities for firms with contribution arrears.
- Administrative controls and more effective collection methods, making evasion of social security contributions a crime punishable by imprisonment.

A fundamental reform of the social security scheme for self-employed workers also came into effect in 1994. The new measures provide two pillars of protection: one is compulsory, covering invalidity, old-age, death and maternity; the other is voluntary, providing insurance in the event of sickness and occupational diseases. Contributions paid by self-employed persons were raised to 23-28 per cent of their gross income, the rate depending on the protection plan they choose. These rates will be increased further to reach 25.4-32 per cent by 1999.

The system for public sector employees

Pension outlays under the public-sector scheme amounted to 2.7 per cent of GDP in 1995 (Table 15), up from 1.1 per cent in 1986. The main forces driving pension payments were adverse demographic trends, the public-pay reform of 1989, the attribution of the fourteenth month from 1990, and most importantly, increased coverage and early retirement programmes. The number of pension beneficiaries surged by 78 per cent between 1986 and 1995, with the number of contributors rising a mere 7 per cent (Table 19). As a result, the contributor/beneficiary ratio fell rather dramatically.

The public-sector system has been much more generous than its private-sector equivalent. For employees hired before September 1993, the reference income is the income of the contributor in the last month of service, against the much longer reference period in the general contributory scheme. The retirement age is 60 years, compared with 65 in the general system. The minimum contribution period is 5 years, against 15 in the general contributory regime. A public

Table 19. **Number of pension beneficiaries and contributors to the public-sector system**

	Contributors	Old-age pensioners	Survivors' pensioners	Number of contributors per beneficiary	
	(a)	(b)	(c)	(a) / (b)	(a) / [(b) + (c)]
1985	583 802	124 673	69 505	4.7	3.0
1986	595 916	132 096	72 536	4.5	2.9
1987	603 467	141 272	88 183	4.3	2.6
1988	615 515	148 704	90 182	4.1	2.6
1989	634 001	152 977	92 238	4.1	2.6
1990	653 842	158 731	94 831	4.1	2.6
1991	665 236	170 667	97 443	3.9	2.5
1992	668 715	187 889	99 933	3.6	2.3
1993	661 347	203 141	102 114	3.3	2.2
1994	638 327	237 378	104 419	2.7	1.9
1995	637 749	258 053	105 761	2.5	1.7
Average annual growth rate (per cent)	0.9	7.5	4.3	–	–

Source: Caixa Geral de Aposentações, Relatório e Contas.

employee with 36 years of service earns a pension equal to the salary of the last position held, a replacement ratio of 100 per cent, which is exceptional by international standards. As a result, pension payments per beneficiary were more than twice as large as those made under the general contributory scheme in 1994 (Table 20).

Table 20. **Pension outlays and beneficiaries**

1994

	Outlays	Beneficiaries	Payment per beneficiary
	(Million escudos)	(Thousands)	(Thousand escudos)
General system	880 185	2 338	376
Contributory scheme	674 918	1 602	421
Non-contributory scheme	53 547	158	339
Special regime for agriculture	151 720	578	262
Public sector scheme	338 793	342	991

Source: Caixa Geral de Aposentações, Relatório e Contas, and Instituto de Gestão Financeira da Segurança Social (1994), Conta da Segurança Social.

As regards contributions, they amount to 10 per cent of gross emoluments – 7.5 per cent for old-age and invalidity pensions and 2.5 per cent for survivors' pension. An additional 1 per cent of gross salary is paid for medical assistance (*Assistência na Doença aos Servidores Civis do Estado*). However, in 1993-95 employees' contributions were only able to finance around 50 per cent of pension expenditure, the remainder being covered by the central government. Budget transfers also finance forms of insurance against a temporary loss of income due to maternity, work injuries and occupational diseases. Benefits provisions are the same as those applicable to the private sector. Welfare benefits are not income-tested (with the exception of special education benefits and death grants) and are regulated by the general system's legislation.

In an attempt to stem the rising tide of social payments, the government downgraded the public pension formula in 1993.[25] Public employees hired after September 1993 are now subject to the same provisions as those applicable to the private sector. However, with around 98 per cent of public employees being currently covered by the previous generous provisions, pension expenditure is set to rise rapidly relative to GDP over the medium run. Savings from the harmonisation will be slow to materialise, the full effect taking an estimated 40 years.

Pension funds

Private pension funds have expanded rapidly since their inception in 1987 (Table 21), especially in the banking sector, part of which is not covered by the general system.[26] Under current legislation, these optional schemes are managed, on a segregated basis, by authorised life insurance companies and by pension fund management companies (*sociedades gestoras de fundos de pensões*). Both entities can manage pension funds created by employers to fund liabilities they have assumed (*fundos fechados* – closed funds) or themselves create pension funds which enable individuals or small businesses to fund their own pensions (*fundos abertos* – open funds). The employer contributions are tax-deductible, provided the scheme complies with rules applicable to the general system, *e.g.* non-discrimination, retirement age etc. Measures aimed at lowering the level of pensions in the future will further stimulate the expansion of private pension funds.

Table 21. **Private pension funds**

	1987	1990	1991	1992	1993	1994	1995
Number of entities managing pension funds							
Insurance companies	10	11	13	12	11	11	12
Pension fund management companies	5	12	13	16	15	15	16
Total	15	23	26	28	26	26	28
Number of pension funds[1]							
Insurance companies	42	90	90	90	87	81	81
Pension fund management companies	20	100	110	126	132	136	144
Total	62	190	200	216	219	217	225
Amount of pension funds[2]							
Insurance companies	14.0	51.4	81.2	53.5	78.7	95.9	98.1
Pension fund management companies	2.9	119.3	209.4	398.9	710.6	891.2	1 286.5
Total	16.9	170.7	290.6	452.3	789.3	987.1	1 384.6

1. Funds authorised and in activity.
2. Billion escudos.
Source: Instituto de Seguros de Portugal, provisional data.

The case for reform

Two major weaknesses characterise the Portuguese pay-as-you-go regimes: a distorted system of benefits and contributions and a financial structure which will necessitate unsustainable increases in contribution rates if current levels of benefits are to be maintained. This section begins by comparing Portugal's system with that of other industrialised countries and then proceeds to examine options for policy reform based upon medium- and long-term projections of financial developments.

International comparisons

Over the past ten years, social security expenditure has increased more rapidly in Portugal than in the rest of the OECD, although, at an estimated 11.8 per cent of GDP in 1995, spending was still 3.5 points below the OECD average (Figure 20). Compared with other European countries, the gap was much larger (around 6.5 points), expenditure being low in each of the major categories and in particular for old-age and unemployment benefits (Figure 21). Scaling social outlays by per capita income confirms Portugal's position as a country with a relatively low level of such spending (Figure 22).

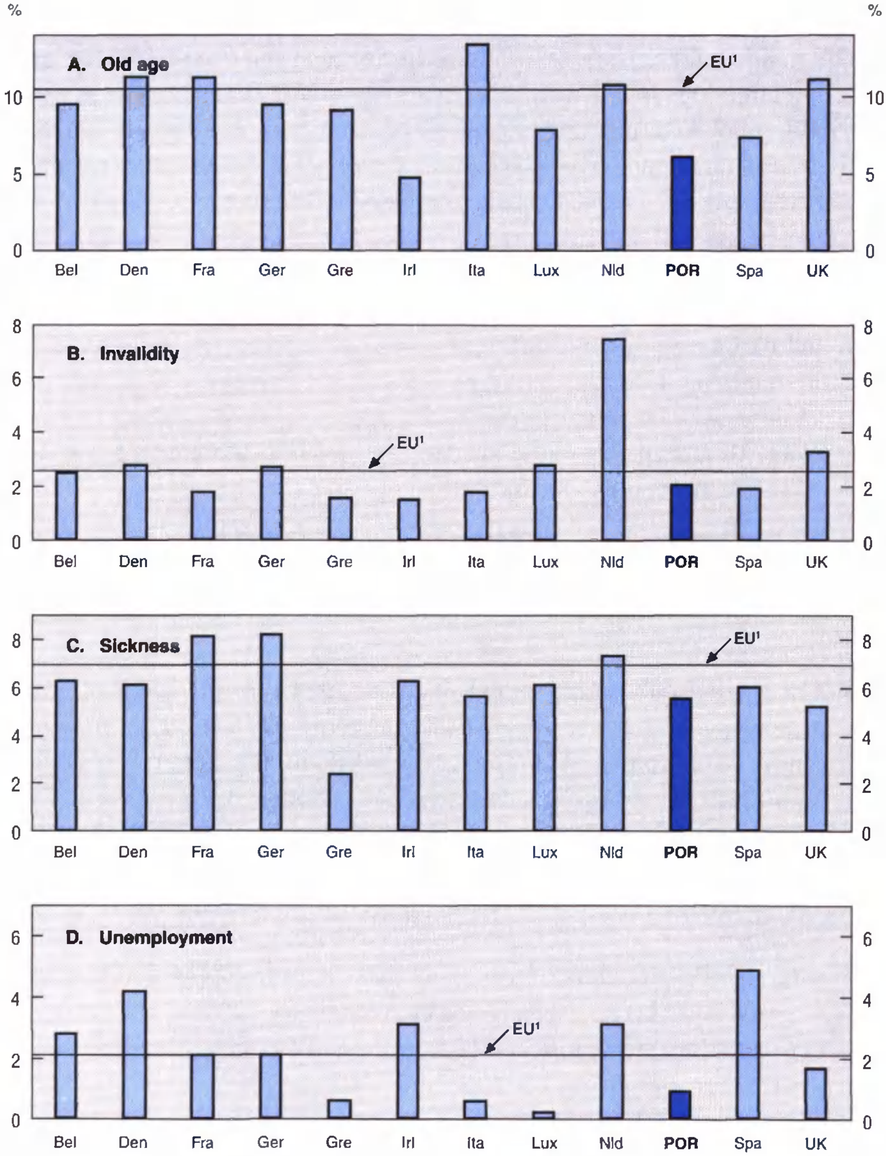
The main factor raising expenditure in Portugal over the last three decades has been enlarged insurance coverage, contrasting with other European countries where demographic trends and increased pension benefits have dominated the surge in social payments. The Portuguese social security system, established in 1935, is a relatively young system compared with those of other European countries. The system was fundamentally changed after 1974, becoming universal with the creation of the non-contributory scheme. At the same time, throughout the 1980s, insurance against contingencies was expanded in the general system and harmonised across different groups of workers. At present, however, protection continues to differ for some categories of workers (*e.g.* banking and public employees) who remain covered by special regimes outside the general system. Plans to incorporate these special regimes into the general contributory scheme have not been fully put into effect.

While pension payments for agricultural workers and beneficiaries under the non-contributory scheme are low (34 per cent of the minimum wage), pension provisions in the general contributory scheme differ from the European norm in several respects:

- The accrual factor (2 per cent after the 1994 reform) and the maximum percentage of assessed income (80 per cent) are still higher than in most European countries. Currently, a worker in the general system, with 40 years of contributions and constant earnings growth over his career, receives a pension equal to 75 per cent of the salary in his last year of service.
- The reference period for calculating pensions (the highest 10-year average income of the last 15 years) results in looser ties between the present value of benefits and contributions than in countries where pensions are assessed over career earnings or contributions.
- Pension adjustments reflect a higher degree of policy discretion compared with other countries, due to the absence of a formal indexation mechanism.

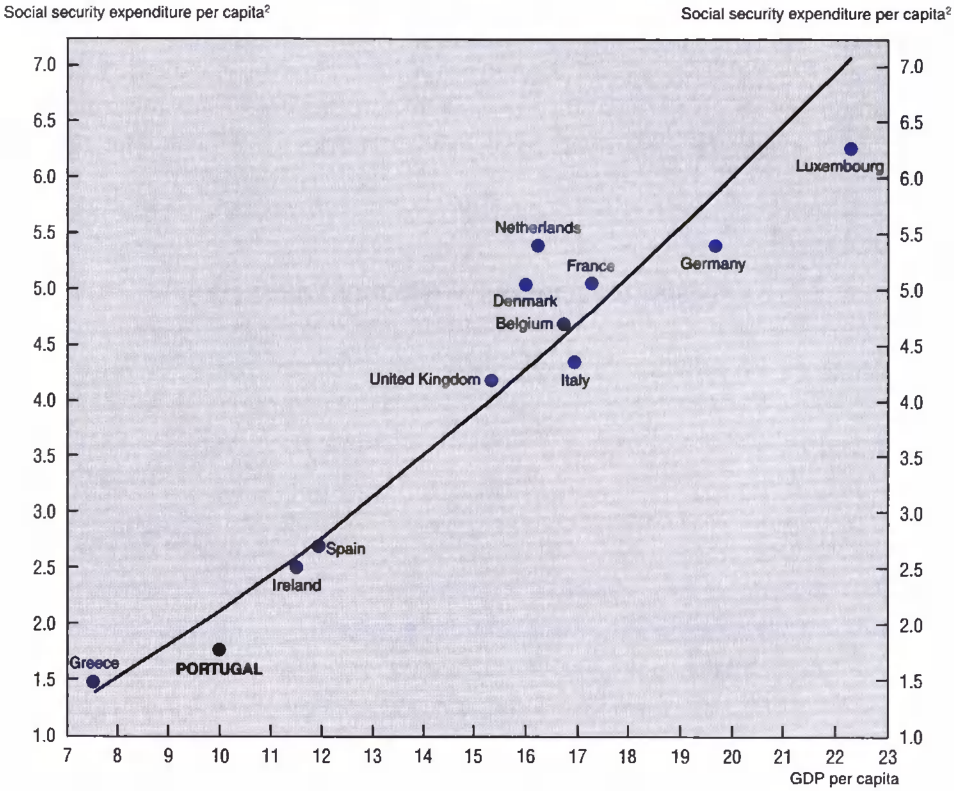
On the contribution side, Portugal's current rate of 34.75 per cent for dependent employment is relatively high, contributions also financing social welfare programmes, whereas in other European countries general tax revenues

Figure 21. **SOCIAL PROTECTION EXPENDITURE IN THE EU**
1993, per cent of GDP



1. The European Union average only covers the twelve countries listed.
Source: Ministry of Labour and Social Security (1995).

Figure 22. **SOCIAL SECURITY EXPENDITURE AND GDP PER CAPITA**[1]
1992

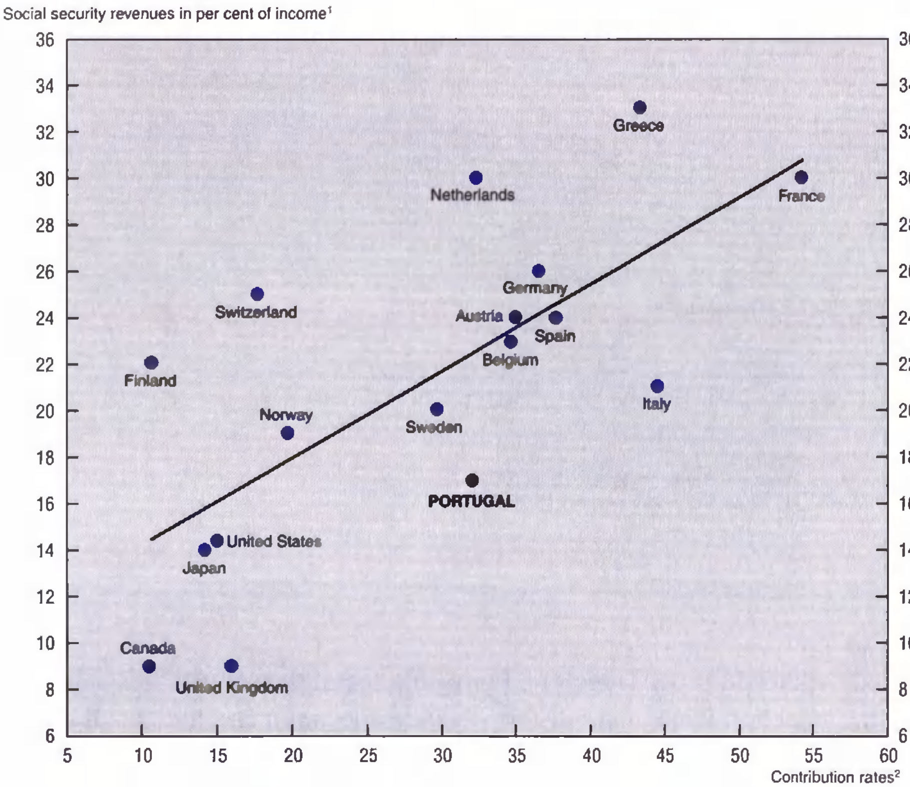


1. In PPP thousand $US.
2. The regression line has the following form: y = –2.8 + 1.5b.

Source: Ministry of Labour and Social Security (1995).

are used for this purpose. Therefore, Portugal's social security system imposes a high tax on labour, which may distort resource allocation and horizontal equity. Indeed, both the high contribution rate and the weak link between contributions and benefits may have stimulated evasion. The short reference period for calculating pensions has encouraged incorrect reporting of income. In addition, several other factors accounted for contribution fraud in the past, including preferential contribution rates for the self-employed, which stimulated ''false contracting-out'', and the predominance of micro-firms, which complicated the task of an inefficient tax administration. Countries with similar weighted contribution rates tended to collect much larger amounts of social security contributions than Portugal (Figure 23), even allowing for contribution arrears, which in 1994 amounted to 2.6 per cent of GDP. There is a transfer of income from those who cannot evade the system easily (dependent workers) to those who can, and

Figure 23. **SOCIAL SECURITY CONTRIBUTIONS AND REVENUES**
1993



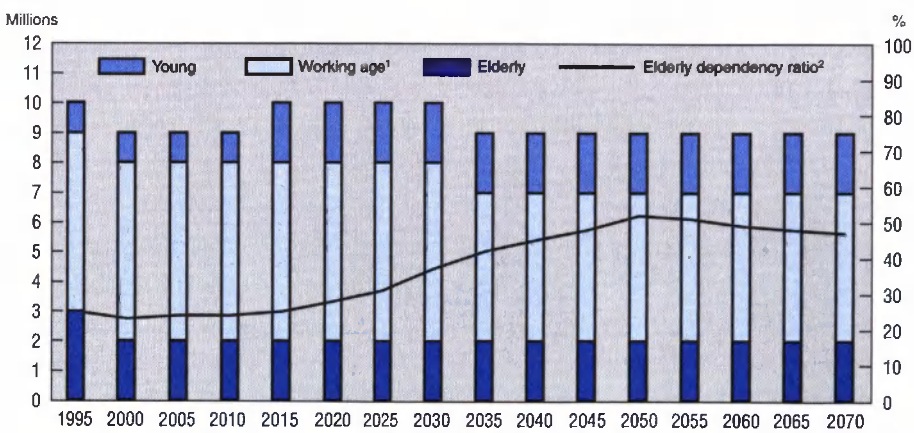
1. Income includes wages, salaries and income from self-employment.
2. Contribution rates paid by employees, employers and self-employed people, weighted by employment shares.
Source: OECD.

from those who contribute as scheduled to those who choose to incur arrears. The new government has announced strong measures to rein in tax and contribution evasion.

Long-term financial prospects for the pension system

At present, the age structure of Portugal's population does not differ much from the OECD average, but adverse demographic changes are bound to put rising pressure on the pay-as-you-go system. In 1990, 18 per cent of the total population was aged 60 years or older, close to the OECD average of 18.2 per cent. Official projections show a moderate rise in this ratio up to the year 2020. The trend, however, is expected to worsen gradually, the proportion rising to 33 per cent by 2050, which would be above the estimated levels for the OECD area as a whole (31 per cent).[27] The ratio of the retired population to the working-age population, is projected to rise sharply from the year 2015, reaching 52 per cent in 2050, twice as large as in 1994 (Figure 24).

Figure 24. **POPULATION PROJECTIONS AND ELDERLY DEPENDENCY RATIOS**
1995 to 2070

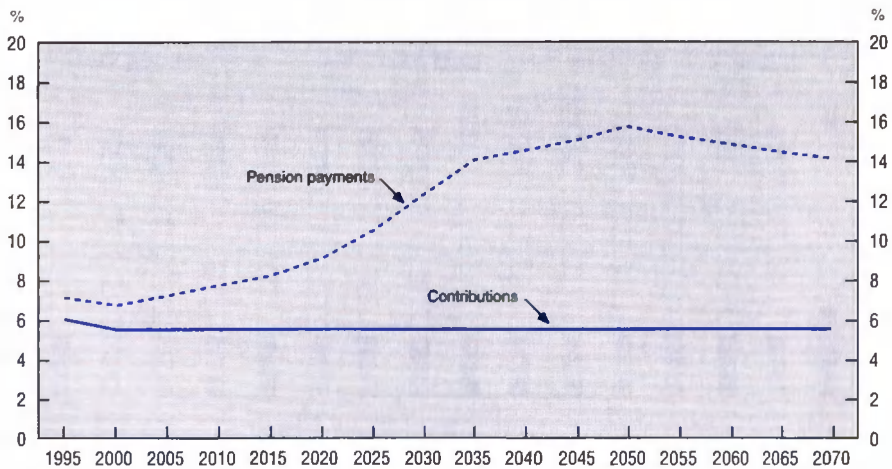


1. Defined as from age 20 until the scheduled retirement ages for public pensions in Portugal.
2. The ratio of the retired age population to the working-age population.
Source: OECD.

To quantify the financial impact of the ageing population on the pay-as-you-go system, simulations have been run for Portugal's two main pension regimes, the general system and the public-sector scheme. The simulation model covers both old-age and survivors' pensions and incorporates the scheduled rise in the retirement age for women. For the general system, the share of contributions accruing to the pension scheme is assumed to be equal to the share of pension payments in total current social expenditure. In the model, labour productivity increases at an annual rate of 1.5 per cent and pensions are indexed to inflation.[28]

The results are based on a hypothetical set of circumstances and should be interpreted with great care and for illustrative purposes only. Overall, the quantitative analysis highlights a significant rise in pension expenditure between 2000 and 2050, more than doubling from around 7 per cent of GDP to 15.8 per cent (Figure 25).[29] Despite the 1993-95 pension reforms, the gap between overall pension spending and contributions is projected to reach 8½ per cent of GDP in 2035, of which nearly 6 points are accounted for by the general system and the

Figure 25. **FUTURE PENSION PAYMENTS AND CONTRIBUTIONS**
Per cent of nominal GDP



Source: OECD.

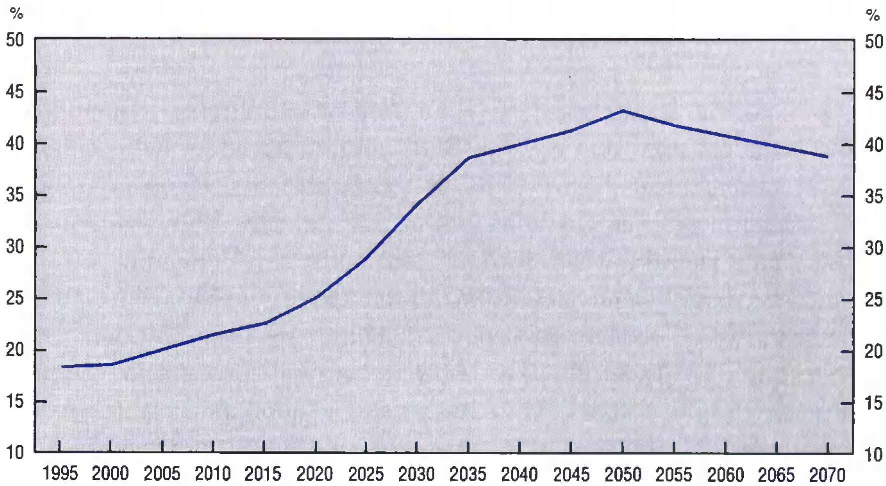
remainder by the public-sector scheme. The deficit is projected to widen to more than 10 per cent in 2050. Subsequently, expenditure may decline slightly, albeit staying at a high level. The general contributory pension scheme itself is projected to show a deficit from 2005, rising to 5 per cent of GDP in 2035.

The financial implications of demographic changes can also be highlighted by the equilibrium contribution rate (ECR), *i.e.* the contribution rate that balances the pay-as-you-go pension system at a given rate of productivity growth.[30] The simulation model, applying to both the private- and public-sector pension schemes, shows the ECR rising from 18 per cent in 1994 to 25 per cent in 2020, and further to 43 per cent in 2050 (Figure 26). This result demonstrates the scale of the potential impact on labour costs of a rising pension burden.

Options for reforming the pay-as-you-go pension system

Given the high global contribution rate, containment of spending needs to be the primary instrument to guarantee the system's solvency. The main avenues for cutting future pension expenditure while maintaining the current pay-as-you-go

Figure 26. **EQUILIBRIUM CONTRIBUTION RATE**[1]



1. General pension system and public-sector pension scheme.
Source: OECD.

system would then be *i)* to reduce the accrual rate and link pensions to lifetime earnings, *ii)* to raise the retirement age, and *iii)* to reduce privileges granted to specific groups of workers, in particular, the highly preferential pension formula applying to public employees hired before September 1993. Some information about potential savings flowing from changes in these parameters is provided in Table 22, which investigates the sensitivity of the gap between contributions and pension outlays with respect to various policy instruments. Results are expressed in net present value terms, assuming a discount rate of 5 per cent and productivity growth of 1.5 per cent per year.[31]

Table 22. **Pension policy options:[1] sensitivity analysis**

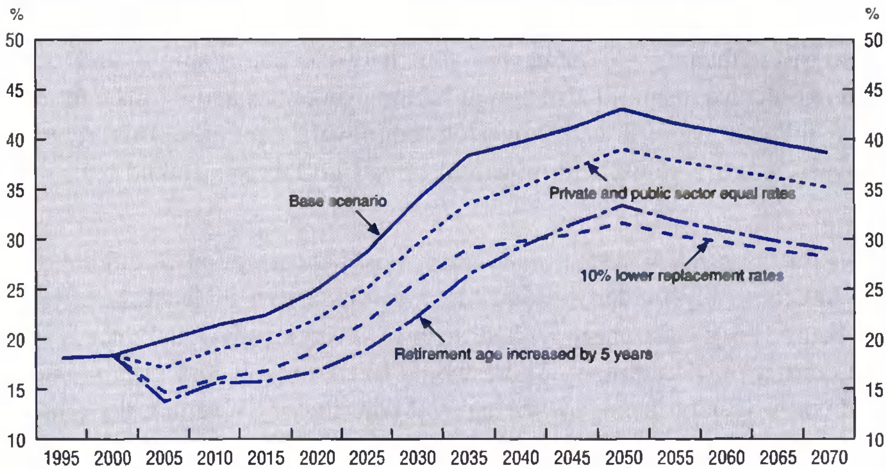
Net present value as a percentage of 1994 GDP

	Base scenario	Retirement age 5 years later	Replacement rate 10 per cent lower	Equal replacement rates in the private and the public sector
Contributions	164	174	164	164
Pension payments	270	222	217	236
Balance	–106	–48	–52	–71

1. Contributions and pension payments assuming a discount rate of 5 per cent and productivity growth of 1.5 per cent.
Source: OECD.

The simulations are based on a number of simplifying assumptions. In particular, it is assumed that these reforms are introduced in 2005 without any phasing-in arrangements. This tends to exaggerate the simulated impact of reforms, which in practice would be introduced gradually. The sensitivity analysis shows that a measure which lowered pensions relative to earnings by 10 per cent would be roughly equivalent to increasing the retirement age by five years. Both reforms would reduce net pension liabilities by over 50 points of GDP relative to baseline (Table 22). The contribution rate that balances the pension system would drop to 15 per cent in 2005, rising to approximately 18 per cent in 2020 (as against 25 per cent in the base scenario) and 32 per cent in 2050 (as against 43 per cent in the base scenario). Aligning the public-sector replacement rate on that prevailing in the private domain is found to lower net pension liabilities by 35 points of GDP. In this case, the equilibrium contribution rate would decline to 17 per cent in 2005, rising to 22 per cent in 2020 and to 39 per cent in 2050 (Figure 27). Overall, the simulations show that none of these measures alone would be sufficient to ensure financial equilibrium, calling for a combination of different measures.

Figure 27. **PENSION POLICY OPTIONS**
Alternative equilibrium contribution rates



Source: OECD.

Assessment and agenda for reform

Measures taken to improve financial sustainability should also seek to enhance both the efficiency and transparency of the social security system. Contributions cover a wide variety of welfare programmes, some of which would be more appropriately financed from general revenues. Moreover, there is little perceived link between current contributions and future benefits. All of these factors aggravate the potential distorting effects of the tax system, by stimulating evasion and raising the statutory contribution rate from labour income to an internationally high level.

This being the case, the guiding principle of any reform should be to create a closer link between contributions and benefits. As a first step, greater differentiation should be made between income-related and welfare benefits and, in respect of contributions, between pension benefits and provision made for other contingencies, such as short-term income loss. This would call for a new set of institutional financing requirements, taking the provision of welfare programmes other than earnings-related benefits out of the general contributory scheme and financing them with tax revenues. This should allow social security contribution rates to be reduced, with positive effects on the demand for labour. At the same time, contribution rates should differentiate between insurance categories, with a view to strengthening the perceived link between contributions and benefits. Such a restructuring should also aim at harmonising rates across different categories of income earners and lowering employers' contributions relative to employees' contributions, with potential effects on labour demand.

As for the pension system *per se,* the most radical option would be to move to a mandatory fully-funded system, which would have the advantage of fairness, while being less distortionary with respect to savings behaviour. Such a scheme would consist of three pillars. There would be two mandatory pillars: one fully funded and privately-managed (the general contributory scheme), the other publicly managed and providing protection for low-income groups through general taxation. Benefits from mandatory contributions could be topped up through payments to voluntary pension funds, the third pillar.[32] Setting up such a scheme would involve complex transitional arrangements and would need to embrace the creation of pension reserves kept separate form the general government funds.

A less radical, and more easily implementable, reform would be to preserve the current pay-as-you-go system, relying on future taxation to finance benefits, while reshaping it to obtain many of the advantages of a fully-funded system. This would involve:

– Cutting the internationally rather generous replacement rate by reducing the accrual rate and linking pensions to lifetime earnings. The accruals system should reward workers for staying within the system, via a pension formula modified to base pensions on the capitalised value of lifetime contributions (as adopted in the recent Italian reform).[33]

– Reducing the diversity of treatment between different categories of workers, and particularly between those in the public and the private sector. If current privileges are kept in place, the gap between pension outlays and contributions to the public-sector scheme could reach an estimated 2.6 per cent of GDP by the year 2035.

Such a reform would reduce allocative distortions and horizontal inequities, helping to improve labour-market outcomes in the longer run.

IV. Implementing the OECD Jobs Strategy

Introduction

Over the ten years to 1992, employment creation proceeded at a faster pace in Portugal than elsewhere in Europe, reducing unemployment at the cyclical peak in the second half of the 1980s in contrast with trends observed in most other countries (Figure 30). Over the past three years, however, real income convergence has stalled, as a comparatively severe recession has given way to a relatively slow recovery. In the process, unemployment has increased by more than in the EU as a whole, reducing the differential between the EU and Portugal's unemployment rates to below 4 points in 1995 as against 5.7 points in 1992, the pre-recession year. While updated OECD projections point to a resumption of real income convergence from 1996, unemployment may remain higher than in the past.

The improved performance during the 1980s took place against the background of impressive, albeit uneven, structural changes following Portugal's accession to the EC in 1986. Labour market reform focused on relaxing employment restrictions, and, more importantly, on upgrading the education and training system. The same institutional framework having remained in place, it would be difficult to attribute higher unemployment over the past five years to the emergence of new labour market rigidities. Indeed, the greater openess of the economy may have created frictional unemployment by affecting the distribution of employment among sectors. However, the need to avoid the unemployment persistence which is characteristic of other continental economies does raise questions as to whether the existing flexibility of the Portuguese labour and product markets will be sufficient to allow the economic and industrial structure to adapt to the new challenges of increased competition and real income convergence.

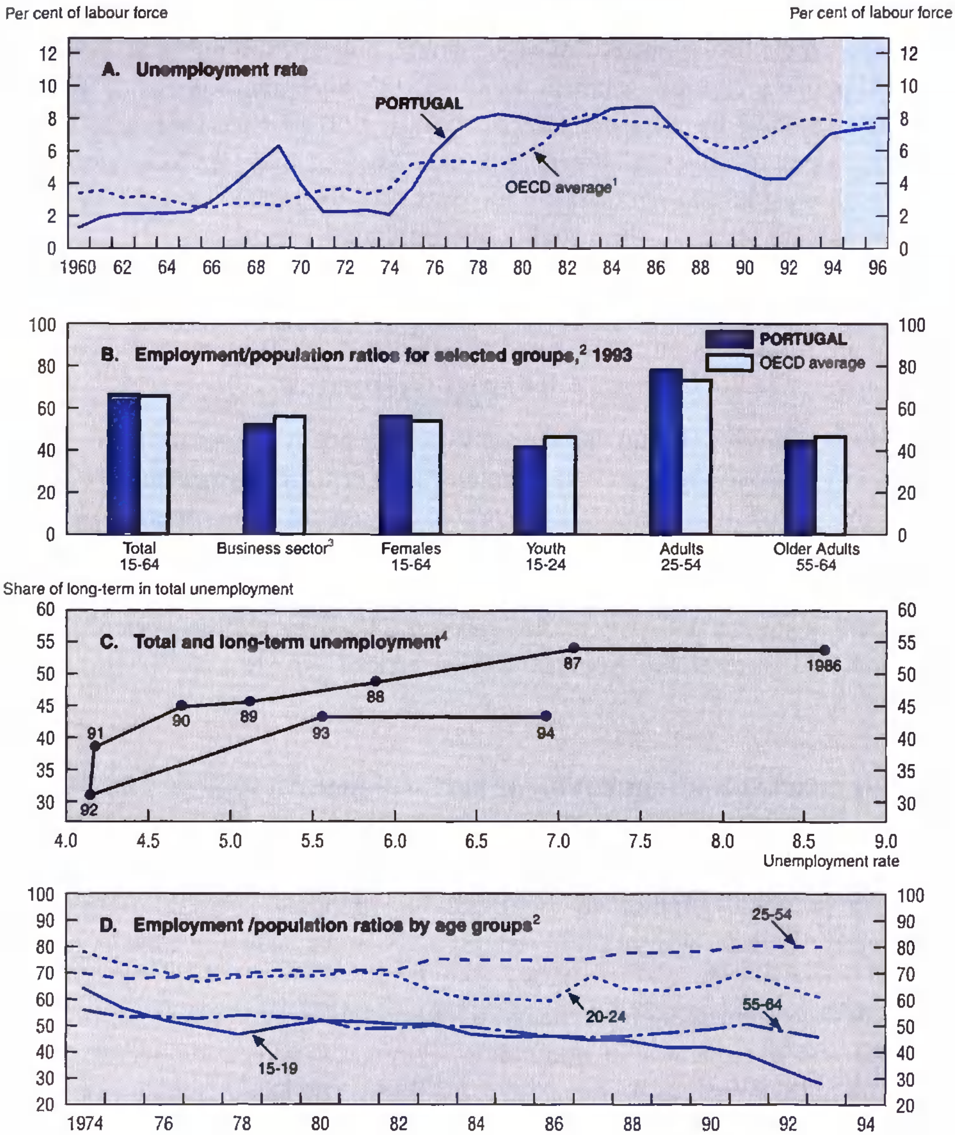
Meanwhile, the macroeconomic background is becoming more favourable. The deterioration in labour market outcomes in the first half of the 1990s took place against the background of macroeconomic policy restraint, fiscal consolidation and public sector retrenchment, as a result of which consumer-price inflation was brought down from around 12½ per cent in 1991 to 4 per cent in 1995, one of the steepest declines in the OECD area (see Chapter I). Macroeconomic restraint was associated with a real appreciation of the escudo. But the exchange markets having steadied, the benefits of disinflation should now show up in a lower cost of capital, more efficient allocation of resources and continued inward direct investment. On the other hand, for public debt to be put on a downward course, the momentum of recent fiscal consolidation needs to be stepped up, and this continues to limit the scope for budgetary manœuvre.

This chapter follows up the general structural policy proposals of the OECD *Jobs Study* with specific recommendations for Portugal. Its structure is as follows. The first section gives an overview of Portuguese labour market performance over the last three decades, describing the nature and scale of Portugal's labour market problems. Policy requirements which emerge from the Study are discussed in the second part of the chapter. The final section reviews recent measures and assesses the scope for further action.

Labour market and employment performance[34]

Over the past 20 years, unemployment followed a roller-coaster pattern, rising in the 1970s, falling in the 1980s and trending upward in the 1990s (Figure 28). The rate of unemployment, observed at the peak of the cycle, jumped from 2.2 per cent in 1973 to 8 per cent in 1980 (Figure 29). The surge in joblessness sprang largely from the return of Portuguese nationals from its former colonies and a reduction in emigration, Portugal's population increasing by around 1 million persons between 1973 and 1980. The labour supply rose by no less than 14 per cent (Figure 30). While the employment rate remained broadly stable, Portugal entered the 1980s with an economy beset by severe structural problems, including an archaic tax system, underdeveloped infrastructure, widespread illiteracy, a large and inefficient agricultural sector, large-scale nationalisation of production, pervasive price regulations and heavy-handed interventions

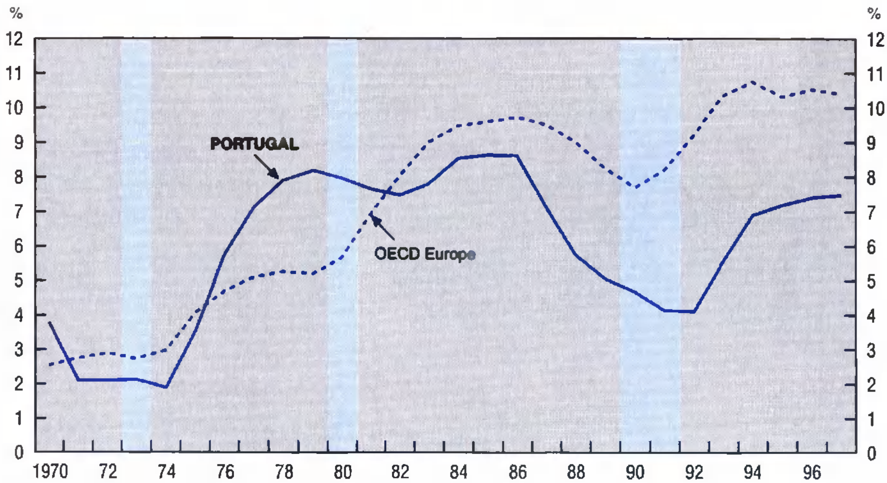
Figure 28. **LABOUR MARKET INDICATORS**



1. Excludes Iceland and Mexico.
2. Defined as the percentage of each population group that is employed.
3. Business sector employment divided by working-age population.
4. Long-term unemployment is defined as individuals looking for work for one year or more.

Source: OECD, *Employment Outlook, Economic Outlook 59.*

Figure 29. **RATE OF UNEMPLOYMENT**

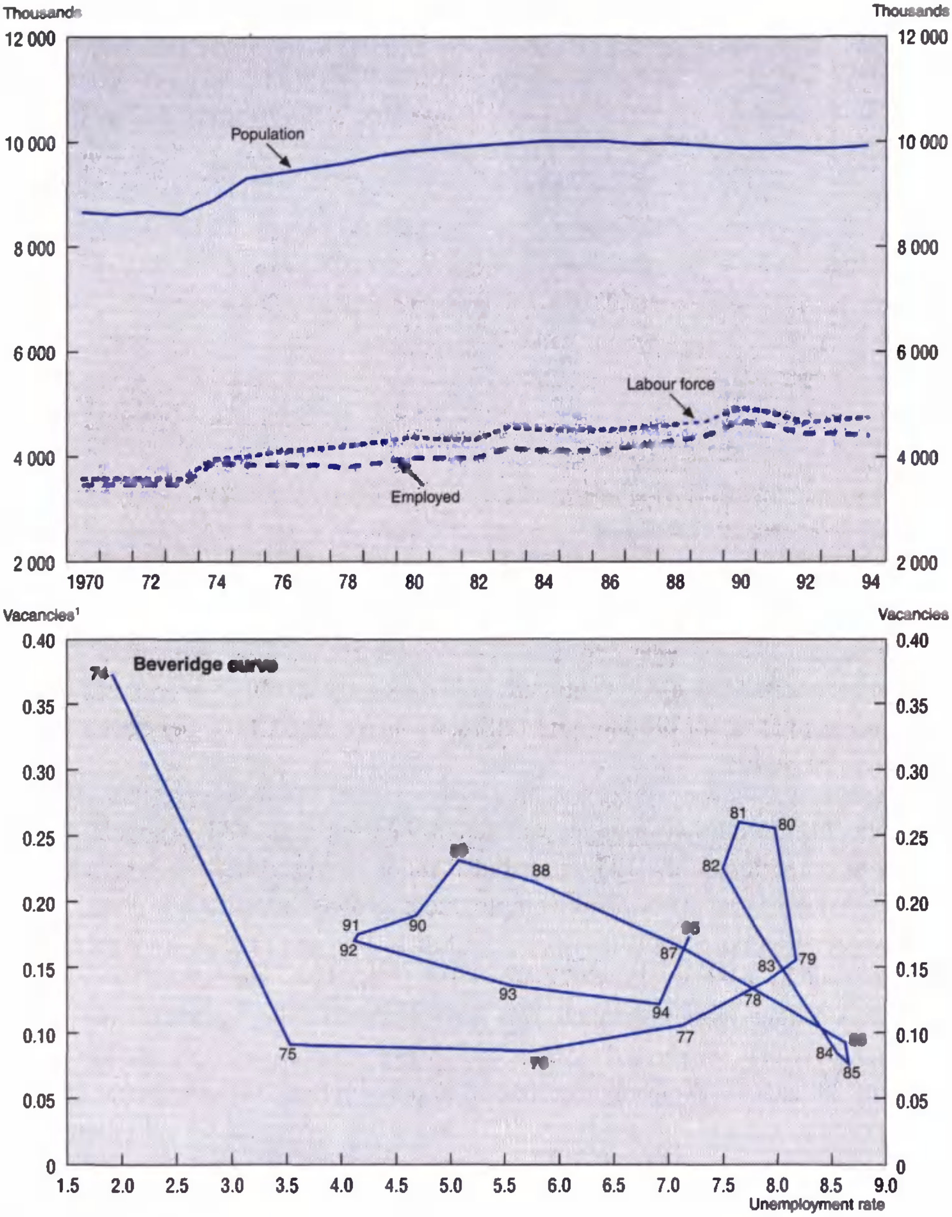


Note: Shaded area indicates cyclical peak.
Source: OECD.

in factor markets. The effects showed up in declining levels of overall efficiency, the level of total factor productivity falling by an average of 0.2 per cent a year in the 1973-80 period.

The shift to market-oriented policies in the 1980s, as well as special factors linked to accession to the EU, contributed much to absorbing the labour supply shock of the 1970s. As a result, employment growth accelerated, contributing, with reduced labour supply growth, to a fall in the rate of unemployment from 8.6 per cent in 1986 to 4.2 per cent in 1992, the last year before output contracted. Stronger labour demand was also visible in the vacancy rate (which doubled between 1985 and 1990) and rising employment/population ratios (Figures 29 and 30). Not only did the fall in non-cyclical unemployment contrast with developments in most other OECD countries, where structural labour market conditions continued to worsen, but the size of this fall was also unmatched among OECD countries, occurring, as it did, during a period when the rate of inflation was halved. The benefits of market-oriented policies also showed up quite rapidly in higher total factor productivity growth, which amounted to an

Figure 30. **POPULATION, EMPLOYMENT AND JOBLESSNESS**



1. Number of vacancies in per cent of labour force.
Source: OECD.

annual 1.6 per cent in the 1979-93 period, strengthening GDP growth. As a consequence, Portugal's real income resumed convergence with those of the rest of the EC (Table 23 and Figure 31).

The fall of 6 percentage points in the female unemployment rate in the 1986-92 period was twice as large as that for men (Figure 32), reducing the excess of female over male unemployment to around 2 points in 1992, among the lowest in the OECD area. Long-term and youth unemployment also declined sharply during the 1980s, long-term unemployment (12 months and over) dropping below 33 per cent of the total in 1992 from nearly 54 per cent in 1986 (Table 24). Employment rates in the 20-24 years category are relatively high and have remained stable. In contrast, for 15-19 year olds the rates have fallen in response to higher enrolment rates (Figure 28). Overall, youth

Table 23. **Macroeconomic indicators**

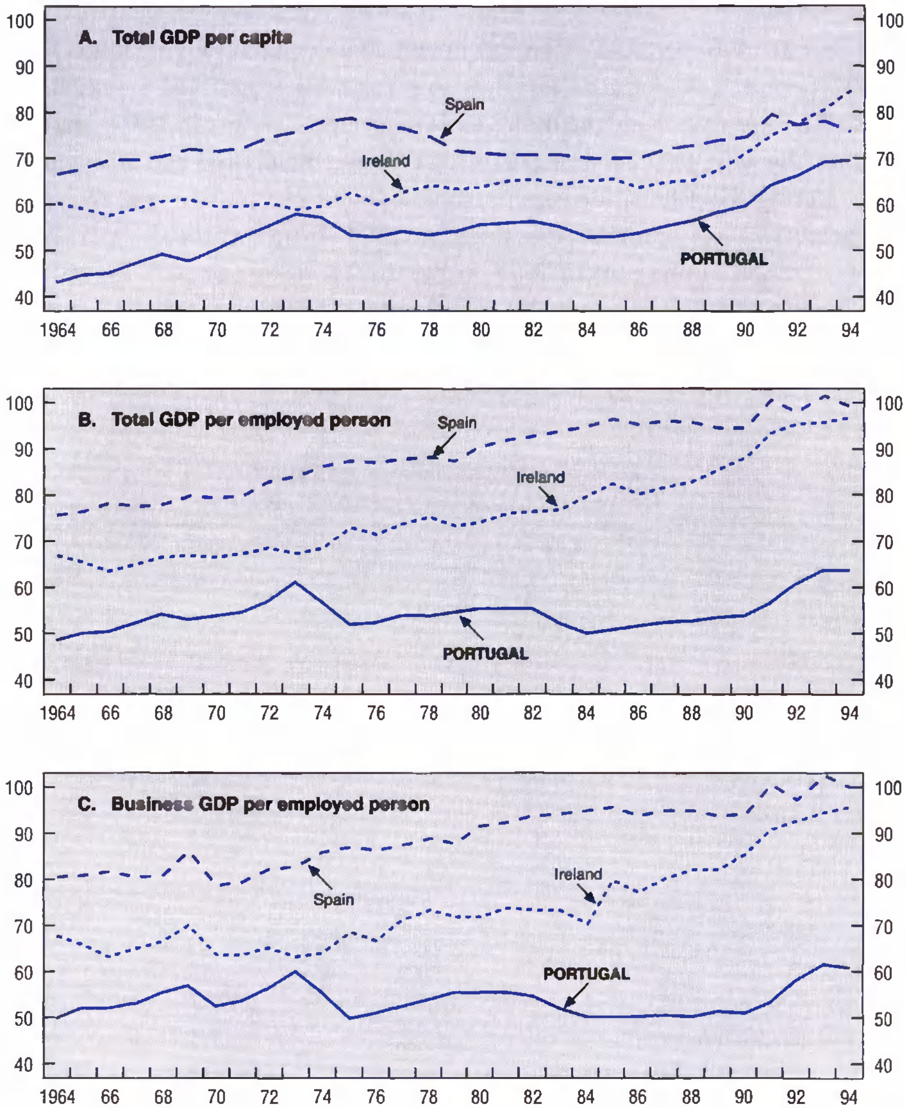
Average percentage change at annual rate

	1960-73	1974-79	1980-89	1990-93	1994	1995[2]
Real GDP						
Portugal	6.9	2.9	3.0	1.6	0.8	2.5
Spain	7.3	2.3	2.8	1.4	2.0	3.2
EU	4.7	2.5	2.2	1.2	2.8	2.7
Labour productivity						
Portugal	6.5	0.5	2.3	1.2	0.9	3.1
Spain	6.4	3.2	2.6	2.4	2.9	0.7
EU	4.4	2.6	1.7	1.5	3.2	2.1
Per capita income						
Portugal	6.8	1.0	2.8	1.7	..	..
Spain	6.2	1.2	2.3	1.2	..	..
EU	4.0	2.2	2.0	0.8	..	..
Rate of unemployment[1]						
Portugal	2.4	6.0	7.3	4.7	6.9	7.2
Spain	2.5	5.3	17.5	18.1	24.2	22.7
EU	2.3	4.6	9.2	9.4	11.5	11.1
Private consumption deflator						
Portugal	3.4	22.0	18.1	10.6	4.8	4.1
Spain	6.5	18.1	10.3	6.2	5.1	4.8
EU	4.1	9.6	6.5	4.7	3.2	3.0

1. Number of unemployed persons as a percentage of the labour force.
2. Estimate.
Source: OECD (1995), *Historical statistics.*

Figure 31. **CONVERGENCE IN PER CAPITA INCOME AND PRODUCTIVITY**[1]

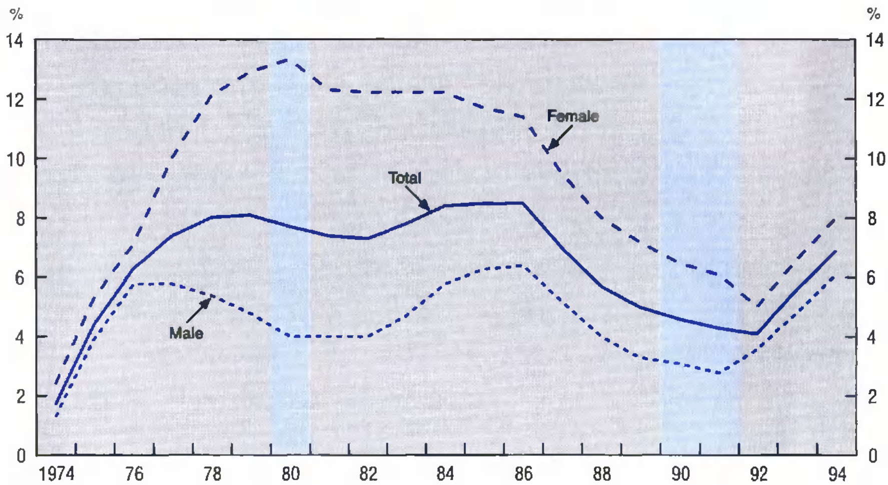
EU = 100



1. Values at current prices and current PPPs. For Portugal, data for the period 1986-94 are based on new national account series, as provided by national authorities and data for business sector are OECD estimates.

Source: OECD, *National Accounts.*

Figure 32. **UNEMPLOYMENT RATES BY GENDER**



Note: Shaded area indicates cyclical peak.
Source: OECD.

unemployment has remained high: more than twice the aggregate unemployment rate and six times the prime age male rate, a ratio little affected by cyclical fluctuations. Young adult rates are almost as high, suggesting that new entrants face persistent obstacles to employment. Differentials between regional unemployment rates moved in sympathy with the overall unemployment rate, narrowing until the early 1990s and widening thereafter (Figure 33). There is a particularly large gap between unemployment in the urban, coastal areas and rural districts.

Portugal also stands out because of high participation rates, which have traditionally exceeded the European averages (Figure 34). As in other countries, female participation rates trended upward in the 1980s, though by less than in the OECD at large, reflecting a shift in the composition of output towards services and better education. Large and flexible wage differentials also supported job creation (Table 25). Earnings differentials for private full-time workers, excluding agriculture, widened in the second half of the 1980s, reflecting gains by the top quintile of the earnings distribution relative to the median (Figure 35), while the ratio of the bottom quintile to the median was broadly stable.

Table 24. **Labour market indicators**

Percentages

	1986	1987	1988	1989	1990	1991[1]	1992	1993	1994	1995[2]
Participation rate[3]	71.1	71.2	71.6	71.1	71.6	73.8	68.4	67.8	67.5	67.2
Male	84.5	85.6	83.9	84.3	84.3	96.1	78.7	77.2	76.4	75.1
Female	58.5	57.7	60	58.7	59.7	62.3	60.6	59.0	59.3	59.3
Civilian labour force (growth rate)	0.1	1.0	1.2	1.5	1.8	2.4	0.9	–0.6	1.3	–0.2
Male	0.7	–0.3	0.2	1.4	1.0	0.9	..	–1.5	0.9	–0.4
Female	–0.8	2.8	2.5	1.6	2.9	4.3	..	0.5	1.8	0.0
Employment (growth rate)	0.2	2.6	2.6	2.3	2.2	3.0	..	–2.0	–0.1	–0.6
Male	0.6	1.0	1.6	2.1	1.3	1.4	..	–2.7	–0.5	–0.9
Female	–0.4	5.1	4.1	2.5	3.5	5.1	..	–1.2	0.3	–0.2
Dependent employment (growth rate)	1.5	2.2	4.3	3.5	3	1.4	..	–2.8	–2	–1
Full-time	..	93.7	93.5	94.1	94.1	93.0	92.7	92.6	92.0	..
Part-time	..	6.3	6.5	5.9	5.9	7.0	7.3	7.4	8.0	..
Agriculture (growth rate)	–8.1	4.0	–4.4	–6.4	–4.1	0.5	..	–1.6	1.6	–2.5
Industry (growth rate)	0.7	4.9	3.3	2.8	0.9	0.3	..	–2.7	–0.4	–2.1
Services (growth rate)	4.4	0.2	5.6	5.9	5.8	5.9	..	–1.7	–0.3	0.8
Unemployment rate[4]	7.8	7.1	5.8	4.9	4.6	4.0	4.1	5.5	6.9	7.2
Male	5.9	4.5	3.5	3.3	3.1	2.7	3.4	4.6	6.1	6.4
Female	10.3	9.0	7.5	7.1	6.5	5.8	4.9	6.5	7.8	7.9
Youth (15-24)	17.8	13.7	11.5	11.4	10.2	8.7	10.0	12.7	14.7	16.1
Long-term unemployment[5]	53.7	54.0	48.3	45.6	44.8	38.7	32.6	36.2	40.8	46.0
Job vacancies[6]	0.10	0.17	0.22	0.24	0.20	0.18	0.18	0.15	0.13	0.17

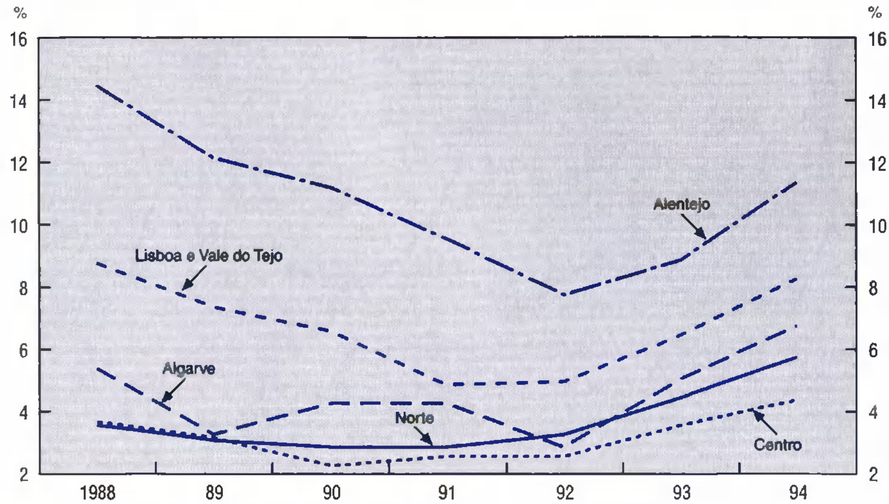
Note: Data for employment refer to the quarterly labour force surveys.

1. The sample used until 1991 represents all persons in the population aged 12 years and over. Since 1992 it represents persons of 14 years and over.
2. Average of the first three quarters.
3. As a per cent of working-age population.
4. As a per cent of the labour force of the group or age group. New defintion of unemployment according to international guidelines since 1992.
5. As a per cent of total unemployment; 12 months and over.
6. As a per cent of the labour force.

Source: OECD (1995), *Labour Force Statistics*; OECD (1995), *Employment Outlook*.

Even though unemployment rose, the non-employment rate (the percentage share of non-employed adults in the adult working age population) remained broadly stable over the ten years to 1986, as more women came into the labour force. The non-employment rate declined subsequently in step with falling unemployment. Figure 28 (centre panel) compares Portuguese employment ratios for

Figure 33. **REGIONAL UNEMPLOYMENT RATES**

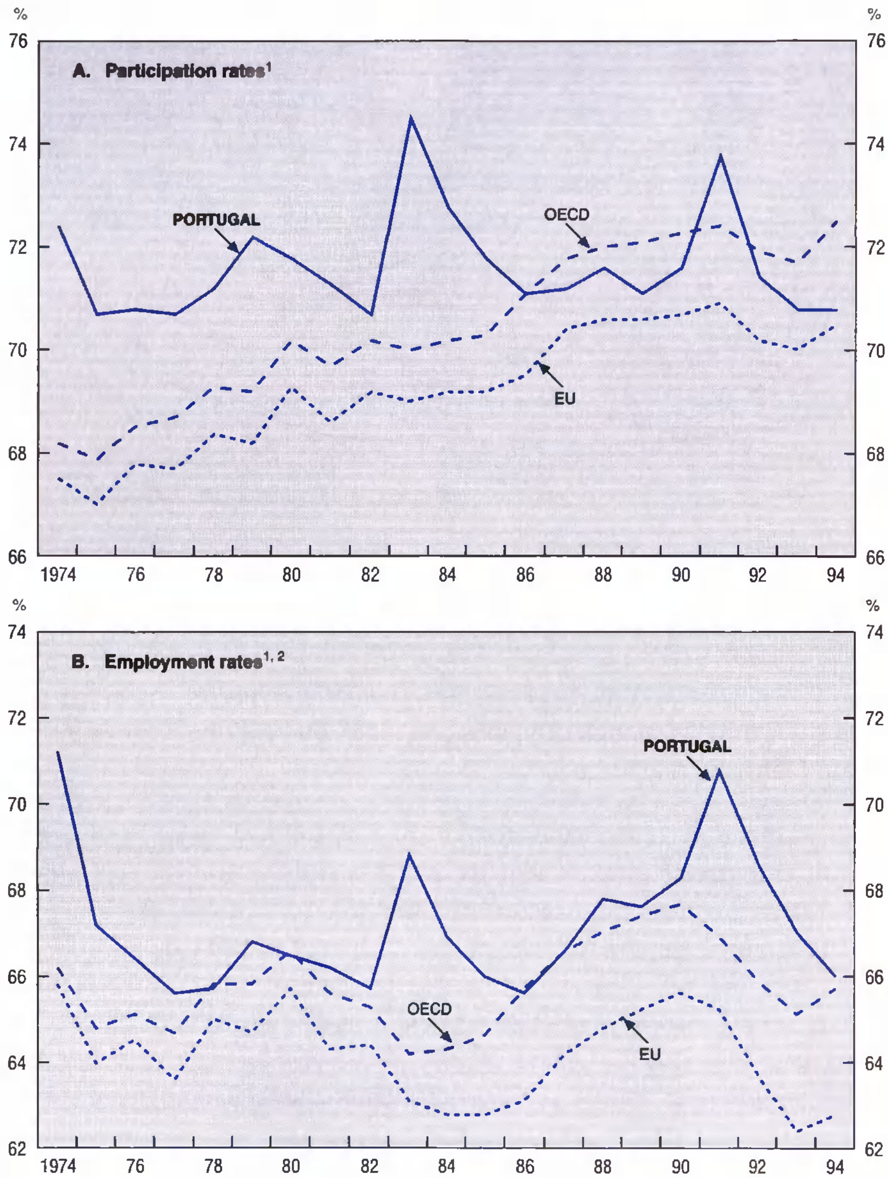


Source: Eurostat.

various sub-categories of the working age population with the respective OECD averages. With the exception of youths and older adults, Portuguese employment rates are higher than average.

Shifts in the sectoral composition of employment have been important. Both industrial and service employment increased sharply after 1986, hastening the outflow of labour out of agriculture (Figure 36). As a result, the share of the agriculture in total employment shrank to 12 per cent in 1994, down from 24 per cent in 1985, but still well above the OECD share of around 6 per cent. Free access to the EU market from 1986 sparked a rapid expansion of the textile and clothing industry (T & C) which in 1989 accounted for nearly 16 per cent of manufacturing output and 31 per cent of manufacturing employment.[35] In contrast to most other OECD countries, the manufacturing employment share has been edging up and in 1991 amounted to 25 per cent compared with 24 per cent in 1986. Another feature of Portugal's labour market is the scale of self-employment, which is concentrated in services and agriculture, and is among the highest in the OECD area (26 per cent in 1995). The self-employment share has risen

Figure 34. **PARTICIPATION AND EMPLOYMENT RATES**



1. Data for 1983 and 1992 are affected by statistical breaks.
2. Employment as a percentage of working-age population.

Source: OECD.

Table 25. **Labour cost dispersion**

Dispersion of intersectoral labour costs in 1989[1]			
United States	0.276	Germany	0.181
Japan	0.268	United Kingdom	0.170
Portugal	**0.277**	France	0.156
Spain	0.216	Italy	0.142
Dispersion of labour costs by size of industrial firms in 1988[2]			
Portugal	**0.253**	Netherlands	0.120
Ireland	0.239	Italy	0.116
Belgium	0.237	United Kingdom	0.108
Germany	0.143	Denmark	0.030
France	0.133		

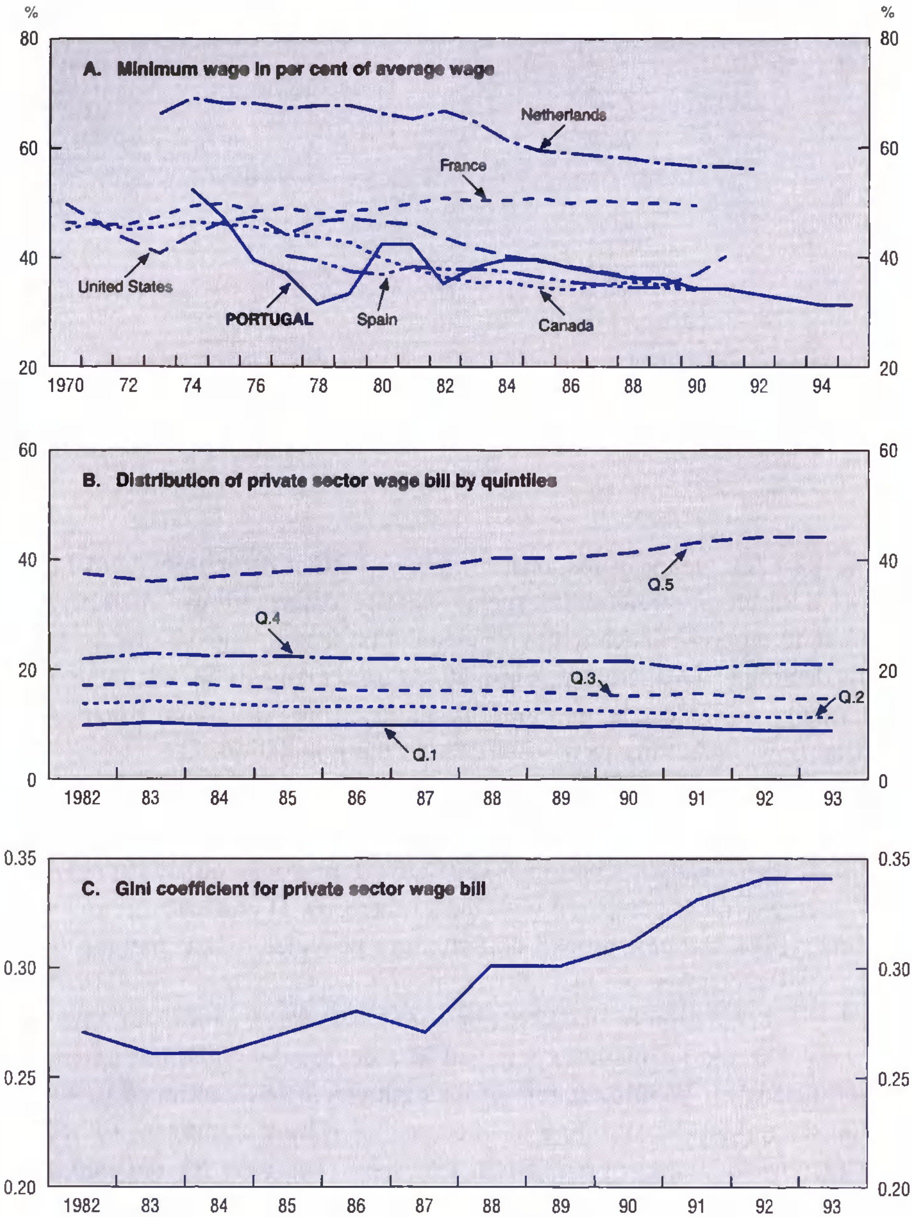
1. Coefficient of variation of labour cost levels per working hour of production workers in 13 sectors.
2. Coefficient of variation of monthly labour cost levels.

Source: Swedish Employers' Confederation (March 1995) "Wages and total labour costs for workers"; EUROSTAT (1988), *Labour Cost Survey*.

over the past few years in response to labour-market difficulties, and in some cases as a result of preferential social security contributions, attempts at tax evasion and non-compliance with employment protection legislation (see below). Though declining on aggregate, emigration, principally to Switzerland, France and Germany, still exceeds immigration, mainly from Africa and Brazil, the net annual outflow amounting to 0.1 per cent of the population.

In sum, Portugal's labour market in the 1980s showed considerable resilience in absorbing the oil- and labour- supply shocks of the 1970s.[36] Indeed, empirical research suggests nominal wage growth responds rather strongly to the rate of unemployment compared with most other OECD countries. In the second half of the 1980s, the new growth opportunities provided by EU membership led to a parallel reduction in unemployment and wage inflation (Figure 37). In contrast, the disinflation of the 1990s has been associated with rising unemployment, as one would normally expect, but to a degree that signifies a substantial short-term trade-off. While the rate of unemployment has continued to edge up, more substantial labour shedding has been avoided by a significant switch from labour income to profits over the past ten years. The case for concluding that there is still substantial aggregate wage flexibility (nominal and real) is also supported by the trend towards larger earnings differentials in the first half of the 1990s (Figure 35).

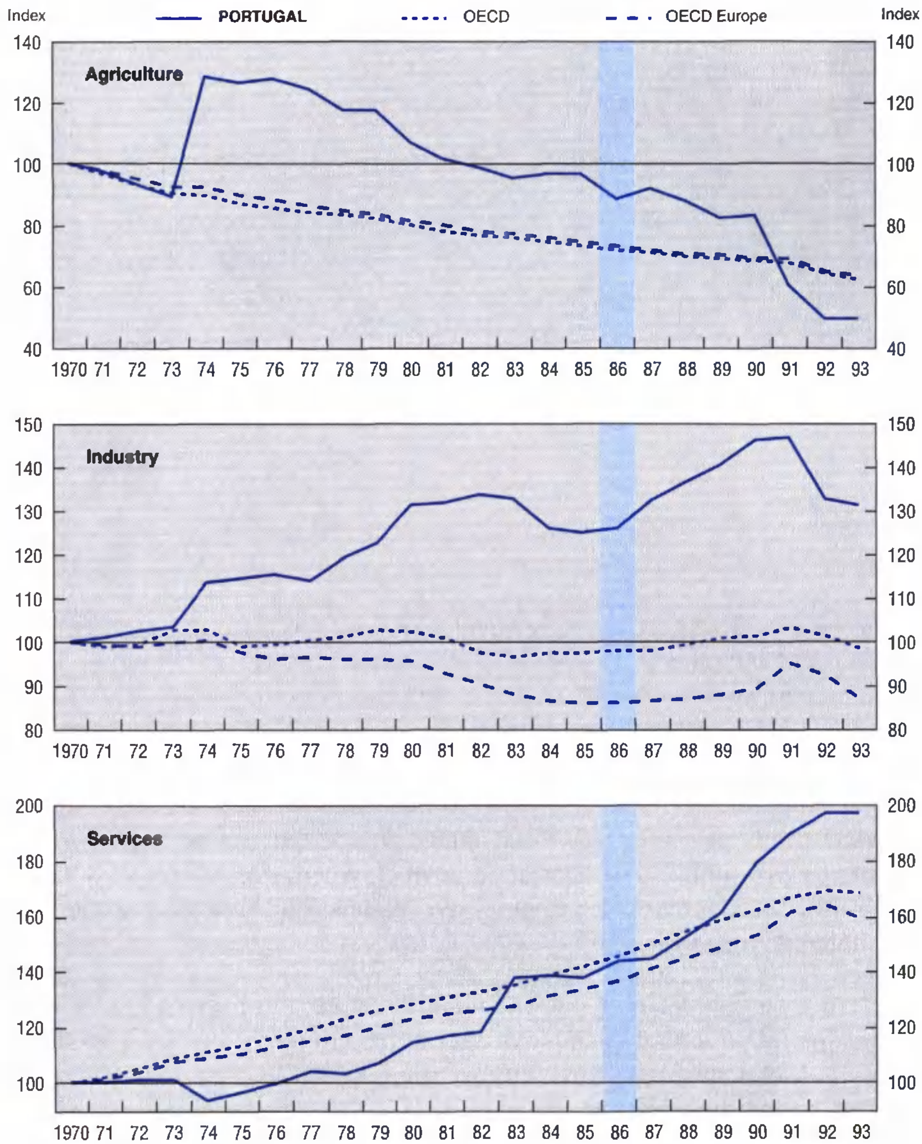
Figure 35. **RELATIVE WAGES**



Source: Portugese authorities, OECD, *Jobs Study*, Part II.

Figure 36. **SECTORAL EMPLOYMENT TRENDS**[1]

1970 = 100

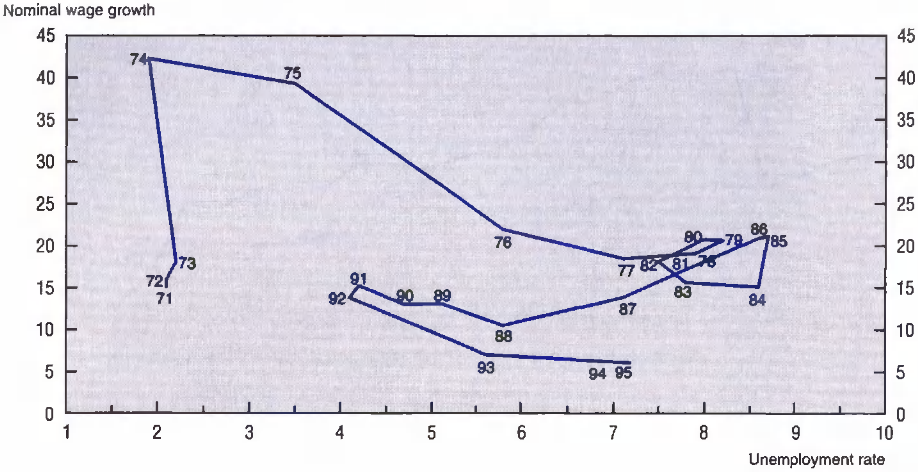


Note: Shaded area indicates Portugal's EU inclusion.

1. Statistical breaks in 1983 and 1992.

Source: OECD.

Figure 37. **NOMINAL WAGE GROWTH[1] AND UNEMPLOYMENT RATE**
1971-1995



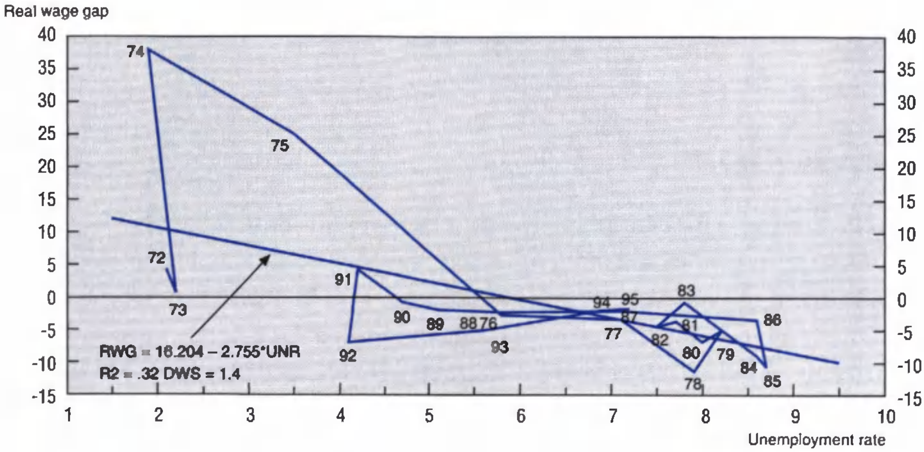
1. Business sector.
Source: OECD.

In the longer run, as prices respond to wages, the trade-off between unemployment and inflation is eroded, as a rate of unemployment below the natural rate tends to be associated with accelerating inflation. A simplified accelerationist model (measured as the difference between wages and past price increases, less productivity gains – the 'real-wage gap') shows that this is probably the case for Portugal: the rate of unemployment consistent with stable wage inflation (NAWRU), thus measured, has been rather steady, the gap between wage and price increases tending to be zero at an unemployment rate of around 6 per cent (Figure 38). Indeed, there is no conclusive evidence of hysteresis in the Portuguese unemployment rate.[37]

From a wage-bargaining point of view, therefore, there seems little reason to suppose that the structural unemployment rate has risen. The economy might then rely on its traditional wage flexibility to bring down the current unemployment rate. This would, however, be to ignore some of the mismatch problems which seem to be emerging, which suggest that the economy may have entered a more difficult period of employment adjustment. Unemployment, especially among women, seems to have risen more than might have been expected on the basis of its past relationship with the output gap[38] (Figure 39). And both the vacancy rate

Figure 38. **REAL WAGE GAP[1] AND UNEMPLOYMENT RATE**

1972-1995

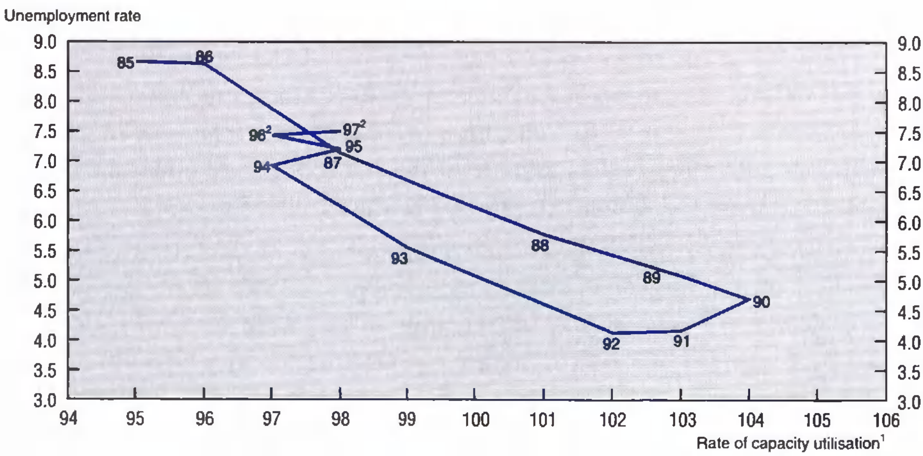


1. The real wage gap is equal to the difference between total nominal wage growth in the business sector deflated by the lagged private consumption deflator and labour productivity gains.

Source: OECD.

Figure 39. **CAPACITY UTILISATION AND UNEMPLOYMENT**

1985 to 1995



1. Capacity utilisation (total economy) is defined as the percentage deviation of output from trend GDP based upon the Hodrick-Prescott filter.
2. Data refer to OECD projections.

Source: OECD.

and the unemployment rate have increased in 1995 (Figure 30, lower panel). These new imbalances call for measures of structural reform, in the form of education, training, deregulation, privatisation and tax reform, to supplement the traditionally observed wage flexibility.

Policy requirements

Achieving a significant reduction in joblessness in Portugal calls for a set of measures to be taken, which stretch beyond the labour market. The above analysis would seem to indicate that policy responses would need to include both the upgrading of human-capital resources and the further enhancement of competitive pressures in goods and service markets. High standards in the education system, adequate training of the work force and targeted programmes to assist the long-term unemployed and managers of small firms are key elements in a long-term strategy aimed at fostering real income convergence.

The principal challenge for Portugal lies in creating conditions where the output of the education and training system matches the demand for skills. Raising the earnings potential of its labour force requires rising capital investment, better skill management at the firm level and favourable conditions for small firms to develop and expand. These requirements were recognised by the Regional Development Programme (RDP) of June 1993 which aims to lift Portugal's per capita income to around 80 per cent of the EU-average by 1999. Key factors in this process are employment and productivity gains based upon EU transfers, largely ear-marked for education, training and infrastructure. Planned EU transfers total 4.5 per cent of GDP over the 1995-99 period under the second Community Support Framework (CSF) of February 1994.

Regulatory reform, privatisation and fiscal convergence are also essential for imparting renewed momentum to the catching-up process. As noted in the OECD *Economic Survey of Portugal* of 1994, the array of measures taken with a view to deregulating and liberalising the economy has been impressive.[39] But in order to sustain the pace of real income convergence it seems imperative to increase the momentum of reform and broaden its approach. Against this background, this section describes the broad thrust of policies needed to improve the functioning of labour markets and further enhance both the entrepreneurial environment and labour force skills. A synopsis of recommendations can be found in Box 2.

Box 2. **The OECD Jobs Strategy: synopsis of recommendations for Portugal**

The *OECD Jobs Study* sets out a strategy based on nine recommendations for improving the ability of OECD economies to cope with structural change. The nine distinct policy areas include the macroeconomic policy framework and the creation and diffusion of technological know-how. With respect to labour and product market flexibility, the study called for initiatives to be taken in the following areas: working-time flexibility, the entrepreneurial climate, wage and labour cost flexibility, employment security provisions, active labour-market policies, labour-force skills and competencies and unemployment and related benefit systems.

Following from the review of labour market and employment performance and the assessment of policy requirements, this box presents a synopsis of required measures for Portugal.

Reduce the tax burden on labour income and increase labour market flexibility

- *Tax rates and contribution rates should be restructured and tax administration improved* so as to equalise treatment of employed and self-employed and reduce tax evasion hence reducing the tax burden on labour. This should include better tax auditing and cross-checking between VAT and corporate tax.
- *The age differentiation of minimum wages should be increased.*
- *Employment protection legislation, though substantially relaxed over the past few years, should be eased and implemented uniformly.* A legal framework should be established to protect workers with no formal contracts.
- *Housing market restrictions damping labour mobility should be phased out.*

Improve the efficiency of active labour-market policies

- *Active labour-market programmes should be tailored more closely to the needs of targeted groups and monitored more efficiently.* Access to vocational training, both initial and continuous, should be widened, including literacy courses for adult workers.
- *Efforts to establish nationally recognised standards in skill achievement and qualifications should be stepped up.*

Improve labour-force skills and competencies

- *The compulsory schooling age should be raised and opportunities for vocational training enlarged, notably at the post-secondary level.*
- *The quality of formal education should be raised,* with an emphasis on reducing high drop-out rates and fully implementing curricular reforms and assessment procedures at the basic and secondary level.

(continued on next page)

(continued)

- *The organisational know-how of managers and owners of small and medium-sized firms should be upgraded and employee training within firms be expanded.*

Increase product-market competition

- *Remaining impediments to access by new entrants to some segments of the private service sector should be dismantled.* Regulatory reforms are needed in some public services, which suffer from high input costs, low output quality and inadequate rate structures.
- *Implement the privatisation programme.* The pace of privatisation should be stepped up, as set out in the privatisation programme, and policies of public procurement made more liberal.

Improve the infrastructure and the climate for entrepreneurship and innovation

- The *infrastructure should be improved* so as to reduce input costs *and responsibilities of local governments enlarged to shorten implementation lags for EU-financed projects.*
- *Research and development should be stimulated.* Research and development spending has remained below par, even abstracting from the low level of per capita income.
- *Reduce transaction costs* arising from merging small firms and/or changing their geographical site, so as to reduce the fragmentation of Portugal's production structure.

Proposals for reform have already been put forward in many of the above areas and their approval and implementation would constitute a valuable step towards the achievement of the above programme.

Enhancing the ability to adjust and adapt

The wage-formation system

Nominal wage growth in Portugal is highly elastic with respect to both unemployment and inflation. In particular, the semi-elasticity of wages with respect to the rate of unemployment is high by international standards – only Japan and Sweden have a larger elasticity in absolute value.[40] Productivity shocks have been found to pass through into wages in the long run, but the process is relatively slow. Wage flexibility is also observed at the level of the individual firm, pay increases typically taking into account local and firm-specific conditions as well as trend productivity.

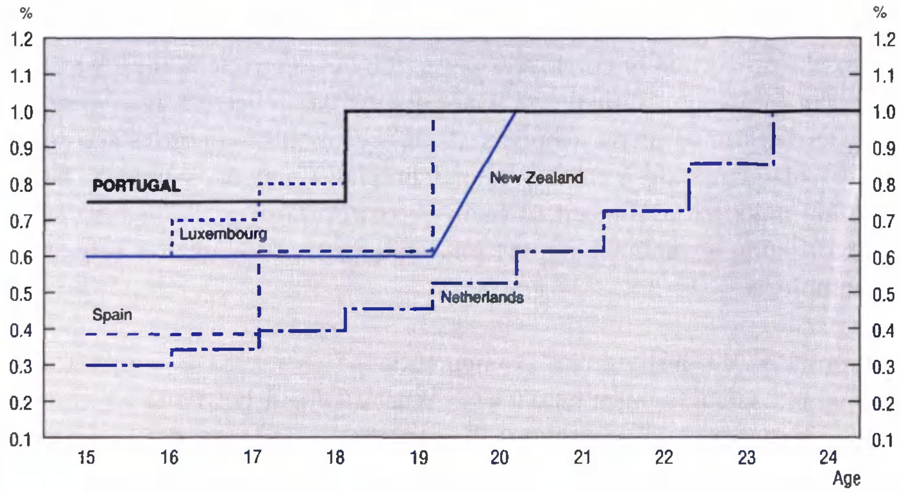
Intermittent national wage agreements concluded between employers and the unions have also served to moderate aggregate nominal wage growth. While at around 30 per cent union membership was much lower than the European average, the proportion of employees covered by collective contracts was almost 90 per cent for the non-agricultural sector in 1995, as collective agreements have been extended to non-union members. A classification of countries according to the level of bargaining (central, sectoral or plant) and co-ordination between bargaining units (none, limited or high) shows Portugal as combining sectoral wage bargaining as the predominant form with little co-ordination between bargaining units.[41]

Normally, an institutional configuration of this kind is correlated with unfavourable unemployment outcomes.[42] What distinguishes Portugal from other countries having a similar institutional set-up, but suffering high unemployment, is a large measure of wage dispersion, which, partly because of the predominance of extremely small firms, appears to be much higher than in most other European countries. Thus, employment in low-wage industries did not fall until the 1993-recession, suggesting that minimum wages and unemployment insurance have not acted as binding wage floors. Indeed, although Portugal's minimum wage (introduced in 1974) is adjusted annually on the basis of projected inflation and productivity developments, it fell in real terms up to 1985, after which it began to rise again. Already low relative to the average wage, relative minimum wage declined further in the first half of the 1990s, confirming the impression of widening wage differentials (Figure 35). An estimated 140 000 persons, around 4 per cent of non-agricultural employees, received minimum wages in 1995.

On the other hand, youth- and long-term unemployment have remained high compared with the overall rate of unemployment. Joblessness has been high for young adults with higher education, perhaps reflecting young persons' preference for receiving general education as opposed to vocational training.[43] In addition, the design of the minimum wage system may have adversely affected job prospects of young people. While the standard minimum wage is graded by age, the age differentiation is less pronounced than in other countries, the full minimum wage being already available to persons 18 years of age (Figure 40). Overall, while the wage formation system works well, the age differentiation of minimum wages needs to be increased.

Figure 40. **STATUTORY MINIMUM WAGES BY AGE**[1]

Adult minimum wage = 1.00



1. 1990.

Source: OECD (1995), *Jobs Study,* Part II.

Increasing the flexibility of employment and working time

Until the end of the 1980s, Portugal had, along with Spain, the most restrictive employment protection legislation (EPL) in the European Union (Table 26). In 1989 and 1991, firing restrictions were eased through a wider range of admissible lay-off motivations, the possibility of collective lay-offs and easier resolution of severance pay disagreements.[44] While the new rules are still stringent by international comparison[45] their effective stringency is probably overstated:

- Firms have tended to circumvent employment regulations by relying upon short-term contracts (normally of six-month duration).[46]
- Portugal's small firms, being much smaller than in the other European countries, have probably found it easy not to comply fully with employment regulations, as they do not pay taxes and social security contributions. As noted, a significant part of the dependent labour force is covered

Table 26. **Selected indicators of employment rigidity**

	Regular procedural inconveniences	Notice and severance pay for no-fault dismissals	Difficulty of dismissal	Overall ranking for strictness of protection against dismissals
	Rank indicator			
Portugal	**8.0**	**8.5**	**11.0**	**10.5**
Belgium	3.5	10.0	2.0	4.0
Denmark	1.0	6.0	3.0	2.0
France	7.0	5.0	5.5	5.5
Germany	9.0	2.0	8.0	7.0
Greece	6.0	7.0	7.0	8.0
Ireland	5.0	3.0	4.0	3.0
Italy	2.0	11.0	10.0	9.0
Netherlands	11.0	1.0	5.5	5.5
Spain	10.0	8.5	9.0	10.5
United Kingdom	3.5	4.0	1.0	1.0

Source: D. Grubb and W. Wells (1993), "Employment regulation and patterns of work in EC countries", *OECD Economic Studies*, No. 21, p. 24.

by the less formal contracts applicable to the self-employed. Under this procedure one-month contracts are extended to workers, who are paid on an hourly or daily basis.[47]

– During the 1993-94 recession rising numbers of workers with permanent work contracts have been laid off (as opposed to those whose fixed-term contract expired), suggesting that dismissals and hirings of employees with a permanent work contract have become more sensitive to changes in overall demand.[48]

Overall, it comes as no surprise that in empirical work the speed of Portugal's employment adjustment to changes in expected output has been found to be closer to that of countries which have a less restrictive *de jure* set of EPL.

Insofar as the flexibility of employment adjustment in Portugal reflects, among other factors, non-compliance with existing EPL, this would seem to call for a further relaxation of the still rather strict legislation, combined with more uniform law enforcement. Stepping up the efficiency of tax administration, so as to rein in widespread evasion of taxes and social security contributions, may be an appropriate way of dealing with the issue of non-compliance with EPL. As things stand, a relatively privileged group of employees enjoys considerable employment security and strict job demarcation, while a significant proportion works under more precarious conditions. As regards part-time work, its scale is minor compared to other European countries, only 7.5 per cent of all jobs being of this kind in 1995. In industry and the energy sector, part-time work is virtually non-existent. About 25 per cent of those holding part-time jobs would prefer to have a full-time job, a higher-than-average proportion by international comparison.[49]

Taxes and transfers

Among the institutional factors potentially having a strong impact on wage formation, particularly at entry levels, are reservation wages generated by income maintenance schemes. In this domain, Portugal's policy requirements appear to be small. Although a composite index of unemployment insurance replacement rates ranks Portugal's system the seventh most generous in the OECD,[50] the provisions are quite restrictive. Introduced in 1974, the unemployment insurance scheme was modified in 1988. The new provisions improved benefits and widened coverage for new entrants into the labour force. As a result, the coverage ratio reached 48 per cent in 1995, the most recent unemployment peak, up from 21 per cent in 1985, the previous unemployment high. Entitlement criteria are strict, the disbursement of benefits requiring 540 days of prior contribution over the last two years. Earned income from part-time work triggers the suspension of unemployment insurance payments.

Portugal also has an unemployment assistance scheme providing for means-tested benefits, which are unrelated to earnings. Amounting to roughly one fifth of the average production workers' earnings, such benefits are low by international comparison (Table 27). Unlike in most OECD countries, on exhaustion of assistance benefit there is no safety net social assistance programme. Being, on average, around 40 per cent lower than the minimum wage, and being limited in time, unemployment assistance payments are unlikely to establish effective wage floors. On the other hand, unemployment insurance benefits based on earnings close to the minimum wage are only marginally above unemployment assistance payments.

One area demanding urgent policy action is the pension regime which until 1994 had generous provisions, including easy access to early retirement benefits as well as disability pensions (see Chapter III for a detailed discussion of pension issues). Inadequate monitoring contributed to the rise in spending on early

Table 27. **Social welfare benefits and guaranteed minimum income**[1]

Percentage of average production worker earnings

	Type of regime[3]	Individual	Married with dependent spouse
Portugal[2]	**UA**	**18.7**	**23.3**
France	GI	22.6	32.4
United Kingdom	GI	16.0	26.0
Belgium	GI	28.7	38.2
Denmark	GI	17.3	34.6
Ireland	GI	19.0	31.7
Netherlands	GI	40.3	57.6
Sweden	SW	26.8	36.2

1. In 1989. Benefits specified per month and per week have been converted into full-year equivalents. Only standard benefits are accounted for and hence benefits related to housing or number of children are excluded. The benefits are on a gross basis, and differential tax treatment of welfare receipts across countries may to some extent explain the variation in gross benefit generosity.
2. Recipients are unemployed persons who have exhausted their right to unemployment insurance benefits.
3. GI: guaranteed income; UA: unemployment assistance; SW: social welfare.

Source: OECD (1991), *Employment Outlook*, Table 7.A.1.

retirement and disability pensions. Transfer payments for invalidity, disability and sickness accounted for 23 per cent of total social benefits compared with 14 per cent for the EU. Over the past few years, however, the rise in the number of beneficiaries of disability and invalidity pensions has slowed under the impact of tighter monitoring.

Portugal's tax pressure (including social security contributions, income and consumption taxes) has increased markedly since 1970, total tax revenue rising from 23 per cent of GDP in 1970 to 32 per cent in 1993, a rise broadly in line with that experienced by the EU (Table 28). The introduction of the VAT in 1986 and the income-tax reform in 1989 (including corporate income tax) accounted for roughly half of this rise. The VAT rate structure is broadly in line with EU guidelines, although the legal payment delay is the longest one in the EU. The corporate income tax rate and social security contribution rates for dependent employment are also close to the EU average, while personal direct tax is among the lowest in the EU (Tables 29 and 30). However, tax and contribution evasion, already large in a country with myriads of micro-firms, appears to have increased with the completion of the internal market in 1993. Better enforcement of tax and contribution laws would yield substantial revenues, and if accompanied by a reduction in the global rate of social security contributions would have positive effects on labour demand.

Table 28. **Government revenue by category**

Per cent of GDP

	1970	1980	1990	1992	1993
Portugal					
Personal income tax	..	..	4.9	6.9	6.3
Corporate income tax	..	..	2.5	2.8	2.3
Employers' social security contributions	3.3	5.1	5.0	5.1	5.1
Employees' social security contributions	2.0	3.2	3.1	3.2	3.1
Property taxes	0.6	0.4	0.8	0.8	0.8
Taxes on goods and services	10.2	12.9	13.5	14.6	13.7
VAT	1.9	4.6	6.0	7.0	6.2
Excise duties	7.7	7.8	7.2	7.5	7.1
Total revenue	22.7	28.7	30.9	34.1	31.7
EU					
Personal income tax	7.5	10.7	10.5	10.8	10.8
Corporate income tax	2.3	2.5	3.0	2.6	2.8
Employers' social security contributions	4.4	6.4	6.2	6.3	6.3
Employees' social security contributions	2.8	3.6	4.1	4.4	4.5
Property taxes	2.0	1.7	1.8	1.8	1.9
Taxes on goods and services	11.1	11.3	12.5	13.0	12.7
VAT	4.8	5.9	7.1	7.3	7.1
Excise duties	5.7	4.9	4.7	5.0	4.9
Other duties	0.6	0.5	0.7	0.7	0.7
Total revenue	30.8	36.7	39.6	40.8	41.0

Source: OECD (1995), *Revenue Statistics*.

Social security contributions are tilted towards employers' contributions. This configuration is widely viewed as being suboptimal, employees being unaware of the full cost of welfare entitlements, because they do not bear the cost directly. In addition, preferential social security rates apply to the self-employed, stimulating contracting-out. Under the 1993-94 reform measures, the contribution rate for the self-employed is scheduled to reach parity with the overall rate for dependent employment by 1999.

Given the above setting, key policy requirements are to modify the rate structure of social security contributions, to make tax administration more effective and to speed up payments of tax arrears, which amounted to 1½ per cent of GDP in 1995. Employers' associations and trade unions are backing the fight against tax evasion.

Active labour market policies

Government spending on active and passive labour market measures has been low by international comparison (2 per cent of GDP in 1994) (Table 31).

Table 29. **Compulsory social security contributions and personal income tax rates**[1]

Per cent

	Social security contributions			Income taxes	
	Self-employment[1]	Wage and salary employment[1]		Average	Top marginal rate
		Employee	Employer		
Portugal	**15.0**	**11.0**	**24.5**	**6.4**	**40**
Germany	..	17.8	17.8	17.2	53
France[2]	41.5	18.0	38.0	7.0	57
Italy[3]	17.6	9.1[4]	45.1[4]	18.0	50
United Kingdom[5, 6]	5.5	7.7	10.4	19.1	40
Belgium	3.8	12.1	41.7	22.9	62
Denmark	..	2.6	0	43.9	68
Netherlands	17.3	29.1	11.5	11.1	60
Spain	..	6.0	30.3	10.9	56
Sweden	20.5	4.0	32.9	34.1	51
Unweighted average (excluding Portugal)	17.7	11.8	25.5	20.5	55

1. In 1990.
2. Figures for self-employment refer to 1987.
3. Including health contributions of 5.6 per cent for incomes under L 40 million.
4. Industrial firms with more than 50 workers.
5. Some benefits subject to means tests.
6. For the first three years of activity, small companies pay social security on a forfeiture basis.

Source: OECD (1992), *Employment Outlook*, p. 181.

Table 30. **Basic rates of central government corporate income tax**

Per cent

	1990	1994
Portugal	..	**36.0**
Germany[1]	36/56	30/45[2]
France[1]	50.0	33.33
Italy	40.0	53.2
United Kingdom[3]	52.0	33.0
Belgium	48.0	39.0
Denmark	37.0	34.0
Netherlands	46.0	35.0
Spain[4]	..	35.0
Sweden[5]	40.0	28.0
United States	46.0	35.0
Japan	30/40	37.5
Canada	36.0	38.0

1. Full imputation credit for corporate tax.
2. Split rate (lower rate on distributed income).
3. Partial imputation credit for corporate tax.
4. Partial deduction of dividends paid.
5. Partial credit for domestic shareholder.

Source: OECD tax data base and D. Carey, J.C. Chouraqui and R.P. Hageman (1993), "The future of capital income taxation in a liberalised financial environment", OECD, *Economics Department Working Paper No. 126*, p. 16.

Table 31. **Expenditure on active and passive labour market measures in 1994**

	Total expenditure	Expenditure on active labour market measures	Unemployment	Expenditure intensity[1]	
	Per cent of GDP		Per cent of labour force	Total	Active labour market measures
Portugal	**2.0**	**0.8**	**6.9**	**0.29**	**0.12**
Germany	3.8	1.6	9.6	0.41	0.17
France[2]	3.3	1.2	11.7	0.28	0.10
Italy[3]	1.81	0.9	10.3	0.17	0.09
United Kingdom	2.2	0.6	9.2	0.24	0.07
Belgium[2]	4.3	1.3	12.0	0.36	0.11
Denmark	7.0	1.8	12.1	0.58	0.15
Netherlands	3.8	1.2	7.6	0.37	0.16
Spain	3.6	0.5	24.2	0.15	0.07
Sweden	5.4	3.0	8.0	0.68	0.38
Total (unweighted)	3.7	1.3	11.3	0.32	0.14

1. Expenditure as a percentage of GDP divided by the rate of unemployment.
2. 1993.
3. 1992.

Source: OECD (1995), *Employment Outlook*, pp. 222-229.

This mirrors both restrictive unemployment insurance provisions and comparatively low outlays on active labour-market programmes (ALMP) (Table 31) as well as favourable labour market outcomes. A large portion of ALPM expenditures has been financed by transfers from the European Social Fund, which are directed to training and employment programmes managed by the public sector and private companies.[51] Under the second Community Support Framework, the role of supporting training activities has been extended to other public bodies, while unions and sectoral employers' associations are allowed to benefit from direct community financing for training plans. In addition, government support may be provided to individual centres or firms.[52]

While the provision of vocational training has expanded significantly in the 1990s, control over the quality of the training provided has not improved at the same pace. This may have reduced the validity of training certificates as a ''hallmark'' of an applicant's expected performance. The challenge is therefore to ensure that training schemes have positive effects beyond providing a buffer for firms in cyclical downturns. Assessing Portugal's training policies in general, the 1995 *OECD Economic Survey of Portugal* concluded that the training system required further development, establishing nationally recognised standards in skill achievement and qualifications.[53] In addition, training programmes need to take greater account of the background, occupation and aspirations of participants. Finally, there is a need to broaden access to vocational training, both initial and continuous, including literacy courses for adult workers.

Increasing the knowledge base, efficiency and innovation capacity

Upgrading skills and competencies

Portugal's education system, at the beginning of the 1990s, still produced less favourable results than those of most other EU countries. The system offered relatively limited opportunities for effective adult education and vocational training (Table 32). A significant proportion of the teenage population failed to complete basic education, remaining exposed to serious risks after entry into the labour market. The system was under-performing in terms of school

Table 32. **Educational attainment of the working-age population**

Percentage distribution of each age group

Age group	Year	Illiterate	Literate with no educational qualification	Primary basic education[1]	Preparatory basic education[2]	Lower secondary education[3]	Upper secondary education[4]	Higher education
15-64	1960	33.9	31.5	30.4	←	3.5	→	0.8
	1970	24.6	22.6	38.7	10.1	2.0	1.4	0.6
	1981	14.6	15.3	42.5	12.3	8.6	4.5	2.3
	1991	6.5	11.6	38.2	17.6	12.2	9.9	4.0
15-24	1960	14.8	36.6	45.6	←	2.9	→	0.1
	1970	3.5	13.8	58.4	19.3	2.2	2.6	0.2
	1981	2.1	6.3	41.8	27.7	15.7	5.9	0.5
	1991	0.8	4.4	21.7	35.7	24.4	12.0	1.0
25-49	1960	35.0	30.6	29.1	←	4.2	→	1.2
	1970	24.1	25.7	37.1	7.9	2.7	1.2	1.2
	1981	10.9	15.6	50.4	7.4	7.5	5.0	3.6
	1991	2.2	9.0	46.2	14.5	10.6	11.3	6.2
50-64	1960	53.9	27.6	15.3	←	2.2	→	0.8
	1970	47.4	24.8	20.5	4.6	1.1	0.6	0.9
	1981	35.0	24.0	32.5	1.5	3.0	2.0	2.0
	1991	20.8	20.1	44.2	3.7	3.7	5.0	2.5

1. Four years of schooling.
2. Six years of schooling.
3. Nine years of schooling.
4. Twelve years of schooling.

Source: INE, Population censuses.

achievements, especially in mathematics and sciences[54] and school attendance above the lower secondary education level remained below that of most other OECD countries. Despite efforts to diversify streams at the secondary education level, the largest proportion of students attended courses providing general rather than vocational education. At the higher education level, the largest participation was in courses with little link to the needs of enterprises. As regards vocational training, this has traditionally been marked by the dominant role of the state and little development of training within firms. Involvement of workers, firms and local communities in the conception and management of these courses was limited. In 1991, Portugal's adult population (25 to 64 years of age) having completed secondary or higher education was by far the lowest among OECD countries, contributing to the low level of per capita income.[55]

The performance of the education and training system improved during the first half of the 1990s, with more than half of young persons now completing upper secondary education or apprenticeship training after compulsory education. Nevertheless, deficiencies persist in a number of areas, calling for the pace of structural reform to be maintained, if not stepped up.

- As regards education, priority should continue to be attached to assuring that students complete their nine years of compulsory schooling and to ensure that the competencies of teachers are adapted so as to achieve full implementation of the curricular reforms.
- Vocational education at the upper secondary level should be reinforced and technical education at the tertiary level, mainly in polytechnic courses, strengthened.
- As noted above, training policies should aim to widen access to vocational training both initial and continuous; upgrade managerial skills, notably at the level of small industrial firms, easing the lack of organisational know-how and making managers conscious of the importance of *in situ* training for their employees; providing a wider range of competencies, promoting the internal redeployment of workers; and establishing skill and training standards.

The new government's main objectives are to enlarge opportunities for on-the-job training and to enhance the efficiency of external training. Such reform efforts are in line with the second Community Support Framework, which, covering the period 1994-99, is scheduled to raise expenditure for education and training, including national co-financing, to 6.1 per cent of 1993 GDP.

Product market competition

The *OECD Jobs Study* also underlines the importance of product-market competition for labour-market outcomes, particularly with respect to the role of State-owned enterprises (SOEs) and the removal of regulatory impediments and entry restrictions impeding the creation of new firms. In the mid-1970s, nationalisations substantially enlarged Portugal's sheltered sector, government interference taking the form of price controls, excessive regulation and restrictive public procurement policies, leading to the inefficient management of SOEs. A change in policy orientation in the mid-1980s, accelerated by EU-membership in 1986, has set in train a process of structural reform, progressively exposing a greater portion of the economy to market forces. Highlights of this process have been the expansion of the legal framework for competition (bankruptcy law of 1992, decree-law on public procurement of 1993 and new competition law of 1994), large-scale privatisation and rapid deregulation of financial markets.

Sales of public assets became an integral part of structural reform in 1989, with more than 30 SOEs privatised over the six to years to 1995, yielding receipts of around 11 per cent of GDP. This makes Portugal one of the largest privatisers in the OECD. About two thirds of overall receipts stemmed from the sale of banks and insurance companies. In the process, the weight of state-owned enterprises in the economy has been reduced below 10 per cent of GDP from 20 per cent in 1989, while the capitalisation of the Lisbon stock exchange has increased by more than 35 per cent. In banking, public ownership has been reduced to around 40 per cent, while nearly all insurance companies are now in private hands.

Despite rapid progress, the scope for reducing the state's presence in the economy is still large, particularly with respect to firms which produce goods and non-financial services. SOEs like the national airline carrier (TAP), railways, road transport, steel and chemicals still record losses, despite attempts at restructuring. Partial privatisation of public utilities has begun (telecommunications and electricity), the government retaining majority stakes or a controlling share. A new regulatory framework has been put into place to promote welfare gains. Nevertheless, by international standards, telephone costs are still high, with cross-subsidisation, while the pricing of electricity is sub-optimal.[56]

Privatisation has gone hand in hand with the adoption of measures to expose the private sector to rising competitive pressure, notably in financial markets, where credit ceilings were abolished, deposit rates freed, restrictions on opening bank branches removed, with returns on financial claims against the public sector brought to market levels and controls on capital flows eliminated. As a result of financial market deregulation, the number of banks more than doubled over the past ten years, with foreign banks enjoying an even stronger expansion. However, the stamp tax on financial transactions (7 per cent in 1995) adds to business costs. Elsewhere, severe restrictions beset the housing market, keeping about 80 per cent of all rents below market levels, depressing maintenance spending and investment and, more importantly, impeding the reallocation of labour from declining to expanding areas.

Overall, Portugal's entrepreneurial environment is still highly dualistic, a great number of small firms co-existing with a few huge private and public enterprises. No less than 98 per cent of firms employed fewer than 10 persons in 1994, their share in total employment being an estimated 70 per cent. To no small extent, Portugal's labour market flexibility seems to be associated with the plethora of tiny firms, accounting for large and flexible wage differentials and, thus, for a strong cyclical influence in wage formation. This structure makes for a high degree of competition. On the other hand, the fragmented production structure is sub-optimal from a resource allocation point of view, calling for economies of scope based upon greater networking and co-operation. Transaction costs for mergers and changes in production sites are high, requiring a rationalisation of administrative procedures.

Technology and innovation

A country's innovative capacity rests on three pillars, the knowledge base; product and process innovation, which combines research and development with the existing knowledge base; and the diffusion process. Portugal's knowledge base is still limited, calling for further strong improvement. Employment in high-technology and high-wage manufacturing sectors is among the lowest in the OECD area. In addition, the atomistic production structure has hampered both the production and diffusion of innovations, R&D spending typically rising with the size of firms.[57] In the 1980s, Portugal had one of the strongest rates of growth in research spending among OECD countries (over 8 per cent per year from

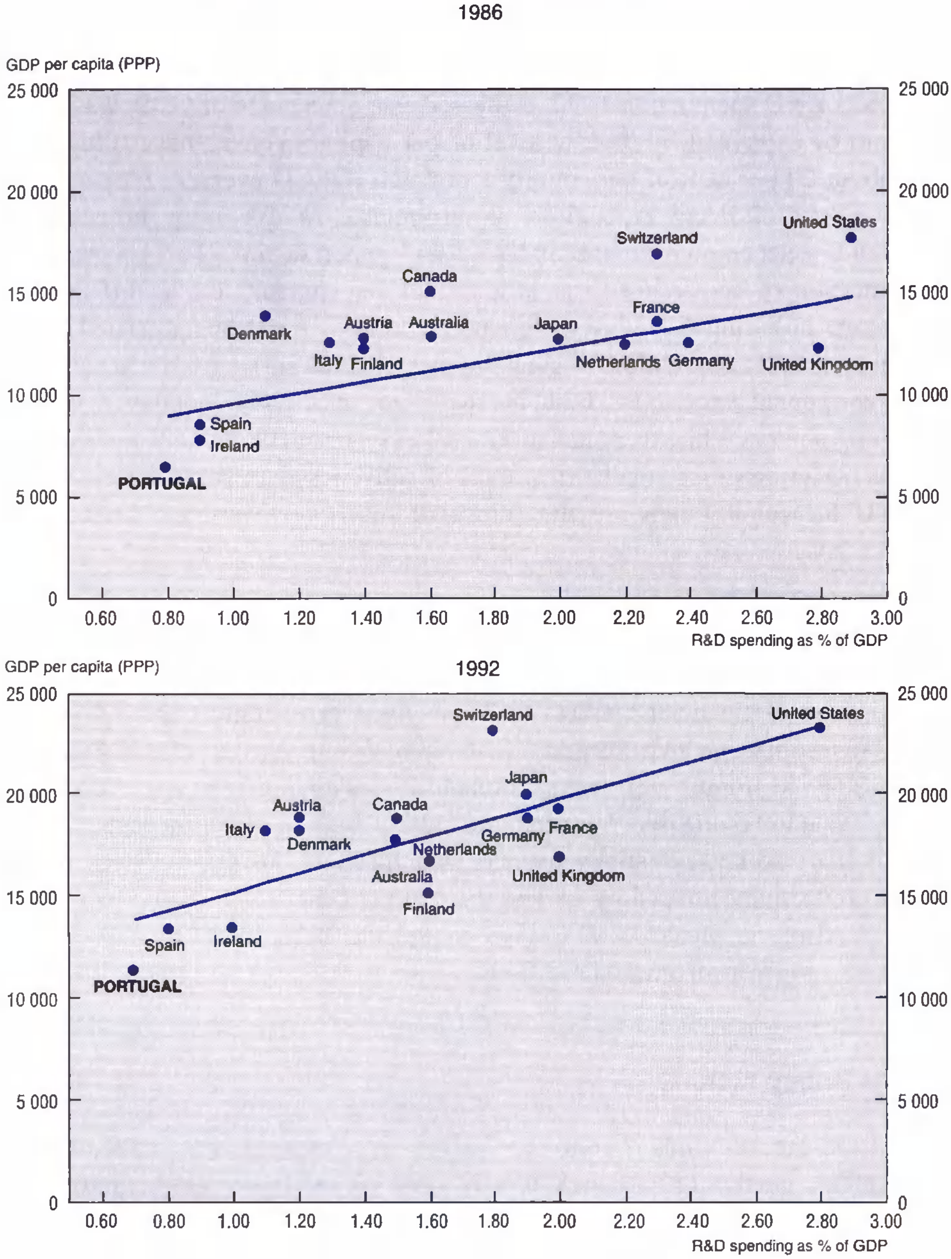
1980 to 1991, partly due to participation in certain EU framework programmes). However, at 0.6 per cent in 1992, the share of R&D in GDP was still much lower than that for the OECD (2.2 per cent). As can been seen from Figure 41, Portugal's R&D spending in 1992, expressed as a percentage of GDP, was lower than can be explained by its low level of per capita income. Industry finances only about 20 per cent of the country's research (OECD average: 60 per cent). About a half of R&D expenditure is attributable to five large firms in the electronics, telecommunications and pulp and paper sectors. The geographical concentration of research efforts is a further impediment to the diffusion of technology in Portugal, slightly below 60 per cent of R&D being carried out in Lisbon and the Tagus Valley. A great number of firms suffer from a severe lack of organisational know-how, both internally and externally, notably a lack of marketing ability. While there are several schemes in operation aimed at improving the performance of small firms, their effectiveness has yet to be evaluated. The EU Structural Funds are the source of much of the public funding for research programmes.

The lack of innovative activity has probably constrained the diffusion of both technology and new forms of business organisation, perhaps preventing real income convergence from proceeding at a faster rate. On the other hand, the liberalisation of financial markets and coincident privatisation spurred inward direct investment, which surged to an annual 4 per cent of GDP in the 1989-92 period (Figure 42). It was through this channel that best-practice technology came to be diffused.[58] Indeed, the bulk of foreign direct investment went to the tertiary sector, essentially finance, insurance and business services, where labour productivity jumped by no less than 50 per cent in the second half of the 1980s.[59] Also, the presence of foreign capital has been found to improve the export performance of Portuguese firms.

Recent policy actions

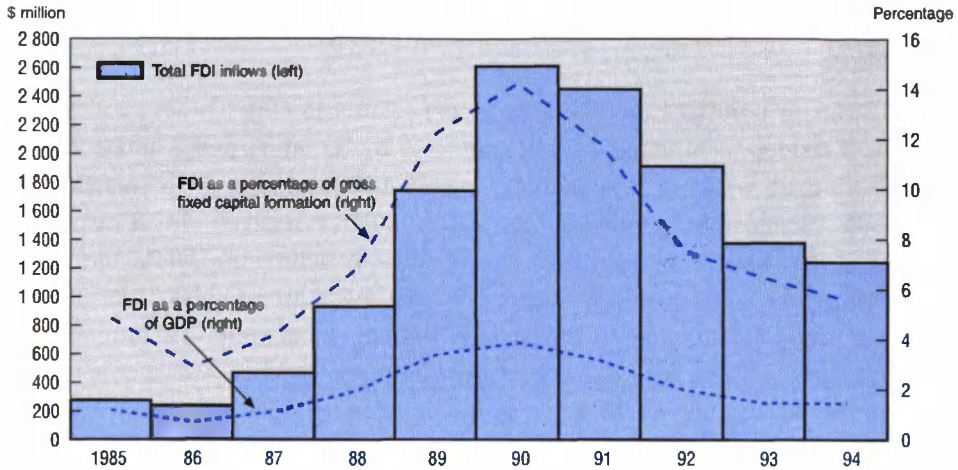
Since the previous *Economic Survey of Portugal* was published in June 1995, a number of measures directly affecting the labour market have been taken. Most of these focus on improving the efficiency of training and education policies, *e.g.* new training facilities for young school leavers (October 1995), the first stage in the creation of a new training institute (June 1995), responsible for

Figure 41. **PER CAPITA INCOME AND R&D SPENDING**



Source: OECD.

Figure 42. **FOREIGN DIRECT INVESTMENT IN PER CENT OF GDP AND GROSS FIXED CAPITAL FORMATION**



Source: OECD.

monitoring and evaluating training programmes as well as harmonising training opportunities, and the introduction of pre-primary schooling facilities (Spring 1995). A special ministerial council has been created to design a consistent, broadly-based policy approach with respect to employment and qualifications, education, culture, science and technology in search of better labour market outcomes. In addition, Portugal is implementing steps to improve the administration of science and technology policy, particularly to increase research links between the public and private sectors and foster technology diffusion.[60]

The new "Short-term Social Pact" of January 1996, the first accord since 1992, proposes additional training measures, the emphasis being placed upon on-the-job training and better counselling of unemployed persons and owners of small firms. Signed by employers, a major trade union and the new government, the pact recognises the 1996 macroeconomic scenario outlined by the new government (see Chapter II). Issuing guidelines for nominal wage growth, employment policy, labour relations and changes in taxation and social security, the accord strives to build up social consensus by enlarging the role of social partners in the design of regional policies and the distribution of EU-funds. A medium-term (''strategic'') social pact, focusing on the modernisation of the productive apparatus and the upgrading of human capital, is due to be concluded in the summer of 1996.

The main points of the short-term pact relating to the labour market are a legislated reduction in standard working time to 40 hours and a more flexible organisation of working time, largely based upon reduced job demarcation.[61] Under draft legislation, now under discussion in Parliament, employees would be required to perform a wider range of activities than hitherto, while the use of non-contractual work would be curbed.[62] Special measures would be taken to eliminate child labour and to create jobs through local initiative programmes, notably in rural areas. The agreement also proposes to liberalise opening hours for retailers during the week, while reducing opening hours for Sunday trading by large retail outlets, the aim being to ease the adjustment of Portugal's 140 000 small retailers – employing 400 000 people – towards an environment of greater competition. Striking a balance between the demands of small retailers and the needs of consumers, new legislation adopted in May 1996 cut the Sunday opening hours of large retail outlets by one hour, to five hours compared with ten for smaller outlets. It also made operating conditions of smaller retail outlets during the week more flexible. Portugal uses European funds to help finance a programme providing grants and low interest loans to encourage small retailers to invest in modernisation and training in order to increase the competitiveness of the sector.

Changes in the social security system, outlined by the 1996 social pact, include the introduction, on an experimental basis, of a minimum income scheme in 1996, the features of which have yet to be specified; the lengthening of the maximum period for unemployment assistance payments for persons between 45 and 54 years of age to 15 months for those with exhausted unemployment insurance benefits and 30 months in other cases. The pact also proposes to appoint a special commission with the mandate of producing a White Paper on social security issues (see Chapter III) and to step up efforts to combat tax evasion. Creating a taxation information network, strengthening local tax offices and improving the ''taxpayer identification number system'' are seen as principal means of reducing undeclared income. Backed by hirings of qualified tax inspectors, the reform of tax administration is planned to precede tax reform. In this context, the government intends to tax companies on their imputed earnings, as proxied by the average earnings of a similar sized company in the same sector, and self-employed individuals who declare income less than the minimum national wage.

Recent measures and proposals to improve product market competition include the transcription into Portuguese law of EU-directives concerning public procurement policies (March 1995); the transfer to the audit court of financial control responsibilities for public enterprises (October 1995); easier notification procedures for foreign direct investment (November 1995); and more consumer-friendly credit regulations (February 1995).[63] The authorities also restructured the regulatory framework of the electricity sector (Decree-law of July 1995), splitting it into two segments, one responsible for rendering a public service *per se* (*Sistema Electrico de Servico Publico,* SEP), the other in charge of services subject to market forces (*Sistema Electrico nao Vinculado,* SENV). A regulatory *body (Entidade Reguladora do Sector Electrico*), endowed with own capital and administrative and financial autonomy, is responsible for regulating SEP and for defining the commercial links between SEP and SENV, with the emphasis being put upon competition and the efficient use of electricity.

Development of the capital market continued to be stimulated by the privatisation programme, receipts from which surged to Esc 292 billion in 1995 compared with Esc 188 billion in 1994. About half of the revenues stemmed from selling a stake of 27 per cent in *Telecom,* one fourth from sales of banks and one sixth from privatising paper and cement companies. The government plans to step up privatisation receipts to a record of Esc 380 billion in 1996 or 2.3 per cent GDP, of which the greater part would be used for public debt redemption. Public companies scheduled to be privatised in 1996 include electrical utilities, *Telecom,* cement, shipbuilding, tobacco, food and petrochemical companies as well as banks (see Chapter II).

Assessment and scope for further action

Portugal has retained a high measure of wage flexibility, based upon wide and flexible wage differentials. Labour market resilience has also been underpinned by preferential rates of social security contributions for self-employed persons as well as by opportunities to avoid and evade payments of contributions and taxes. Self-employment and service employment have grown rapidly over the past ten years helping to underpin Portugal's traditional nominal wage flexibility. However, the unemployment problem which Portugal now faces requires the redeployment of labour from the more traditional – but now less competitive – labour intensive-industries. While wage flexibility is essential for dealing with this, it needs to be buttressed by policy actions in other domains, encompassing initiatives aimed at generating an environment for creating and enlarging enterprises as well as regrouping micro firms.

As recognised by the new government, the issue of more stringent law enforcement is fundamental in the domain of taxation and social security contributions, where significant non-compliance has distorted competitive conditions and created horizontal inequities. The government plans to recoup the equivalent of 2 per cent of GDP in lost tax revenue over three years through better enforcement procedures. The decentralisation of tax administration, as planned by the authorities, will serve to enforce laws and regulations more efficiently. Cross-checks should be made between corporate tax and VAT payments. Establishing a more favourable legal framework for voluntary part-time work, as is planned by the government, is a step towards stronger job creation. At the same time, there is room for easing employment protection laws further and for implementing such rules in a more uniform fashion. Labour mobility could be enhanced by easing housing market restrictions, while the search for part-time work could be stimulated by abolishing the provision under which earned income from part-time work triggers the suspension of all unemployment insurance payments.

As noted in the 1995 *Economic Survey of Portugal,* at the beginning of the 1990s Portugal's education system, produced less favourable results than those of other EU countries.[64] The training system is still marked by a relatively low participation, particularly among those most in need, while enterprises invest little in training. There is substantial scope, as evidenced by the measures announced in the Social Pact of January 1996, for augmenting the efficiency of training programmes by way of targeting these on specific labour market needs. This would require enlarging the number of job counsellors for the unemployed, establishing nationally recognised standards in skill achievement and qualifications and improving the capacity for monitoring training programmes.[65]

Given Portugal's atomistic production structure, more determined and targeted measures are needed to upgrade the managerial skills of employers, who lack organisational and marketing know-how and who often underrate the importance of training their employees. At present, transaction costs ("red tape") arising from merging small firms and/or from changing their geographical site are prohibitively high and should be lowered. In this way, the conditions could be created whereby networks of small firms, concentrated in specific geographical areas and producing the same or similar goods and services, could benefit from the same positive externalities – in the form of co-operation and specialisation – that accrue to small firms in Italy.[66]

V. Conclusions

The recovery, which began in the first quarter of 1994, appeared to gather pace in the first half of 1995 but stalled in the course of the year. Unfortunately, the lack of updated national accounts data continues to impair a proper evaluation of the economic situation. However, the first signs of a slowdown were observable in declining export orders and this seems to have impacted rather rapidly on business confidence: fixed investment slowed quite sharply in the second half of 1995. Private consumption also weakened. The unemployment rate had risen to 7.3 per cent by the end of 1995, 3½ points higher than the previous low in 1992. Surveys taken early in 1996 indicate a continuing pessimism about the economic climate, with some, but not all, conjunctural indicators suggesting that the slowdown extended into the first quarter.

The OECD is projecting a modest revival in economic activity from the second half of 1996 as export market growth revives. New capacity for car exports may add around ¾ percentage point to real GDP growth. Capital spending will be stimulated by infrastructure investment co-financed by the EU structural funds. Output is projected to grow by 2¼ per cent on average in 1996, rising to 2¾ per cent in 1997. This being insufficient to make inroads into unemployment, sluggish labour demand could continue to undermine consumer confidence. Perhaps the greatest risk, however, is that European export markets expand less strongly than expected, damping both external demand and industrial investment.

The recession and subsequent pause in the recovery have brought a halt to the process of rapid real-income convergence, which had taken Portugal's per capita income from just over half to nearly 70 per cent of the European average between 1985 and 1992. Since the 1993 recession, real GDP growth has averaged 1.6 per cent in Portugal, one point below the EU average. Against this, the process of nominal convergence has been impressive. The official inflation target was again met in 1995, for the fourth consecutive year. In April 1996 the average rate of consumer-price inflation stood at 3.4 per cent, less than a third of the rate four years earlier, implying a differential *vis-à-vis* the EU average of only 0.4 points, the lowest recorded. Disinflation is projected to continue in 1996 and 1997, albeit at a slower pace, assisted by favourable foreign price trends and the Social Pact of January 1996, which may reinforce the effects which weak labour market conditions normally have on nominal wage growth in Portugal.

Progress in inflation convergence has taken place against the background of monetary polic aimed at stabilising the nominal value of the escudo within the ERM. While wage behaviour has adapted fairly substantially and relatively quickly to this new regime, so that increases in unit labour costs have been relatively subdued, there has been a rise in the real value of the escudo during the 1990s, as measured by relative unit labour costs. The short-run adjustment costs should not be exaggerated, however. While the process of real-income convergence would seem, of necessity, to entail adjustment costs for traditional sectors, the economy-wide costs have actually been rather small. The process of disinflation has not led to an excessive squeeze on profits in order to maintain export competitiveness: the average non-wage income share has risen and Portugal has been able to expand its share of world trade significantly. Although in 1995 this has been partly due to one big automotive project, the general indications are that the Portuguese export cost structure is still relatively favourable, the level of manufacturing labour costs being well below that observed in the rest of the European Union. A lower trade deficit combined with higher official transfers moved the current account close to balance in 1995.

At the same time, the economy has entered a period where the benefits of exchange-rate stability are beginning to come through in lower costs of capital, which will increasingly support the expansion. Until Spring 1995, sporadic exchange-market turbulence, linked both to the volatility of international capital flows and market perceptions about Portuguese fundamentals, necessitated hikes in policy-controlled interest rates and three devaluations of the escudo. However, Portugal's commitment to exchange rate stability has been gaining in credibility, as evident in reduced volatility of daily exchange rates and a weakening linkage between the escudo and the peseta. The need for official intervention in foreign exchange markets has decreased correspondingly, and, with inflation falling, the Bank of Portugal has been able to resume its policy of gradual interest rate reductions since August 1995. In this environment, market rates have eased, the rate on 10-year government bonds dropping by more than 300 basis points over the twelve months to May 1996, cutting the differential relative to Germany to 2.5 percentage points. With the prospects for further disinflation good, and fundamentals continuing to favour the process of nominal convergence, the interest rate premium should diminish further, enhancing the prospects for a resumption of the recovery.

The pursuit of exchange rate stability may also have been facilitated by the undershoot of the budget deficit in 1995. The general government deficit contracted to 5.2 per cent of GDP, about ½ per cent of GDP below both the original target and the 1994 outcome. The new government, which took office in October 1995, has re-affirmed the commitment to the Maastricht convergence requirements. Stepping up the pace of fiscal consolidation, the 1996 budget targets a general government deficit equal to 4.2 per cent of GDP and sets the stage for a 3 per cent deficit in 1997.

This commitment appears to be a credible one, particularly if the experience of the last two years is repeated. However, there are risks, which need to be closely monitored. The first relates to tax receipts. The better-than-expected deficit outcome in 1995 was due to tax revenues being more buoyant than expected, mainly reflecting the collection of tax arrears and reduced tax evasion. In 1996, also, the projected fiscal consolidation is due to come largely through rising tax pressure. Part of this is due to the assumption of stronger economic growth, which may prove optimistic. Part is due to better tax enforcement. Tax evasion is a serious problem in its own right, not least for inequities it involves. In response, the government has rightly stepped up the fight against evasion, decentralising the tax administration, introducing cross-checks via a new tax information network, strengthening the "tax-payer identification system" and hiring skilled tax inspectors. Effective implementation and enforcement of these administrative improvements will be needed to minimise the risk of revenue shortfalls which would derail the convergence process.

The second risk relates to public expenditure control. Inadequate expenditure control was evident in large overruns for current spending in 1995, essentially on health, making a supplementary budget necessary. The public expenditure share in GDP is programmed to rise by less than 1 per cent of GDP in 1996, but incorporates desirable shifts away from current spending towards higher capital outlays, notably infrastructure, and away from debt interest to higher outlays on education and social transfers. This strategy of selective programme growth requires effective administrative controls to be carried through. Avoiding the danger of overruns demands, at a minimum, that additional measures of fiscal restraint be taken in the event of spending straying from target. But strategically the authorities would also be well advised to design a new medium-term convergence plan, replacing the previous outdated programme. In this respect the decision to frame the 1997 budget within a medium-term financial programme is to be welcomed. The new programme should be based upon prudent assumptions about real GDP and export market growth and reaffirm fiscal targets for 1997 and beyond, quantifying, separately and on an annual basis, the effects from revenue and expenditure measures, as is the practice in other European countries.

A medium-term focus is all the more important because, at 71.4 per cent of GDP in 1995, the level of public debt continues to be excessive. Although the primary surplus is expected to widen to 1 per cent of GDP, this may prove insufficient to stabilise the debt/GDP ratio. Improvements in public debt management can help. The Treasury lengthened the average maturity of public debt to 3.5 years in 1995 – still low by international standards – and assured a regular presence in all segments of domestic markets, helping to lower the overall cost of debt service in 1995. Debt operations became more predictable with the publication of a yearly calendar for bond issues. With greater reliance placed on foreign funds and domestic interest rates easing, the cost of direct public debt fell below 10 per cent in 1995. However, better debt management techniques need to be supplemented by measures to put public debt on a downward medium-term path.

While tight control of all government spending is essential for fiscal consolidation, the speed with which the public debt will fall over the medium run, for a given profile of output growth, will be conditioned by privatisation receipts and pension expenditures as well as revenues from reduced tax evasion. In this respect, the new government's privatisation programme for 1996 is both ambitious and broadly based. Projected receipts from sales of both financial and non-financial enterprises are expected to total 2.3 per cent of GDP, compared with 1.3 per cent in 1994. The objectives are not primarily budgetary, however, and relate to the need for greater efficiency in the sectors concerned. The greater part (1.8 per cent of GDP) of the revenues is earmarked for public debt redemption and the remainder for the restructuring of ailing public firms. Even so, the scope for diminishing the presence of state and local government enterprises in the economy (which in output terms amounts to more than 9 per cent of GDP) will remain large, particularly with respect to airlines, railways, municipal transport, and electricity.

Reducing public debt over the medium run also hinges upon a restructuring of the social security system (including both the public-sector scheme and the tripartite general system applicable to the private sector), outlays of which exceeded contributions by 2.6 per cent of GDP in 1994. This gap does not stem from particularly high social security spending per head of population, but rather from both generous pension provisions per recipient, notably for public sector-employees, and low social security receipts in relation to the overall rate of contributions, the latter stemming from avoidance and evasion.

To reduce the social security deficit, a set of corrective measures were taken in 1993-95, lengthening the reference period for calculating pensions, lowering the accrual rate, raising the retirement age for women towards that of men, aligning pension provisions of newly-hired public workers on those in force in the private sector and raising contribution rates for the self-employed. But, important as they are, these reform measures may prove insufficient to restore financial equilibrium in the social security accounts over the medium run. OECD simulations show that unfavourable demographic trends would tend to push the pension deficit to 8.5 per cent of GDP in 2035, if no additional reform measures were taken. Aware of this prospect, the government has ordered a White Paper on social security issues to be prepared by a special commission, the preliminary recommendations of which are due to be presented in time for the 1997 budget.

Portugal's social security system calls for further reforms along four main lines: financing provisions need to be redesigned, the contribution system restructured, pension provisions altered and social security revenues boosted via an attack on contribution evasion:

- *Redesigning financing provisions*. The institutional set-up needs to be changed to strengthen the perceived link between contributions and earnings-related benefits. As a first step, non-income-related welfare payments made under the contributory scheme of the general system – family and children allowances as well as benefits for the disabled – should be separated from pension provisions *per se* and financed through general tax revenue.

- *Restructuring the contribution system.* Better transparency would be ensured by differentiating between categories of insurance, particularly old-age versus unemployment insurance. Contribution rates differentiated in this way should then be harmonised across different categories of income earners. There is also a case for easing the strong tilt towards employers' contributions, which employees normally do not perceive as being part of their overall compensation.
- *Altering pension provisions.* Pension provisions should be modified by lengthening the reference period from the last 10 years worked. An ambitious approach would be to base pensions upon the capitalised value of lifetime contributions along the lines of the new pension system in Italy in 1995, which, though not fully funded, will produce market-oriented outcomes following a long transition period. Action along these lines would strengthen the connection between contributions and pension entitlements. At present, this link is fragile at best. Moreover, public-sector employees hired before September 1993 benefit from overly generous pension provisions (a short reference period; a high accrual rate, and a low retirement age). These privileges call for a gradual realignment on private-sector provisions.
- *Curbing contribution evasion.* Non-compliance with contribution rules is distorting competitive conditions and discriminating against employees, who typically lack opportunities for escaping from such payments. The scope for raising revenues is correspondingly large. Countries with similar contribution rates collect much larger amounts of social security contributions than Portugal, even if allowance is made for contribution arrears, which in 1994 amounted to 2.6 per cent of GDP. The phasing-out of the preferential contribution rate for the self-employed by 1999 should also generate larger revenues.

By reducing allocative distortions as well as horizontal inequities, social security reform would help to improve labour market outcomes over the medium run. The causes of the recent rise in Portugal's unemployment rate are complex. As noted above, overall the flexibility of the labour market has meant that the strategy of disinflation and nominal convergence has had only limited effects on unemployment. Indeed, the relationship between unemployment and nominal wage growth shows no sign of instability, indicating that Portugal has retained a high measure of aggregate wage flexibility based upon large and flexible wage differentials. Overall, Portugal has been able to gain export market shares and its service sectors have continued to create jobs more rapidly than the EU average. Nevertheless, over the past three years the labour market has been exposed to a shake-out in key traditional industries (textiles and footwear), stemming from two different sets of influences, one being the disappearance of special positive forces linked to EU membership in 1986, the other the emergence of keener competition from countries with low labour costs. The relationship between employment and output seems to indicate the beginning of a structural shift away from traditional labour-intensive industries. Although cyclical and structural factors are difficult to disentangle, some mismatch in skills may be emerging in the parallel rise in vacancies and unemployment.

In this new climate, the advantage of wage flexibility would not alone be sufficient to avert a rise in structural unemployment without sacrificing longer-run distributional and real-income objectives. For this reason, the special chapter of this *Survey* following up the OECD *Jobs Study* recommends a broadly-based strategy, stretching beyond wage flexibility; embracing lower non-wage labour costs; greater input flexibility; human capital development; enterprise creation and innovation, and enhanced product-market competition. The recommendations are:

- *Reduce non-wage labour costs.* Improvements in administration, as discussed above, would reduce contribution evasion and hence the tax burden on labour, especially if accompanied by an equalisation of treatment between employed and self-employed.
- *Increase labour market flexibility.* The search for part-time work by job losers could be stimulated by graduating unemployment benefits according to new earned income. Relaxing housing market restrictions would enhance labour mobility, while easing employment protection legislation would serve to enhance employment adaptability. At the same time, such legislation should be applied more uniformly and a legal framework is needed to protect workers with no formal contracts.
- *Upgrade labour force skills and competencies.* Despite improvements in Portugal's education system, a substantial number of the working population still have a low level of educational attainment. Education, notably at the basic and secondary level, should be improved via a drive to ensure that students finish their compulsory schooling, and that the curricular

reform and new assessment procedures are fully implemented. As already officially proposed, restrictions on child labour should be better enforced, in order to reduce high drop-out rates. In addition, public training should be made more efficient by way of targeting specific groups, including managers and owners of small and medium-sized firms, while opportunities should be created for training within enterprises. Experience of other countries suggests that training needs to be accompanied by expert counselling for school leavers, unemployed persons and managers.

- *Improve the climate for enterprise creation and innovation.* Transaction costs arising from merging firms and/or changing their geographical site are high, hindering the creation of networks of small firms. Concentrated in specific geographical areas and producing the same or similar goods and services, such networks have been shown to yield positive externalities, speeding up the diffusion of product and process innovation and stimulating spending on research and development. R&D expenditure is still below par in Portugal, even considering its low level of per capita income. Implementation lags for EU-financed projects, among the longest in the EU, should be shortened.
- *Enhance product market competition.* Portugal has made significant progress in deregulation but further action is needed to strengthen competition in the sheltered sectors. In addition to the action called for above on privatising state-owned enterprises, further liberalisation and modernisation of the distribution and private service sectors offers the greatest potential employment gains.

Initiatives have already been taken on several of these fronts. The process of easing regulatory restrictions is relatively advanced in retailing, new laws having taken effect in 1994 and 1996 to facilitate the creation of new retail outlets and to increase the flexibility of shop opening hours. The need for greater flexibility of labour is recognised by the "Short-term Social Pact" of January 1996 which calls *inter alia* for a more flexible organisation of working time, largely based upon reduced job demarcation. Legislation to this effect has been put before Parliament. The government is also in the process of negotiating a medium-term strategic agreement with the social partners, the aim of which would be to ensure that macro-economic, social and structural policies are mutually consistent and capable of meeting Portugal's employment and convergence goals in an increasingly globalised economy.

Overall, the policy challenges facing Portugal have evolved considerably since the early 1990s. The convergence strategy pursued has been remarkably effective in creating the financial conditions required for stable, non-inflationary growth, but the process of real income convergence has stalled as growth has slowed and unemployment risen. The emphasis of policy now needs to be on preventing higher unemployment from becoming structural, and relying on wage flexibility alone to prevent this might well have adverse consequences for real income convergence. To re-attain a path of real-income convergence with the rest of Europe while avoiding the labour-market outcomes which have caused problems elsewhere, requires that structural reforms be put into effect as outlined above, which increase the flexibility and adaptability of the labour force and further enhance competition in product markets. Such reforms, allied to the continued pursuit of monetary stability and fiscal consolidation, would provide the soundest basis for continued economic development.

Notes

1. Assessing developments in economic activity in Portugal is complicated by the lack of up-to-date official national accounts data. Annual data, at constant 1985 prices, are only available for the 1986-92 period. Preliminary quarterly data, at constant 1990 prices, extending to end-1995, were released in May 1996; these data, however, do not include the contribution of stocks to economic growth for years beyond 1992.
2. *AutoEuropa,* a joint venture by Ford and Volkswagen with investment outlays equal to 2.9 per cent of GDP, began production of multi-purpose mini-vans at a plant in Palmela in mid-1995.
3. Several conjunctural indicators point to strong growth of investment in machinery and equipment. In 1995, production of the investment goods sector increased by 8.2 per cent and the volume of sales of heavy commercial vehicles by 6 per cent; the volume of imports of machinery and equipment increased by around 10 per cent.
4. According to the EU *ad hoc* labour market survey conducted in the summer of 1994, a significantly higher proportion of Portuguese industrial firms than in other EU countries indicated "rationalisation" and "introduction of new technologies" as the main reason for their expected employment change. When asked about payroll levels relative to the volume of sales, the proportion of firms indicating overstaffing was, however, lower than in other EU countries. European Economies (1995), Performance of the European Union labour market. Results of an *ad hoc* survey covering employers and employees, No. 3, p. 70.
5. Corado C. and Gomes J.F. (1995), "Adjusting to Trade Liberalisation: the case of Portugal", in Barba Navarretti G., R. Faini and A. Silberston, *Beyond the Multifibre Arrangement: Third World Competition and Restructuring Europe's Textile Industry,* OECD Development Centre, p. 62.
6. Corado C., Benacek V. and Caban W. (1995), "Adjustment and Performance of the Textile and Clothing Industry in the Czech Republic, Poland and Portugal", CEPR Discussion Paper No. 1260, p. 37.
7. The harmonised CPI index of Eurostat, which is used for assessing inflation convergence among member countries and which is based on a more restricted basket of goods, points to a lower price rise than that recorded by the INE index. Based on the harmonised index, Portugal's average inflation in January 1996 was 1.1 points above the Maastricht limit (*i.e.* 1.5 points above the rate of the three EU countries with lowest inflation).
8. The macroeconomic assumptions underlying the agreement included real GDP growth of 3 per cent in 1996.

9. The Bank of Portugal's measure of profit margins in the export sector, based on costs of labour and of imported inputs, points to a cumulative reduction of margins of around 16 per cent between 1987 and 1994, reversing earlier gains in the 1981-87 period. Profit margins in the export sector improved by 1.6 per cent in 1995.
10. The import content of production from *AutoEuropa* is estimated at around 55 per cent, making for a net contribution to real GDP growth of around 0.3 points in 1995 and of 1 point in 1996.
11. Data for portfolio investment in 1995 are not comparable with those of previous years, as they include investment in international clearing centres.
12. On 12 September 1995, the government approved a decree law that amended the Organic Law of the Bank of Portugal, setting price stability as the primary objective of monetary authorities, while taking into account the overall economic policy of the government. The decree law also transcribed in national legislation EU regulations prohibiting overdraft facilities to the Treasury and purchase of public debt instruments on the primary market.
13. The Bank of Portugal also reduced the discount rate by 1 percentage point, to 9.5 per cent, on 30 August, and by 1.25 points in 1996, to a level of 8.25 per cent in April 1996. Although not an "intervention" rate of the Bank of Portugal, some interest rates, in particular old government bond issues, are indexed on the discount rate.
14. M1 continued to accelerate until the end-of 1992, when the larger monetary aggregate had already started decelerating; both its acceleration in the second half of 1994 and its deceleration in 1995 lagged the larger monetary aggregate series.
15. A clear deceleration of bank credit to firms and individuals is, however, evident when looking at the quarterly rate of change of seasonally adjusted figures; on this basis, growth falls from a maximum of around 25 per cent in the first quarter of 1995 to below 10 per cent by end-year.
16. The undershooting of the official target for 1995 partly reflected a more pessimistic estimate of the 1994 deficit at the time of the preparation of the budget document. The 1994 deficit, on a cash basis, was then estimated at 5.8 per cent of GDP, 0.6 points higher than its outcome. For 1995, the budget targetted a general government deficit unchanged, as a proportion of GDP, from the previous year.
17. The budgetary document approved by Parliament is on a cash basis (*contabilitade pública*). Most of the discussion presented in the main text of this *Economic Survey* is based on data on a national accounts basis provided by the Portuguese authorities.
18. This target for the general government deficit in 1996 is marginally lower than the 4.3 per cent contained in the EU recommendation for Portugal of July 1995. Nonrespect of this reference value might, in principle, trigger a suspension in the disbursement of the EU Cohesion Fund financing.
19. To ensure that the 1996 deficit target will be met, the government in May 1996 temporarily froze around 10 per cent of spending appropriations for goods and services.
20. Privatisation receipts earmarked for debt reduction totalled Esc 575 billion over the 1989 to 1995 period, directly contributing to a reduction in the stock of public debt equivalent to 4.5 per cent of GDP. Other privatisation receipts used for the restructuring of public enterprises totalled Esc 580 billion over the same period. In 1993, the share of privatisation receipts earmarked for debt redemption was reduced from a mandatory 80 per cent to a minimum of 40 per cent.

21. In 1994, the general contributory scheme covered 2.9 million dependent workers and 870 000 self-employed. 48 000 banking employees were covered against risks of unemployment and occupational diseases. The employers contributing to the scheme were 514 000.
22. This scheme may, under certain legal conditions, also cover refugees, stateless persons and nationals of the member states of the European Union with residence in Portugal as well as nationals of other countries with which bilateral agreements have been concluded.
23. The public sector includes the central, local and regional administrations, public institutions, the army and other entities subject to public law. Excluded from the scheme are employees of some public enterprises.
24. Normal retirement age for women will gradually be increased to 65 years between 1995 and 1999. Early retirement provisions are available to some categories of workers, particularly those affected by economic restructuring (60 years) or in arduous occupations – *e.g.* miners (50 years), workers in the merchant navy, fishermen and dock workers (55 years), and aircraft pilots (60 years). The retirement age may be anticipated (60 years) for unemployed persons having reached the end of the concession period for the unemployment benefit.
25. The law 28/84 established the integration of the public-sector scheme into the general system to create a unified social security system.
26. From 1991, banks are required to fund pension liabilities.
27. World Bank (1994), *Averting the Old Age Crisis.*
28. The population projections are from the World Bank (1994). Data for the private and the public sector pension schemes are supplied by the Portuguese authorities. After 2000, the ratio of employed to the working-age population is assumed to remain constant. GDP growth rates are determined by the growth in labour productivity and changes in the working-age population. For a description of the model used, see W. Leibfritz, D. Roseveare, D. Fore and E. Wurzel (1995), "Ageing Populations, Pension Systems and Government Budgets: How do they Affect Saving?", *OECD Economics Department Working Papers,* No. 156.
29. These figures do not include invalidity pensions, as the simulation model only covers old-age and survivors' pensions.
30. The equilibrium contribution rate is calculated as the ratio of pension expenditure to the total wage bill on which contributions are paid.
31. The main advantage of summarising pension flows in net present value form is that it allows for easier comparison between different scenarios, but the same pension flows can produce quite different net present values depending on the discount rate used. The alternative productivity growth assumptions used to estimate pension flows (1, 1.5 and 2 per cent per year) have much less impact on the results than the discount rates used. Although a 1 percentage point difference in discount rates and in productivity growth rates would yield similar changes in net present values, the plausible range of productivity growth rates is much narrower than the plausible range of discount rates.
32. The World Bank's report *Averting the Old Age Crisis* (1994) points in this direction. The report recommends separating the saving function from the redistributive function within a multi-pillar social security system based on three different financing and managerial arrangements.
33. OECD (1996), *Economic Survey of Italy,* pp. 49-55.

34. Portuguese labour force statistics have undergone three major revisions, making historical comparisons difficult. The most important took place in 1974, significantly increasing the count of both employment and the labour force. The revision in 1982-83 corresponds to the introduction of a quarterly labour market survey, while the most recent one (1991-92) raised the minimum age for being recorded in the labour force from 12 to 14 years of age and modified the household sample for the survey on the basis of the 1991 census of the population.

35. In textiles, the level of labour productivity was less than two-thirds the manufacturing average, in clothing less than half. Portugal's T & C industry suffers from fragmentation, with about 50 per cent of firms having fewer than 20 employees and less than 2 per cent employing more than 500 workers. The small and family-run firms have difficulties in marketing products. Competition among T & C industries worldwide has intensified during the 1990s. See C. Corado *et al.* (1995), "Adjustment and performance of the textile and clothing industry in the Czech Republic, Poland and Portugal", Centre for Economic Policy Research, November, pp. 3 and 9.

36. S. Scarpetta (1996), "Assessing the role of labour market policies and institutional settings on unemployment: further evidence from 17 countries' pooled time-series", OECD *Economic Studies, No. 26* (forthcoming).

37. While the change in the unemployment rate emerges as significant in some specifications of the Portugese wage equation (e.g. OECD (1992) *Economic Survey of Portugal* p. 101), unit root tests are much less conclusive in supporting the persistence hypothesis than, for example, is the case for Spain.

38. OECD (1995), *Economic Survey of Portugal,* p. 13.

39. OECD (1994), *Economic Survey of Portugal,* p. 75.

40. OECD (1992), *Economic Survey of Portugal,* pp. 100-101.

41. OECD (1994), *OECD Jobs Study,* Part II, p. 11.

42. L. Calmfors (1993), "Centralisation of wage bargaining and macroeconomic performance – a survey", Economic Studies, no 21, pp. 161-184; O. Blanchard and J.F. Jimeno (1995), "Structural unemployment: Spain versus Portugal", *American Economic Review,* May, pp. 212-218.

43. OECD (1995), *Economic Survey of Portugal,* pp. 71-74.

44. OECD (1994), *Economic Survey of Portugal,* p. 18.

45. R. Jackman (1996) *et al., op. cit.* p. 29.

46. Short-term contracts can only be renewed twice, and the total duration of fixed-term employment cannot exceed 36 months.

47. OECD (1994), *Labour market notes,* Part 2, p. 58.

48. OECD (1995), *Economic Survey of Portugal,* p. 14.

49. OECD (1995), *Employment Outlook,* pp. 65-79.

50. OECD (1994), *The OECD Jobs Study,* Part II, p. 174.

51. Over the four years to 1990 the proportion of firms providing training more than doubled, rising to 34 per cent. Nearly two thirds of training expenditure was privately funded.

52. OECD (1995), *Economic Survey of Portugal,* p. 61.

53. OECD (1995), *Economic Survey of Portugal,* pp. 61-66.

54. For a detailed discussion of Portugal's human capital development see: OECD (1995), *Economic Survey of Portugal,* pp. 43-83.

55. OECD (1995), *Economic Survey of Portugal,* pp. 75-78.

56. The restructuring of the electric utility (*Electricidade de Portugal, EDP*) ended in 1994 with the creation of a production company, a high-tension transmission company, four regional distribution companies, 13 specialised service companies and the holding company EDP. See OECD (1995), *Economic Survey of Portugal,* p. 42.

57. For a discussion of this issue see OECD (1995), *Economic Survey of Italy,* pp. 89-90.

58. D. Coe and E. Helpman (1993), "International R&D spillovers", NBER Working Paper Series, No. 4444.

59. OECD (1994), *Economic Survey of Portugal,* pp. 54-55.

60. In addition to creating the Ministry for Science and Technology in 1995, Portugal reorganised the National Board for Science and Technology Research (JNICT), to increase flexibility in funding research, as well as the Higher Council for Science and Technology to increase its links with industry. The Innovation Agency is to be opened to private shareholders to enhance its ability to promote industrial R&D, particularly by smaller firms.

61. Draft legislation to this effect has been introduced in the Spring of 1996. The step-wise reduction of working time to 40 hours and arrangements on more flexible working time proposed by the 1990 Economic and Social Agreement (ESA) were not put into effect.

62. Conselho Económico e Social (1996), Acordo de Concertação de Curto Prazo, January, p. 18.

63. For details see Bank of Portugal (1995), *Economic Bulletin,* September, pp. 40-41.

64. OECD (1995), *Economic Survey of Portugal,* p. 88.

65. Many evaluations show that training is not effective for disadvantaged youths. Among the few significant exceptions to this finding are the Job Corps in the United States and the Canadian Employability Improvement Programme. Much of the success in the former appears to have been derived from in-depth counselling and training provided in an independent environment. The Canadian programme appears to derive much of its success from well-targeted measures, both to the individual and to local labour market needs. OECD (1996), "Enhancing the effectiveness of Active Labour Market Policies". Unpublished draft.

66. OECD (1991), *Economic Survey of Italy,* p. 64.

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Annex I

Major privatisations

Table A1. **Major privatisations, 1989-1995**

Enterprise	Date	Percentage sold	Method	Total revenue (in billion escudos)	Sector
Banco Totta & Açores (first tranche)	10.07.89	49.0	Public offer	28.6	Banking
Tranquilidade (first tranche)	04.12.89	49.0	Public offer	25.8	Insurance
Banco Totta & Açores (second tranche)	31.07.90	31.0	Public offer	22.4	Banking
Centralcer	12.11.90	100.0	Public offer	34.6	Brewery
Banco Português do Atlantico (first tranche)	11.12.90	33.0	Public offer	49.8	Banking
Banco Espirito Santo & C.L. (first tranche)	09.07.91	40.0	Public offer	60.9	Banking
Banco Fonseca & Burnay (first tranche)	27.08.91	80.0	Public tender	36.1	Banking
Banco Espirito Santo & C.L. (second tranche)	25.02.92	60.0	Public offer	89.0	Banking
Companhia de Seguros Mundial Confiança	14.04.92	100.0	Public offer	33.4	Insurance
Banco Português Atlantico (second tranche)	25.05.92	17.64	Public offer	50.6	Banking
Petrogal	04.06.92	25.0	Public tender	40.8	Oil
Companhia de Seguros Imperio	17.11.92	100.0	Public offer	25.5	Insurance
CPP	02.12.92	100.0	Public offer	40.8	Banking
União Bancos Portugueses (first tranche)	03.02.93	61.1	Public offer	24.4	Banking
Banco Português Atlantico (third tranche)	07.07.93	17.5	Public offer	32.4	Banking
Banco Português Atlantico (fourth tranche)	25.03.94	7.5	Direct sale	15.4	Banking
SECIL	31.05.94	51.0	Public tender	31.2	Cement
CMP	31.05.94	80.0	Public tender	31.8	Cement
CIMPOR	04.07.94	20.0	Public offer	39.6	Cement
BPSM (first tranche)	16.11.94	80.0	Public tender	37.3	Banking
Banco Português Atlantico (fifth tranche)	24.03.95	24.4	Direct sale	75.1	Banking
Portugal Telecom	01.06.95	27.3	Public offer Direct sale	142.6	Telecom.
Portucel Industrial	27.06.95	40.0	Public offer Direct sale	35.6	Pulp and Paper
Petrogal	31.06.95	20.0	Direct sale	40.0	Oil

Source: Data supplied by the Portuguese authorities.

Annex II

Calendar of main economic events

1995

March

The central rate of the escudo against other currencies of the ERM is lowered by 3.5 per cent. On 13 March, the average repo rate increases by 2.9 points to 11.6 per cent, easing thereafter in two steps to 10.1 per cent.

Tax exemptions granted to non-residents on interest earned on government securities are modified.

The sale of 24.4 per cent of *Banco Português Atlantico,* through direct sales, yields privatisation receipts of Esc 75.1 billion.

June

Deposit guarantees are extended to include deposits taken by Portuguese banks in other EU countries.

Privatisation of 27.3 per cent of *Portugal Telecom,* through a combination of direct sale and public offer, yields receipts of Esc 142.6 billion. The sale of 40 per cent of Portucal Industrial yields receipts of Esc 40 billion.

July

New provisions are introduced regulating futures and options trading in the stock exchange market.

Sale of 20 per cent of *Petrogal* through bilateral negotiations yields receipts of Esc 40 billion.

August

The Bank of Portugal lowers the liquidity absorption rate by 0.25 points to 8.25 per cent and the overnight credit facility rate by 0.5 points to 11 per cent, the first reductions since October 1994. The average repo rate falls in four steps to 8.75 per cent.

September

New legislation modifies the Organic Law of the Bank of Portugal, setting price stability as the primary objective of the Bank and prohibiting overdraft facilities to the State and other public bodies.

October

The victory of the Socialist Party in the legislative elections of 1 October leads to the formation of a minority government, headed by Mr Antonio Gutierres.

December

The new government presents a supplementary budget for 1995, which raises current expenditure limits by 3 per cent.

The Bank of Portugal cuts the liquidity absorption rate and the overnight credit facility rate by 0.5 points to 7.75 per cent and 10.5 per cent respectively. The average repo rate decreases by 0.25 points to 8.5 per cent.

1996

January

The government, the employers' association (AIP) and one of the largest unions sign the *Short-term Social Dialogue Agreement* setting guidelines for wage negotiations in 1996. The minimum monthly wage is raised by 5 per cent to Esc 54 600.

New provisioning requirements for insurance companies are established.

The average repo rate decreases in three steps to 8.25 per cent.

February

The government presents to Parliament the 1996 budget, targeting a reduction of the (cash) deficit of the general government to 4.2 per cent of GDP. The government approves the new privatisation programme for 1996-97, with privatisation receipts projected at Esc 380 billion or 2.3 per cent of GDP.

The Bank of Portugal lowers the rate for regular supplies of liquidity to 8 per cent.

March

Parliament approves the 1996 budget.

The Bank of Portugal lowers the liquidity absorption rate and the overnight credit facility rate to 7.5 and 10.25 per cent respectively. The rate for regular supply of liquidity is set at 7.9 per cent on 12 March, and at 7.8 per cent on 26 March.

April

The Bank of Portugal cuts the liquidity absorption rate and the overnight credit facility rate to 6.8 and 9 per cent respectively. The repo rate falls to 7.5 per cent.

STATISTICAL ANNEX AND STRUCTURAL INDICATORS

Table A. **Selected background statistics**

	Average 1986-94	1986	1987	1988	1989	1990	1991	1992	1993	1994
A. Percentage changes										
Private consumption[1]	4.1	5.6	6.0	5.7	3.6	6.9	4.8	3.7	0.4	0.2
Government consumption[1]	3.9	7.2	3.8	8.0	4.4	5.7	3.0	1.4	0.0	1.4
Gross fixed capital formation[1]	6.3	10.9	16.8	11.2	4.3	6.8	2.4	5.4	–4.8	3.9
Total domestic demand[1]	5.3	8.2	9.5	9.5	4.4	6.5	4.3	4.3	–0.9	1.5
Exports of goods and services[1]	6.8	6.8	10.6	7.9	13.3	10.5	0.5	6.1	–5.1	10.7
Imports of goods and services[1]	10.8	16.9	20.2	16.5	7.9	13.7	5.4	11.1	–3.2	8.5
GDP[1]	3.1	4.1	5.5	5.8	5.7	4.3	2.1	1.1	–1.2	0.8
GDP price deflator	11.9	20.5	11.1	10.9	11.4	12.9	14.2	13.5	7.4	5.2
Industrial production	2.9	7.3	4.3	3.9	6.8	9.1	0.0	–2.6	–2.4	–0.1
Employment	0.5	0.1	2.6	2.6	2.2	2.2	2.9	..	–2.0	–0.1
Compensation of employees (current prices)	15.0	20.3	16.3	16.5	17.9	20.9	16.0	15.0	6.1	6.0
Productivity (real GDP/employment)	2.8	4.8	2.8	3.1	3.4	2.0	–0.8	8.0	0.9	0.9
Unit labour costs (compensation/real GDP)	11.5	14.3	10.5	10.2	11.5	15.8	16.8	13.8	7.6	3.4
B. Percentage ratios										
Gross fixed capital formation as per cent of GDP[1]	26.8	23.2	25.7	27.0	26.6	27.3	27.3	28.5	27.5	28.3
Stockbuilding as per cent of GDP[1]	1.0	–2.3	–1.1	1.0	1.4	1.2	1.6	2.2	2.3	2.6
Foreign balance as per cent of GDP[1]	–8.7	–2.3	–5.1	–7.9	–6.6	–8.1	–9.9	–12.5	–12.9	–13.2
Compensation of employees as per cent of GDP at current prices	48.0	47.9	47.5	47.2	47.3	48.5	48.2	48.4	48.3	48.3
Direct taxes as per cent of household income[2]	7.9	5.9	5.2	6.8	8.6	7.7	8.4	9.8	9.6	9.3
Household saving as per cent of disposable income	16.3	22.3	21.8	17.6	16.3	15.9	15.3	14.6	12.4	10.9
Unemployment rate[3]	5.8	8.6	7.1	5.8	5.1	4.7	4.2	4.1	5.6	6.9
C. Other indicators										
Current balance (billion dollars)	0.0	1.2	0.4	–1.0	0.2	–0.2	–0.7	–0.2	0.9	–1.0

1. At constant 1990 prices.
2. Pre-tax disposable income.
3. Data based on the narrowest definition of unemployment.

Source: OECD, *National Accounts*, Volume 1, 1960-1994.

Table B. **Expenditure on gross domestic demand product**

Billion escudos

	1986	1987	1988	1989	1990	1991	1992	1993	1994
A. At current prices									
Private consumption	3 241.5	3 767.8	4 437.5	5 140.4	6 137.3	7 244.5	8 346.9	8 971.8	9 420.5
Government consumption	718.4	830.7	1 020.8	1 226.7	1 495.6	1 810.8	2 142.0	2 338.5	2 489.7
Gross fixed investment	1 225.4	1 590.6	1 949.6	2 237.0	2 612.4	2 987.7	3 426.5	3 413.9	3 708.3
Stockbuilding	–45.9	42.1	152.3	117.7	116.4	100.0	117.4	94.8	46.8
Total domestic demand	5 139.4	6 231.3	7 560.2	8 721.8	10 361.7	12 143.0	14 032.8	14 819.1	15 665.3
Exports	1 467.4	1 793.1	2 128.3	2 681.0	3 131.9	3 218.8	3 266.1	3 522.1	4 121.1
Imports	1 580.9	2 132.7	2 778.9	3 262.3	3 908.5	4 177.7	4 470.2	4 715.6	5 347.3
GDP (at market prices)	5 025.9	5 891.7	6 909.6	8 140.5	9 585.1	11 184.2	12 828.7	13 625.6	14 439.1
B. At 1990 prices									
Private consumption	4 941.6	5 239.6	5 538.4	5 738.6	6 137.3	6 432.9	6 672.3	6 697.8	6 710.7
Government consumption	1 207.9	1 253.8	1 354.6	1 414.7	1 495.6	1 540.5	1 562.2	1 562.2	1 584.1
Gross fixed investment	1 807.2	2 110.3	2 345.8	2 446.7	2 612.4	2 676.2	2 821.4	2 685.8	2 791.4
Stockbuilding	–179.4	–89.7	86.2	131.8	116.4	156.0	215.7	229.8	252.6
Total domestic demand	7 777.3	8 514.0	9 325.0	9 731.7	10 361.7	10 805.6	11 271.5	11 175.5	11 338.9
Exports	2 097.7	2 319.1	2 501.7	2 834.9	3 131.9	3 148.5	3 341.3	3 171.7	3 511.2
Imports	2 276.3	2 736.2	3 186.6	3 438.6	3 908.5	4 119.4	4 576.9	4 432.5	4 809.4
Statistical discrepency	186.7	120.0	52.3	64.2	0.0	–44.0	–138.2	–131.0	–183.0
GDP (at market prices)	7 785.5	8 216.8	8 692.4	9 192.2	9 585.1	9 790.7	9 897.7	9 783.8	9 857.7

Source: OECD, *National Accounts*, Volume 1, 1960-1994.

Table C. **Household appropriation account**

Billion escudos

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Compensation of employees	2 225.9	2 588.7	3 014.0	3 556.6	4 313.4	5 215.4	5 831.7	6 218.8	6 470.3	6 905.2
Property and entrepreneurial income	1 753.5	1 924.7	2 144.3	2 419.7	2 939.4	3 293.3	3 743.4	3 795.8	4 027.3	4 226.3
Domestic transfers	598.8	753.7	862.5	995.1	1 239.1	1 573.1	1 732.5	2 007.5	2 237.6	2 472.6
Foreign transfers	395.6	479.9	520.6	587.9	638.3	666.2	641.5	612.8	567.4	503.9
Gross total income	4 973.8	5 747.0	6 541.4	7 559.3	9 130.2	10 748.0	11 949.1	12 634.9	13 302.6	14 108.0
Direct taxes	242.1	245.3	360.5	491.5	546.2	695.3	908.9	937.8	977.4	1 053.3
Social security contributions	572.5	688.0	789.0	928.2	1 153.7	1 383.9	1 454.9	1 689.2	1 873.9	2 066.1
Disposable income	4 159.2	4 813.7	5 391.9	6 139.6	7 430.3	8 668.8	9 585.3	10 007.9	10 451.3	10 988.6
Consumption	3 263.8	3 778.1	4 451.0	5 141.0	6 123.4	7 153.2	8 212.0	8 808.4	9 323.8	9 881.6

Source: INE, *National Accounts* (1986-1991); Ministry of Finance (1992-1995).

Table D. **General government account**[1]

Billion escudos

	1987	1988	1989	1990	1991	1992	1993	1994	1995
Current receipts	2 034.6	2 470.1	2 933.7	3 486.2	4 190.6	5 175.1	5 101.6	5 474.2	6 110.6
Direct taxes	327.6	477.1	678.3	805.7	1 026.7	1 294.1	1 244.5	1 315.8	1 480.0
Social security contributions	576.8	651.9	764.8	952.1	1 135.4	1 339.6	1 451.6	1 598.1	1 773.5
Indirect taxes	844.2	1 017.0	1 128.1	1 323.1	1 508.2	1 804.3	1 775.6	2 019.2	2 244.3
Other current receipts	286.0	324.1	362.5	405.3	520.3	737.1	630.0	541.1	612.8
Current expenditure	2 162.9	2 467.7	2 840.6	3 661.0	4 531.6	5 133.6	5 487.3	5 809.3	6 332.9
Public consumption	830.7	1 023.3	1 239.3	1 512.9	1 938.3	2 186.0	2 393.1	2 547.9	2 777.1
Subsidies	123.6	128.1	122.0	147.1	153.3	156.9	135.9	121.8	139.2
Interest paid	462.9	491.4	519.7	832.4	946.3	989.0	908.9	842.0	899.2
Current transfers	745.7	824.9	959.6	1 168.6	1 493.7	1 801.7	2 049.4	2 297.6	2 517.4
Saving	–128.3	2.4	93.1	–174.8	–341.0	41.5	–385.7	–335.1	–222.3
Capital receipts	102.8	118.7	176.7	227.1	301.0	378.5	447.2	335.9	427.1
Capital expenditure	306.3	373.8	470.7	593.7	700.5	871.8	996.3	818.8	1 008.5
Investment	192.9	247.9	283.2	329.1	388.3	491.4	571.1	556.9	654.1
Transfers	113.4	125.9	187.5	264.6	312.2	380.4	425.2	261.9	354.4
General government overall balance	–331.8	–252.7	–200.9	–541.4	–740.5	–451.8	–934.8	–818.0	–803.7
(Per cent of GDP)	–5.6	–3.7	–2.5	–5.6	–6.6	–3.5	–6.9	–5.7	–5.2
General government primary balance	131.1	238.7	318.8	291.0	205.8	537.2	–25.9	24.0	95.5
(Per cent of GDP)	2.2	3.5	3.9	3.0	1.8	4.2	–0.2	0.2	0.6

1. Data on national account basis.

Source: INE for the period 1986 to 1990; Ministry of Finance for the period 1991 to 1995.

Table E. **Prices and wages**

Percentage changes

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Consumer prices[1]										
Total[2]	11.7	9.4	9.6	12.6	13.4	11.4	8.9	6.5	5.2	4.1
Food and drink	9.1	8.8	9.2	14.4	13.6	9.9	7.1	2.8	4.8	4.0
Clothing and footwear	23.5	15.8	13.2	10.5	9.5	11.9	11.9	7.0	4.1	1.9
Housing costs	10.7	7.4	10.1	11.8	11.9	12.1	9.6	7.0	3.5	3.3
Miscellaneous	14.5	9.0	6.0	11.6	11.3	10.9	8.6	13.2	6.7	5.5
Wages										
Contractual wages[3]	17.1	14.4	9.9	10.6	14.1	14.2	10.9	7.9	5.1	4.8
Average effective wages[3]	18.5	15.1	12.5	14.6	17.0	16.0	13.7	6.5	6.0	..
Minimum monthly wages	17.2	12.0	7.9	13.1	13.8	14.6	11.0	6.5	4.0	4.5

1. Mainland. New index as from 1988.
2. Excluding rent.
3. Excluding public administration and non-market services.

Source: INE; Bank of Portugal; OECD, *Main Economic Indicators*.

Table F. Civilian employment by sector[1]

Thousands

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Agriculture	890.3	925.9	885.4	829.0	795.3	799.1	490.1	482.3	490.2	477.5
Mining	27.2	26.6	28.5	33.6	35.8	30.6	22.3	19.6	17.5	16.8
Manufacturing	995.3	1 040.3	1 073.7	1 108.1	1 122.5	1 123.5	1 038.8	1 010.3	1 008.3	971.9
Construction	332.1	354.2	362.1	365.4	361.1	363.6	346.2	340.2	330.8	340.3
Electricity, gas and water	31.9	33.4	38.1	38.5	40.2	45.9	31.1	29.3	36.7	34.6
Transport and communication	174.0	167.7	176.9	183.0	201.7	220.7	210.1	198.9	196.4	183.1
Trade	598.6	584.6	629.9	666.9	692.0	742.2	857.9	825.6	817.3	819.2
Banking, insurance, real estate	127.0	132.1	139.5	154.5	203.6	211.2	137.3	140.9	134.9	137.4
Personal services	887.0	904.8	944.8	997.4	1 020.2	1 068.5	1 176.6	1 176.0	1 185.9	1 213.7
Total	4 063.4	4 169.6	4 278.9	4 376.4	4 472.4	4 605.3	4 310.4	4 223.1	4 218.0	4 194.5

1. Break in series in 1992. From 1992, the data refers to persons aged 14 years and over. Before 1991 the data refered to persons aged 12 years and over.

Source: INE, *Labour force survey.*

Table G. **Money supply and credit**

Billion escudos at end of period

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Total money supply (L–)	3 990	4 773	5 627	6 226	6 906	8 185	9 280	9 853	10 783	11 664
Money (M1–)	1 334	1 612	1 952	2 242	2 352	2 705	3 164	3 393	3 641	3 972
Notes and coins in circulation	399	458	510	577	624	683	708	753	796	841
Sight deposits of households and enterprises	935	1 154	1 442	1 665	1 728	2 022	2 456	2 640	2 845	3 131
Quasi-money	2 323	2 669	3 108	3 475	3 878	5 097	5 943	6 366	7 013	7 550
Treasury bills	333	492	567	509	676	383	173	94	129	142
Credit aggregates										
Net foreign assets	1 090	1 240	1 716	2 306	2 623	3 174	3 529	4 454	3 866	2 837
Domestic credit	5 095	5 787	6 529	6 883	7 812	9 262	10 767	11 710	13 100	14 663
Bank credit to general government	1 846	2 313	2 604	2 520	2 800	2 914	3 122	3 195	3 673	3 472
Bank credit to private sector	3 249	3 474	3 925	4 363	5 012	6 348	7 645	8 515	9 427	11 191
Other items (net)	–2 195	–2 254	–2 620	–2 962	–3 530	–4 251	–5 017	–6 312	–6 182	–5 836

Source: Bank of Portugal, *Quarterly Bulletin*.

Table H. **Breakdown by nationality of foreign visitors**

Thousands

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Total	11 692	13 057	16 173	16 077	16 471	18 422	19 641	20 742	20 579	21 764
Spain	8 798	9 960	12 583	12 124	12 186	13 806	14 583	15 553	15 776	16 635
United Kingdom	880	1 069	1 204	1 140	1 137	1 203	1 307	1 435	1 368	1 436
Germany	413	430	526	569	611	681	852	877	795	877
France	347	350	435	593	646	658	712	686	591	637
Netherlands	164	172	214	285	333	330	361	367	369	399
United States	230	150	195	223	235	252	178	220	208	219
Italy	93	109	134	155	185	221	291	283	265	282
Brazil	69	83	72	92	102	119	114	106	85	93
Canada	70	74	78	79	91	91	69	74	71	76
Sweden	54	69	70	87	95	98	114	108	94	..
Belgium	68	68	90	117	151	173	198	207	197	..
Switzerland	61	66	71	73	78	78	80	73	83	..
Other countries[1]	444	457	502	540	621	713	782	753	677	1 110

1. Starting in 1994, data include Sweden, Belgium and Switzerland.

Source: INE, *Bolletim mensal de estatistica.*

Table I. **Foreign trade by main commodity groups**

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Imports, total (million US$)	7 649.7	9 454.0	13 965.7	17 884.8	19 043.1	25 332.6	26 328.6	30 482.4	24 119.0
As a percentage of total									
Food and beverages	11.5	11.0	10.6	10.3	9.9	9.7	11.2	11.1	12.3
Basic metal and semi-finished goods	42.3	25.0	19.4	15.9	17.5	16.9	14.5	12.6	13.6
Manufactures	46.0	63.4	69.6	73.7	72.5	73.3	74.2	76.3	74.1
Chemicals	10.2	11.3	10.5	9.8	9.2	9.1	9.0	9.0	9.7
Goods classified chiefly by material	14.5	17.7	19.2	19.2	19.8	19.6	19.5	19.1	17.6
Machinery and transport equipmnent	21.6	29.3	33.9	38.3	36.8	36.9	36.5	38.2	35.8
Miscellaneous	3.3	5.1	6.1	6.3	6.7	7.7	9.2	10.0	11.0
Unspecified	0.3	0.6	0.3	0.1	0.1	0.1	0.1	0.1	0.0
Exports, total (million US$)	5 685.4	7 204.9	9 318.3	10 989.7	12 797.7	16 415.7	16 326.1	18 540.6	15 403.4
As a percentage of total									
Food and beverages	7.8	8.2	7.3	7.7	7.0	6.6	7.3	7.0	6.8
Basic metal and semi-finished goods	14.5	12.2	11.9	12.8	14.0	12.8	10.5	9.9	9.6
Manufactures	76.0	78.4	80.1	79.1	78.6	80.3	81.9	82.9	83.5
Chemicals	7.0	6.1	5.4	6.0	5.6	5.2	4.6	4.2	4.4
Goods classified chiefly by material	27.7	26.4	25.4	25.4	23.7	23.4	24.1	23.4	23.7
Machinery and transport equipment	15.6	15.7	16.5	16.7	19.1	19.6	19.7	21.6	21.1
Miscellaneous	25.7	30.3	32.8	31.0	30.3	32.1	33.6	33.6	34.4
Unspecified	1.7	1.2	0.7	0.4	0.4	0.3	0.3	0.2	0.1

Source: OECD, *Foreign Trade Statistics*, Series C.

Table J. **Geographical breakdown of foreign trade**

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Exports, total (billion escudos)	1 055.0	1 304.1	1 598.1	2 035.5	2 255.6	2 405.2	2 475.2	2 546.0	2 975.6	3 414.5
As a percentage of total										
OECD countries	89.1	91.0	90.6	90.7	91.2	90.9	89.2	87.2	90.0	89.7
EU	68.3	71.1	72.0	71.8	73.9	75.4	75.0	73.1	75.3	80.1
Germany	14.7	15.4	14.7	15.7	16.7	19.1	19.1	19.7	18.9	21.6
France	15.2	15.8	15.2	15.0	15.5	14.4	14.2	14.7	14.7	14.0
Italy	3.9	3.9	4.2	4.3	4.1	4.0	3.9	2.9	3.4	3.3
United Kingdom	14.2	14.1	14.3	12.3	12.1	10.8	11.1	11.0	11.6	11.0
Spain	6.9	9.3	11.5	12.7	13.5	15.1	14.8	14.0	14.5	14.7
Other EU	13.3	12.6	12.1	11.8	11.9	12.0	11.8	11.4	12.3	15.5
United States	7.0	6.4	5.9	5.9	4.8	3.8	3.5	4.2	5.2	4.6
Other OECD countries	13.8	13.5	12.7	13.0	12.5	11.7	10.7	9.9	9.5	5.0
Non-OECD countries	10.9	9.0	9.4	9.3	8.8	9.1	10.8	12.8	10.0	10.3
of which: OPEC	*1.6*	*1.5*	*1.1*	*0.7*	*0.6*	*0.5*	*0.6*	*0.9*	*0.8*	*0.7*
Previous escudo area	2.1	2.1	2.7	3.3	3.4	4.2	5.2	3.0	2.8	2.5
Imports, total (billion escudos)	1 399.4	1 955.1	2 596.7	3 033.4	3 467.6	3 893.7	4 087.6	3 882.8	4 480.1	4 889.6
As a percentage of total										
OECD countries	78.4	81.7	84.0	83.5	83.4	85.4	86.8	85.1	84.2	83.3
EU	58.9	63.8	67.3	68.2	69.2	72.0	73.8	71.8	71.1	73.9
Germany	14.4	15.1	14.7	14.6	14.4	15.0	15.1	15.0	13.9	14.4
France	10.0	11.2	11.5	11.7	11.5	11.9	12.9	12.7	12.8	11.9
Italy	7.9	8.7	9.3	9.1	10.0	10.2	10.2	8.7	8.6	8.4
United Kingdom	7.5	8.1	8.3	7.5	7.6	7.5	7.1	7.4	6.6	6.6
Spain	11.0	11.7	13.2	14.5	14.4	15.8	16.6	17.8	19.9	20.8
Other EU	8.2	8.9	10.3	10.8	11.3	11.5	11.9	10.1	9.4	11.8
United States	7.0	4.8	4.3	4.4	3.9	3.4	3.0	3.2	3.6	3.3
Other OECD countries	12.5	13.1	12.4	10.9	10.3	10.0	10.0	10.1	9.5	6.1
Non-OECD countries	21.6	18.3	16.0	16.5	16.6	14.6	13.2	14.9	15.8	16.7
of which: OPEC	*8.5*	*6.0*	*4.9*	*6.1*	*6.7*	*4.7*	*3.8*	*5.0*	*5.7*	*5.3*
Previous escudo area	0.8	0.4	0.2	0.4	0.4	0.5	0.5	0.1	0.1	0.2

Source: INE, *Bolletim mensal das estatisticas do commercio externo.*

Table K. **Balance of payments**

Million US dollars

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Exports, f.o.b	5 678	7 263	9 262	10 874	12 744	16 299	16 199	18 188	15 906	18 577	24 103
Imports, c.i.f.	7 186	8 955	12 842	16 387	17 630	23 099	24 057	27 721	23 880	26 633	32 645
Trade balance	–1 508	–1 692	–3 580	–5 513	–4 886	–6 800	–7 858	–9 533	–7 974	–8 056	–8 542
Services, net	–379	–80	246	154	490	1 120	1 185	1 496	1 620	1 129	1 111
Travel	894	1 212	1 726	1 891	2 114	2 673	2 712	2 528	2 170	2 410	2 725
Transports	–182	–131	–372	–584	–665	–888	–1 017	–1 073	–164	–398	–217
Investment income	–1 164	–1 024	–934	–878	–720	–241	77	606	134	–204	–586
Government transactions	–46	–100	–161	–172	–134	–192	–201	–181	–172	–177	–199
Other services	119	–37	–13	–103	–105	–232	–386	–384	–348	–502	–612
Transfers, net	2 235	2 935	3 778	4 332	4 558	5 496	6 011	7 824	6 681	5 404	7 180
Current balance	348	1 163	444	–1 027	162	–184	–662	–213	327	–1 523	–251
Medium and long-term capital	1 091	–391	146	777	2 808	3 587	4 069	–613	1 720	–1 002	–2 669
Private	787	153	659	2 282	3 269	4 149	4 452	–555	2 268	–566	–2 424
Official	304	–544	–513	–1 505	–461	–562	–383	–58	–548	–436	–245
Short-term and unrecorded	–513	–1 103	1 333	1 871	1 101	594	1 733	1 451	232	–683	–3 472
Non-monetary transactions, net	926	–331	1 923	1 621	4 071	3 997	5 140	625	2 279	–3 208	–6 392
Private monetary institutions short-term capital	4	207	–109	–694	643	–329	785	–520	–4 943	1 340	5 862
Balance on official settelements	930	–124	1 814	927	4 714	3 668	5 925	105	–2 664	–1 868	–530
Use of IMF credit	0	0	–257	–498	0	0	0	0	0	0	0
Miscellaneous official accounts	–205	1	–13	–18	16	0	0	2	–718	. .	. .
Change in reserves (increase = –)	–725	123	–1 801	–909	–4 730	–3 668	–5 925	–107	3 382	1 868	530

1. Data for 1993, 1994 and 1995 are not fully compatible with data for previous years due to the introduction of a new statistical system in 1993.

Source: Bank of Portugal.

Table L. **Labour market indicators**

A. LABOUR MARKET PERFORMANCE

	Cyclical peak: 1979	Cyclical trough: 1984	1985	1992[1]	1993	1994	1995
Standardised unemployment rate	6.1	8.5	8.7	4.2	5.5	6.9	7.1
Unemployment rate: Total	8.3	8.5	8.6	4.1	5.5	6.9	7.2
Male	4.3	5.9	6.4	3.4	4.6	6.1	6.4
Female	14.0	12.1	11.7	4.9	6.5	7.9	7.9
Youth[2]	14.6	19.9	20.1	9.9	12.7	14.7	16.1
Share of long-term unemployment in total unemployment[3]	..	47.0	53.0	32.6	36.2	40.8	46.0

B. STRUCTURAL OR INSTITUTIONAL CHARACTERISTICS

	1975	1980	1985	1992	1993	1994	1995
Participation rate:[4] Total	64.5	67.8	67.9	68.4	67.8	67.5	67.2
Male	83.1	84.7	81.6	78.7	77.2	76.4	75.1
Female	48.0	52.9	55.2	60.6	59.0	59.3	59.3
Employment/population (15-64 years)	66.7	66.4	65.5	68.3	66.7	65.8	65.3
Non-wage labour costs (as percentage of total compensation)	13.4	15.9	18.4	17.2	19.5	20.0	20.9
Unemployment insurance replacement ratio[5]	..	30.8	29.2	28.7	32.3	37.0	36.1
Minimum wage, non-agricultural sector (workers of 20 years and more, as percentage of the average earnings)	..	57.6	56.4	47.1	45.6	47.2	..

Average percentage changes (annual rates)[6]	1970/1960	1980/1970	1985/1980	1990/1980	1994/1993	1995/1994
Labour force (15-64 years)	0.1	2.0	1.0	1.1	1.0	–0.4
Employment: Total	–0.5	1.8	0.7	1.3	–0.1	–0.6
Industries	0.6	3.1	–0.5	1.0	–0.4	–2.1
Services	1.5	1.5	4.3	4.3	–0.2	0.7

1. Break in series.
2. People between 15 and 24 years as a percentage of the labour force of the same age group.
3. Persons seeking a job for 12 months and over as a percentage of total unemployed.
4. Labour force as a percentage of relevant population group, aged between 15 and 64 years.
5. Unemployment benefits per unemployed as a percentage of compensation per employee.
6. 1960 and 1970, National Accounts. 1980, 1985, 1990, 1993, 1994, Employment Survey.

Source: INE, DEP/MQE.

Table M. **Public sector**

Per cent of GDP

A. BUDGET INDICATORS: GENERAL GOVERNMENT ACCOUNT

	1970	1980	1990	1993	1994	1995
Current receipts	25.6	31.4	36.4	37.4	38.0	39.3
Current primary expenditure	22.8	36.4	29.5	33.6	34.5	34.9
Primary balance	3.3	–4.8	3.0	–0.2	0.2	0.6
Budget balance	2.8	–7.9	–5.6	–6.9	–5.7	–5.2

B. GENERAL GOVERNMENT EXPENDITURE

	1970	1980	1990	1993	1994	1995
Total expenditure	23.4	39.5	44.4	47.6	46.0	47.2
of which:						
Public consumption	14.0	14.5	15.8	17.6	17.7	17.8
Current transfers	4.0	10.7	12.2	15.0	15.9	16.2
Subsidies	1.5	5.2	1.5	1.0	0.8	0.9
Interest payments	0.5	3.1	8.7	6.7	5.8	5.8
Investment	2.5	4.1	3.4	4.2	3.9	4.2

Source: INE and the Ministry of Finance.

Table N. **Production and employment structures**

	Per cent share of GDP at factor costs (current prices)					Per cent share of total employment				
	1980[1]	1985[1]	1990[1]	1990[2]	1992[2]	1980[1]	1985[1]	1990[1]	1990[2]	1992[2]
Agriculture, forestry and fishing	10.3	8.0	5.8	6.8	4.9	27.2	25.4	20.3	17.7	15.2
Manufacturing	31.0	30.4	27.9	27.0	24.7	25.1	24.3	23.8	25.0	23.6
of which:										
Food, beverages and tobacco	5.7	6.1	6.0	5.5	5.3	3.3	3.2	3.3	2.7	2.5
Textiles, clothing, leather	7.0	7.8	7.2	6.2	6.2	8.1	8.3	8.3	8.8	8.0
Wood, paper and paper products	3.7	3.2	3.1	2.9	2.6	3.2	2.9	2.7	2.9	2.9
Chemicals and products of petroleum, coal, rubber, etc.	2.8	3.3	2.1	2.2	1.8	1.7	1.6	1.5	1.2	1.1
Non-metallic mineral products except products of petroleum and coal	2.6	2.1	1.9	0.6	0.5	1.9	1.7	1.7	0.6	0.7
Fabricated metal products, machinery and equipment	6.8	5.6	4.9	4.3	3.8	4.5	4.2	3.9	4.2	4.1
Electricity, gas and water	2.1	3.5	3.1	4.0	4.3	0.8	0.9	0.8	0.9	0.8
Construction	7.1	5.7	6.9	5.6	5.6	10.1	9.5	9.9	8.4	8.2
Services	49.5	52.5	56.4	56.5	60.5	36.8	39.9	45.2	48.0	52.2
of which:										
Wholesale and retail trade, restaurants and hotels	21.7	22.4	19.8	16.2	16.1	13.4	13.6	17.2	16.5	17.3
Transport, storage and communication	5.5	7.7	5.4	7.0	7.0	4.5	4.4	4.4	3.9	3.6
Finance, insurance, real estate and business services	10.5	10.1	13.1	12.3	12.4	2.6	3.0	3.2	4.3	5.9

1. OECD National accounts, base 1977.
2. INE, base 1986.

Source: OECD, *National Accounts*, INE.

BASIC STATISTICS

BASIC STATISTICS:

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period[1]	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany
Population										
Total	Thousands	1994	17 840	8 031	10 124	29 251	5 206	5 088	57 960	81 407
Inhabitants per sq. km	Number	1994	2	96	332	3	121	15	106	228
Net average annual increase over previous 10 years	%	1994	1.4	0.6	0.3	1.6	0.2	0.4	0.5	2.9
Employment										
Total civilian employment (TCE)[2]	Thousands	1994	7 680 (93)	3 737	3 724 (92)	13 292	2 508	2 015	21 781 (93)	35 894
of which: Agriculture	% of TCE	1994	5.3 (93)	7.2	2.6 (92)	4.1	5.1	8.3	5.1 (93)	3.3
Industry	% of TCE	1994	23.7 (93)	33.2	27.7 (92)	22.6	26.8	26.8	27.7 (93)	37.6
Services	% of TCE	1994	71 (93)	59.6	69.7 (92)	73.3	68.1	64.9	67.2 (93)	59.1
Gross domestic product (GDP)										
At current prices and current exchange rates	Bill. US$	1994	331.6	198.1	227.9	544	146.7	97.2	1 328.5	1 832.3
Per capita	US$	1994	18 588	24 670	22 515	18 598	28 181	19 106	22 944	27 826
At current prices using current PPP's[3]	Bill. US$	1994	327.9	162.3	204.2	596.7	107	82.5	1 111.8	1 601.7
Per capita	US$	1994	18 382	20 210	20 166	20 401	20 546	16 208	19 201	24 325
Average annual volume growth over previous 5 years	%	1994	2.2	2.5	1.6	1.1	1.9	–1.6	1.1	2.6
Gross fixed capital formation (GFCF)	% of GDP	1994	21.4	24.8	17.4	18.7	14.8	14.3	18.1	18.5
of which: Machinery and equipment	% of GDP	1993	9.8	8.7	7.8	6.2	7.2	5.90	8.10	7.5
Residential construction	% of GDP	1993	5.2	6.3	4.6	6.1	2.9	3.7	4.9	6.5
Average annual volume growth over previous 5 years	%	1994	0.8	3.7	0.4	–0.1	–2.8	–12.9	–1	0.8
Gross saving ratio[4]	% of GDP	1994	16.8	25.3	22	16	17	16.6	19	21
General government										
Current expenditure on goods and services	% of GDP	1994	17.5		15	20.2	25.3	22.4	19.6	17.7
Current disbursements[5]	% of GDP	1993	36.9	48.4	55.3	49	61.1	58.9	51.5	45.6
Current receipts	% of GDP	1993	33.5	48.6	50.1	43	58.3	52.5	46.8	45.7
Net official development assistance	% of GNP	1993	0.34	0.31	0.41	0.46	1.03	0.76	0.66	0.44
Indicators of living standards										
Private consumption per capita using current PPP's[3]	US$	1993	10 803	10 546	12 090	11 863	10 042	8 814	11 395	10 733
Passenger cars, per 1 000 inhabitants	Number	1990	430	382	387	469	311	386	413	480[8]
Telephones, per 1 000 inhabitants	Number	1991	464	432	410	586	577	544	511	420[8]
Television sets, per 1 000 inhabitants	Number	1991	480	478	451	639	536	501	407	556[8]
Doctors, per 1 000 inhabitants	Number	1993	2.2 (91)	2.3	3.7	2.2	2.8 (92)	2.6 (92)	2.8	3.2 (92)
Infant mortality per 1 000 live births	Number		6.1	6.5	8	6.8	5.4	4.4	6.5	5.8
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1994	3	5.5	3.7	3.3	3.5	4.8	3.5	5.2
Consumer prices	%	1994	3	3.4	2.8	2.8	2.1	3.3	2.5	3.3
Foreign trade										
Exports of goods, fob*	Mill. US$	1994	47 363	44 881	137 259[7]	165 358	41 850	29 514	235 337	422 243
As % of GDP	%	1994	14.3	22.7	60.2	30.4	28.5	30.4	17.7	23
Average annual increase over previous 5 years	%	1994	5	6.7	6.5	7.1	8.3	4.9	5.6	4.4
Imports of goods, cif*	Mill. US$	1994	49 731	55 071	126 006[7]	148 297	35 932	23 091	220 508	376 566
As % of GDP	%	1994	15	27.8	55.3	27.3	24.5	23.8	16.6	20.6
Average annual increase over previous 5 years	%	1994	4	7.2	5	5.4	6.1	–1.3	3.5	6.9
Total official reserves[6]	Mill. SDRs	1994	7 730	11 523	9 505[7]	8 416	6 203	7 304	17 986	52 994
As ratio of average monthly imports of goods	Ratio	1994	1.9	2.5	0.9	0.7	2.1	3.8	1	1.7

	Greece	Iceland	Ireland	Italy	Japan	Luxembourg	Mexico	Netherlands	New Zealand
Population									
Total	10 430	267	3 571	57 190	124 960	398	93 010	15 382	3 526
Inhabitants per sq. km	79	3	51	190	331	153	47	377	13
Net average annual increase over previous 10 years	0.5	1.1	0.1	0	0.4	0.8	2	0.6	0.8
Employment									
Total civilian employment (TCE)[2]	3 790	138	1 168 (93)	20 152 (93)	64 530	162 (91)	32 439	6 631	1 560
of which: Agriculture	20.8	9.4	12.7 (93)	7.5 (93)	5.8	3.7 (91)	25.8	4	10.4
Industry	23.6	26.1	27.7 (93)	33 (93)	34	31.5 (91)	22.2	23	25
Services	55.5	65.2	59.7 (93)	59.6 (93)	60.2	64.8 (91)	52.1	73	64.6
Gross domestic product (GDP)									
At current prices and current exchange rates	73.1 (93)	6.2	52	1 017.8	4 590	10.6 (92)	371.2	334.3	51.2
Per capita	7 051 (93)	23 199	14 550	17 796	36 732	27 073 (92)	3 991	21 733	14 513
At current prices using current PPP's[3]	118	5.1	54.3	1 068.4	2 593.7	11.7	673.3	285.9	57.3
Per capita	1 450	19 271	15 212	18 681	20 756	29 454	7 239	18 589	16 248
Average annual volume growth over previous 5 years	1.4 (93)	0.6	4.7	1	2.1	4.1 (92)	3	2.3	2.5
Gross fixed capital formation (GFCF)	17.4 (93)	15.2	15.1	16.4	28.6	20.4 (93)	20.7	19.3	20
of which: Machinery and equipment	7.8	3.9	6.3	7.4	11.5	..	9.4	8.6	9.3
Residential construction	3.6	4.4	4.1	5.3	5.4	..	4.9	5.1	4.9
Average annual volume growth over previous 5 years	2.7 (93)	–4	1	–2.3	1.4	6.5 (92)	7.7	0.4	5.8
Gross saving ratio[4]	15.5 (93)	16.9	19.5	18.8	31.2	60.2 (92)	15.1	24.4	20.7
General government									
Current expenditure on goods and services	19.1 (93)	20.6	16	17.1	9.8	17.1 (92)	11.8[9]	14.2	14.7
Current disbursements[5]	51.2	34.9	..	53.2	26.9	..	..	55.4	..
Current receipts	40.2	35.9	..	47.1	32.9	..	..	54.5	..
Net official development assistance	..	..	0.15	0.42	0.27	0.34 (92)	..	0.88	0.22
Indicators of living standards									
Private consumption per capita using current PPP's[3]	6 367	11 546	7 750	11 029	11 791	15 545	4 853	10 726	9 266
Passenger cars, per 1 000 inhabitants	169	464	228	478	282	470	85	356	440
Telephones, per 1 000 inhabitants	413	527	300	400	454	511	70	477	436
Television sets, per 1 000 inhabitants	197	319	276	421	613	267	148	485	443
Doctors, per 1 000 inhabitants	3.8 (92)	3	1.7 (92)	1.7 (91)	1.7 (92)	2.1 (92)	1	2.5 (90)	2
Infant mortality per 1 000 live births	8.5	4.8	5.9	7.3	4.5 (92)	8.5 (92)	18	6.3	7.3
Wages and prices (average annual increase over previous 5 years)									
Wages (earnings or rates according to availability)	14.6	..	4.6	5.9	2.4	..	5.3	3.2	2.1
Consumer prices	16.2	6.3	2.7	5.2	2	3.1	16.1	2.8	2.5
Foreign trade									
Exports of goods, fob*	8 958	1 628	34 125	189 802	396 149	..	60 882	155 084	12 169
As % of GDP	11.5 (93)	26.3	65.7	18.6	8.6	..	16.4	46.4	23.8
Average annual increase over previous 5 years	3.4	2.7	10.5	6.2	7.6	..	21.7	7.6	6.5
Imports of goods, cif*	21 111	1 464	25 812	167 690	274 916	..	79 346	139 800	11 859
As % of GDP	30.1 (93)	23.6	49.7	16.5	6	..	21.4	41.8	23.2
Average annual increase over previous 5 years	5.4	0.7	8.1	1.9	5.5	..	25.5	6.1	6.1
Total official reserves[6]	9 924	201	4 189	22 102	86 214	..	4 301	23 655	2 540
As ratio of average monthly imports of goods	5.6	1.6	1.9	1.6	3.8	..	0.7	2	2.6

	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States
Population								
Total	4 337	9 900	39 150	8 781	6 994	60 573	58 375	260 651
Inhabitants per sq. km	13	107	78	20	169	78	238	28
Net average annual increase over previous 10 years	0.5	–0.1	0.2	0.5	0.7	2.1	0.3	1
Employment								
Total civilian employment (TCE)[2]	1970 (93)	4 372	11 760	3 926	3 772	19 664	25 044 (93)	123 060
of which: Agriculture	5.6 (93)	11.5	9.8	3.4	4	44.8	2.2 (93)	2.9
Industry	23.1 (93)	32.8	30.1	25	28.8	22.2	26.2 (93)	24
Services	71.3 (93)	55.7	60.2	71.6	67.2	33	71.6 (93)	73.1
Gross domestic product (GDP)								
At current prices and current exchange rates	103.4 (93)	87	482.4	196.6	257.3	130.7	1 019.5	6 649.8
Per capita	23 984 (93)	8 792	12 321	22 389	36 790	2 157	17 468	25 512
At current prices using current PPP's[3]	95.3	122	531.7	153	167.4	319.3	1 030.2	6 649.8
Per capita	21 968	12 335	13 581	17 422	23 942	5 271	17 650	25 512
Average annual volume growth over previous 5 years	2.1 (93)	1.4	1.5	–0.3	0.5	3.6	0.8	2.1
Gross fixed capital formation (GFCF)	22 (93)	25.7	19.8	13.7	22.8	24.5	15	17.2
of which: Machinery and equipment	..	..	5.7	5.7	7.5	10.3	7.3	7.7
Residential construction	..	..	4.1	4	14.9[10]	9.1	3.1	4
Average annual volume growth over previous 5 years	–3.93	2.7	–1.2	–7.6	–0.4	5.1	–2.1	4.6
Gross saving ratio[4]	21.9 (93)	24.2	18.8	13.7	29.3	22.5	13.5	16.2
General government								
Current expenditure on goods and services	22.1 (93)	17.2	16.9	27.3	14.1	11.7	21.6	16.4
Current disbursements[5]	..	..	43.7	67.3	36.7	..	42.7	35.8
Current receipts	..	..	40.1	59	36	..	36.8	31.7
Net official development assistance	1.23	0.36	0.32	1.33	0.49	..	0.34	0.19
Indicators of living standards								
Private consumption per capita using current PPP's[3]	9 826	7 780	8 412	9 240	13 730	3 617	10 942	16 444
Passenger cars, per 1 000 inhabitants	378	260	307	418	441	29	361	568
Telephones, per 1 000 inhabitants	515	273	340	687	603	143	445	553
Television sets, per 1 000 inhabitants	423	187	400	468	406	175	434	814
Doctors, per 1 000 inhabitants	3.2 (92)	2.9	4.1	3	3	0.9	1.5 (92)	2.3 (92)
Infant mortality per 1 000 live births	5	8.7	7.6	4.8	5.6	52.6	6.6	8.5 (92)
Wages and prices (average annual increase over previous 5 years)								
Wages (earnings or rates according to availability)	4	..	7.2	5.4	..	..	6.7	2.8
Consumer prices	2.7	9	5.6	5.7	3.9	73	4.6	3.6
Foreign trade								
Exports of goods, fob*	34 645	17 072	73 129	61 122	70 467	18 456	205 170	512 627
As % of GDP	30.9 (93)	19.6	15.2	31.1	27.4	14.1	20.1	7.7
Average annual increase over previous 5 years	5	6.1	10.5	3.4	6.4	9.5	6.1	7.1
Imports of goods, cif*	27 345	25 967	92 182	51 730	68 126	22 976	227 026	663 256
As % of GDP	23.3 (93)	29.9	19.1	26.3	26.5	17.6	22.3	10
Average annual increase over previous 5 years	2.9	6.6	5.2	1	3.2	37.9	2.8	7
Total official reserves[6]	13 033	10 627	28 475	15 929	23 790	4 911	28 094	43 350
As ratio of average monthly imports of goods	5.7	4.9	3.7	3.7	4.2	2.6	1.5	0.8

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Refers to the public sector including public enterprises.
10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics*. GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators*. Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics*.

November 1995

EMPLOYMENT OPPORTUNITIES

Economics Department, OECD

The Economics Department of the OECD offers challenging and rewarding opportunities to economists interested in applied policy analysis in an international environment. The Department's concerns extend across the entire field of economic policy analysis, both macroeconomic and microeconomic. Its main task is to provide, for discussion by committees of senior officials from Member countries, documents and papers dealing with current policy concerns. Within this programme of work, three major responsibilities are:

- to prepare regular surveys of the economies of individual Member countries;
- to issue full twice-yearly reviews of the economic situation and prospects of the OECD countries in the context of world economic trends;
- to analyse specific policy issues in a medium-term context for the OECD as a whole, and to a lesser extent for the non-OECD countries.

The documents prepared for these purposes, together with much of the Department's other economic work, appear in published form in the *OECD Economic Outlook, OECD Economic Surveys, OECD Economic Studies* and the Department's *Working Papers* series.

The Department maintains a world econometric model, INTERLINK, which plays an important role in the preparation of the policy analyses and twice-yearly projections. The availability of extensive cross-country data bases and good computer resources facilitates comparative empirical analysis, much of which is incorporated into the model.

The Department is made up of about 80 professional economists from a variety of backgrounds and Member countries. Most projects are carried out by small teams and last from four to eighteen months. Within the Department, ideas and points of view are widely discussed; there is a lively professional interchange, and all professional staff have the opportunity to contribute actively to the programme of work.

Skills the Economics Department is looking for:

a) Solid competence in using the tools of both microeconomic and macroeconomic theory to answer policy questions. Experience indicates that this normally requires the equivalent of a Ph.D. in economics or substantial relevant professional experience to compensate for a lower degree.

b) Solid knowledge of economic statistics and quantitative methods; this includes how to identify data, estimate structural relationships, apply basic techniques of time series analysis, and test hypotheses. It is essential to be able to interpret results sensibly in an economic policy context.

c) A keen interest in and extensive knowledge of policy issues, economic developments and their political/social contexts.

d) Interest and experience in analysing questions posed by policy-makers and presenting the results to them effectively and judiciously. Thus, work experience in government agencies or policy research institutions is an advantage.

e) The ability to write clearly, effectively, and to the point. The OECD is a bilingual organisation with French and English as the official languages. Candidates must have excellent knowledge of one of these languages, and some knowledge of the other. Knowledge of other languages might also be an advantage for certain posts.

f) For some posts, expertise in a particular area may be important, but a successful candidate is expected to be able to work on a broader range of topics relevant to the work of the Department. Thus, except in rare cases, the Department does not recruit narrow specialists.

g) The Department works on a tight time schedule with strict deadlines. Moreover, much of the work in the Department is carried out in small groups. Thus, the ability to work with other economists from a variety of cultural and professional backgrounds, to supervise junior staff, and to produce work on time is important.

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