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BETTER POLICIES FOR BETTER LIVES

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This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Portugal were reviewed by the Committee on 17 December 2018. The draft report was then revised in light of the discussions and given final approval as the agreed report of the whole Committee on 1 February 2019.

The Secretariat's draft report was prepared for the Committee by Ben Westmore, Yosuke Jin,and Paula Adamczyk under the supervision of Pierre Beynet. The survey also benefitted from consultancy contributions by Sofia Amaral-Garcia. Editorial support was provided by Poeli Bojorquez and Sylvie Ricordeau.

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Information about the latest as well as previous Surveys and more details about how Surveys are prepared is available at www.oecd.org/eco/surveys.

Basic Statistics of Portugal, 2017

(Numbers in parenthesis refer to the OECD average)*

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	10.3		Population density per km²	112.4	(35.8)
Under 15 (%)	13.6	(17.9)	Life expectancy (years, 2016)	81.2	(80.6)
Over 65 (%)	21.5	(16.8)	Men	78.1	(77.8)
Foreign-born (%, 2012)	8.3		Women	84.3	(83.2)
Latest 5-year average growth (%)	-0.4	(0.6)	Latest general election	October	2015
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	219.8		Primary sector	2.2	(2.5)
In current prices (billion EUR)	194.6		Industry including construction	22.4	(26.8)
Latest 5-year average real growth (%)	1.3	(2.1)	Services	75.4	(70.7)
Per capita (000 USD PPP)	31.9	(43.7)			
GENERAL GOVERNMENT					
Per cent of GDP					
Expenditure	45.7	(41.3)	Gross financial debt[a]	147.0	(109.9)
Revenue	42.7	(39.1)	Net financial debt[a]	108.1	(71.1)
EXTERNAL ACCOUNTS					
Exchange rate (EUR per USD)	0.885		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.592		Machinery and transport equipment	27.2	
In per cent of GDP			Manufactured goods	22.4	
Exports of goods and services	42.8	(55.7)	Miscellaneous manufactured articles	17.9	
Imports of goods and services	41.9	(51.3)	Main imports (% of total merchandise imports)		
Current account balance	0.5	(0.4)	Machinery and transport equipment	30.6	
Net international investment position	-112.2		Manufactured goods	15.2	
			Chemicals and related products, n.e.s.	13.4	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate for 15-64 year-olds (%)	67.8	(67.7)	Unemployment rate, Labour Force Survey (age 15 and over) (%)	8.9	(5.8)
Men	71.1	(75.4)	Youth (age 15-24, %)	23.9	(11.9)
Women	64.8	(60.1)	Long-term unemployed (1 year and over, %)	4.4	(1.7)
Participation rate for 15-64 year-olds (%)	74.7	(72.0)	Tertiary educational attainment 25-64 year-olds (%)	24.0	(36.9)
Average hours worked per year	1 863	(1 759)	Gross domestic expenditure on R&D (% of GDP, 2016)	1.3	(2.3)
ENVIRONMENT					
Total primary energy supply per capita (toe)	2.3	(4.1)	CO_2 emissions from fuel combustion per capita (tonnes, 2015)	4.6	(9.0)
Renewables (%)	20.5	(10.2)	Municipal waste per capita (tonnes, 2016)	0.4	(0.5)
Exposure to air pollution (more than 10 μg/m³ of PM2.5, % of population, 2015)	53.3	(75.2)			
SOCIETY					
Income inequality (Gini coefficient, 2016)	0.331	(0.314)	Education outcomes (PISA score, 2015)		
Relative poverty rate (%, 2016)	12.5	(11.8)	Reading	498	(493)
Median disposable household income (000 USD PPP, 2015)	14.8	(23.2)	Mathematics	492	(490)
Public and private spending (% of GDP)			Science	501	(493)
Health care	9.0	(8.8)	Share of women in parliament (%)	34.8	(28.8)
Pensions (2013)	14.0	(9.1)	Net official development assistance (% of GNI)	0.18	(0.37)
Education (primary, secondary, post sec. non tertiary, 2014)	4.5	(3.6)			

Better Life Index: www.oecdbetterlifeindex.org

* Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

'a. 2016 data for the OECD.

Source: Calculations based on data extracted from the databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

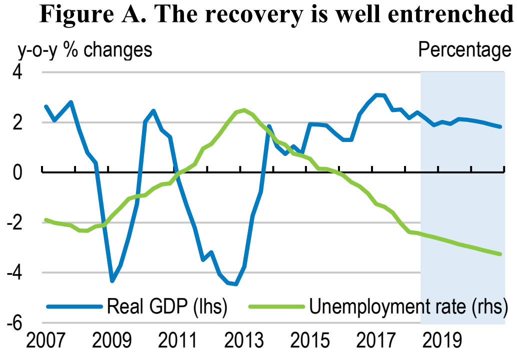
Executive summary

The economy has recovered

Economic conditions in Portugal have improved markedly over the past few years. GDP is now back to its pre-crisis level and the unemployment rate has declined 10 percentage points since 2013 to below 7%, one of the largest reductions in any OECD country over the past decade. Nevertheless, legacies of the crisis remain, with the poverty rate of the working age population still elevated and perceptions of subjective wellbeing below pre-crisis levels.

The recovery has now broadened to domestic demand. Strong exports sustained economic activity in the years immediately following the crisis. This was underpinned by rapid growth in the tourism sector, as well as exports across a variety of manufacturing sectors that reflected improvements in product quality and a decline in relative export prices. Machinery and equipment investment is now rising strongly again and housing investment is being stoked by rising dwelling prices. Consumption has also made a solid contribution to GDP growth over the past few years, buoyed by rising private earnings.

Figure A. The recovery is well entrenched



Source: OECD Economic Outlook: Statistics and Projections (database), November.

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The economy is projected to continue expanding at a stable pace. GDP is projected to rise by around 2% a year between 2018 and 2020 (Table A). Further employment gains and rising real wages will underpin consumption growth and inflation will rise slightly. An anticipated slowdown in the pace of activity in Portugal's major trading partners will provide a headwind to further export growth.

Table A. The solid expansion will continue

% change	2018	2019	2020
Gross domestic product (GDP)	**2.1**	**2.1**	**1.9**
Private consumption	2.2	1.8	2.0
Government consumption	0.7	-0.1	-0.1
Gross fixed capital formation	4.5	5.6	4.7
Exports of goods and services	6.0	4.5	3.7
Imports of goods and services	6.2	4.7	4.2
Unemployment rate	7.1	6.4	5.7
Consumer price index	1.3	1.3	1.4

Source: OECD Economic Outlook Database.

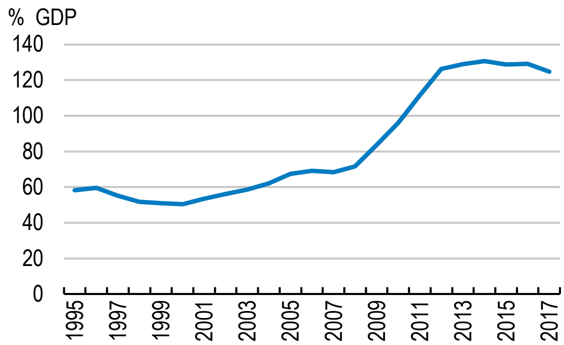
Risks to the outlook exist. These include an increase in interest rates, potentially stemming from the normalisation of monetary policy by the European Central Bank, which could negatively impact business and household spending.

The health of public finances and the financial system need to be further improved

The public debt ratio is falling, but the high debt burden still limits the government's ability to respond to future economic shocks. Improvements in fiscal balances have contributed to a decline in the ratio of public debt to GDP from 130.6% in 2014 to around 121% in 2018. Nevertheless, this ratio remains one of the highest across OECD countries. Further improving public finances will require reducing the fiscal deficit and maintaining a primary surplus. Faced with a rapidly ageing population, the government has pursued reforms to the health system and pensions. Nevertheless, fiscal sustainability will benefit from further moving health treatment to primary care settings and further reducing pathways to early retirement.

There is also scope to buttress public finances through broadening the tax base. The use of consumption tax exemptions and reduced rates narrows the tax base and should be minimised. Furthermore, there is scope to raise environmental taxation, given that the domestic pricing of some fuel sources do not reflect the environmental costs of their use.

Figure B. Public debt has fallen but remains high



Source: OECD Economic Outlook: Statistics and Projections (database).

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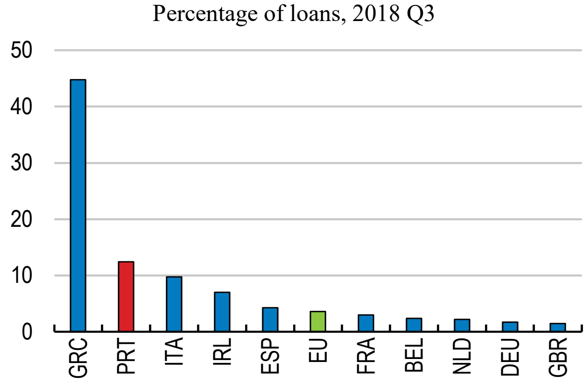
Remaining vulnerabilities in the financial sector also make the economy less resilient. The stock of non-performing loans (NPLs) have consistently declined (more than 35% since the peak in June 2016 to June 2018). However, the ratio of NPLs to total loan exposures is still one of the highest in the OECD (Figure C), weighing on bank profitability. The NPL reduction plans submitted by those banks with high NPLs should continue to be strictly monitored, translating performance in achieving targets into capital requirements. Since some NPLs are unlikely to be recovered, NPL write-offs should continue to be encouraged, taking into account measures adopted at the European level. NPLs can also be further reduced by making the liquidation of failed firms easier and reducing constraints to them exiting the market.

Figure C. Non-performing loans remain elevated

Percentage of loans, 2018 Q3



Source: European Banking Authority.

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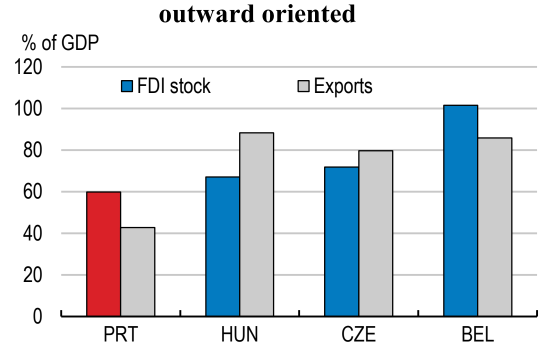
Future prosperity will depend on the utilisation of labour and productivity growth

Subjective wellbeing is low, reflecting modest living standards compared with other OECD countries and little convergence over the past few decades. To narrow wellbeing gaps, there should be a continued focus on getting unemployed or marginalised workers back into jobs. Despite recent progress, the long-term unemployment rate remains comparatively high, especially among the low-skilled. The government has been encouraging the employment of such workers through the provision of hiring subsidies, up-skilling and re-skilling programmes. Nevertheless, vocational training programmes that have been found to have a positive impact on the employment prospects of participants should be expanded to reach more of the low-skilled population.

Convergence in living standards can also be promoted through reawakening productivity growth, which has slowed over the past two decades. One of the benefits of higher productivity will be to boost the external competitiveness of the economy (see Chapter 1). Exports as a share of GDP and the stock of foreign direct investment still remain below that of other comparable small European economies (Figure D), although higher than the euro area average.

Figure D. The economy can become more outward oriented



Source: OECD (2018), Trade in goods and services (indicator); OECD (2018), FDI stocks (indicator).

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Competition-enhancing reforms to regulatory settings would raise efficiency. Strict regulations in some services sectors including professional services and transport are particularly harmful for productivity. For example, various professional services are both strictly regulated and represented by the same professional association. These include lawyers, where the Bar Association is responsible for formulating restrictions on entry, lawyers' fees and the form of business. To ensure that regulations in these industries are in the public interest, independent supervisory bodies should be established that approve any new regulatory arrangements and promote competition within the profession.

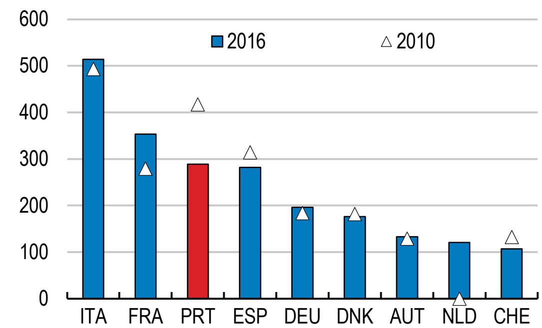
Regulatory settings in the transport sector reduce competition, particularly in the ports. Reforming such measures will be important for promoting further strong export performance. Port concession contracts can be awarded to private contractors providing port services, but these are often excessive in their duration, reducing the potential for market entrants that can provide higher quality services. Furthermore, the criterion for awarding port concessions gives insufficient consideration to the bidder who will charge the lowest price to port users, contributing to higher costs for businesses.

Productivity is not only shaped by regulations, but governance and the institutions which implement legislation. The authorities have made sustained efforts to tackle corruption and graft in the public and business sectors and that should continue to be prioritised. Going forward, the capacity of the Public Prosecution Office to fight economic and financial crime should continue to be enhanced, partly through ensuring that adequate resources are available to allow public prosecutors to undertake specialised training in this area. The appeal procedures should be reviewed to prevent abuse. The Public Prosecution Office and the Criminal Investigation Police should continue to be endowed with adequate resources. Furthermore, a regularly-updated electronic registry of interests for all government members and senior civil servants should be introduced and monitored.

Judicial inefficiency lowers productivity in the business sector (see Chapter 2). Recent reforms have reduced the time to resolve a case in the court system, but it remains long (Figure E). Improving judicial efficiency will ensure contract enforcement in a timely manner and reduce the cost of making transactions in the market, thereby promoting competition. It is particularly important for financial transactions to ensure collateral enforcement and therefore creditors' rights. Long and complex court proceedings are reflected in a very low collateral recovery rate, which can negatively affect bank lending conditions. At present, inefficiencies in the court system result from difficulties in effectively managing the case workload. The information system that registers court proceedings can be more fully utilised for the purpose of workload assessment, to prioritise cases and inform resource allocation across the judiciary. There is also scope to strengthen the autonomy of courts, which have been given greater accountability without increased capacity to manage resources.

Figure E. Court proceedings are long

Days to resolve a court case



Source: CEPEJ.

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Greenhouse gas emissions per unit of GDP are below the OECD average. Nevertheless, progress in decoupling emissions from GDP has stalled in recent years. Transport accounts for a large share of pollution and emissions and has been reducing its environmental impact at a slower pace than other sectors in the economy. This partly reflects the very high share of passenger cars that are used relative to public transport. As well as raising tax on some forms of energy, such as coal and natural gas, new shared transport solutions should be encouraged, accompanied by appropriate supervision and regulation.

MAIN FINDINGS	KEY RECOMMENDATIONS
Improving fiscal sustainability and financial stability	
There have been steady reductions in the fiscal deficit as a share of GDP. Nevertheless, public debt is high and poses risks in an environment of heightened global economic uncertainty.	Continue gradual fiscal consolidation to ensure the decline of public debt.
Tax administration remains particularly cumbersome for businesses.	Simplify the tax system by reducing the use of special provisions (e.g. tax exemptions, special rates) and ambiguity in the tax language.
The non-performing loan ratio remains high, weighing on banks' profitability and solvency. Banks should be better able to enforce collateral without going through long and uncertain court proceedings.	Competent authorities should continue to monitor NPL reduction plans, translating performance in achieving targets into capital requirements. Make bankruptcy a viable solution for heavily indebted individuals, reducing the time to discharge and exempting more of the debtor's assets from bankruptcy proceedings. Introduce an out-of-court mechanism to facilitate the liquidation of non-viable firms.
Further promoting export performance	
The skills of the population aged over 24 are lagging. Participation in lifelong learning activities are particularly modest for those with initially low skill levels.	Target lifelong learning opportunities to the low-skilled, including by collecting information on the private returns to skills and making it publicly available.
The efficiency of Portuguese ports is held back by regulations and practices that reduce competition between private operators.	In awarding port concessions, take into account the price that bidders will charge port users in addition to other criteria. Ensure that port concession contracts specify a minimum level of investment by the operator and do not renew concessions without opening a new public tender.
Enhancing the judiciary to foster economic activity	
Court proceedings remain very long, hampering timely contract enforcement for businesses. In spite of recent reforms, there are significant bottlenecks in some court districts, thereby inducing court congestion.	Increase the managerial autonomy of the courts so that they can effectively allocate resources such as judges, other judiciary staff and budgets. Fully analyse the data collected from the information system on court proceedings (CITIUS) so that it allows the courts to identify problematic cases and those that should be prioritised.
Productivity in the legal sector is low. The Bar Association represents the legal profession and regulates its services. Such self-regulation tends to identify with the interests of the profession, rather than the public interest.	Set up an independent supervisory body to ensure that regulations in the legal profession are in the public interest.
The authorities have made significant efforts to investigate and fight economic and financial crime, including corruption. Nevertheless, there is still room to improve institutional arrangements in this area.	Continue to enhance the capacity of the Public Prosecution Office to address economic and financial crime, including corruption. Public prosecutors should continue to undertake specialised training in this area. Establish an electronic registry of interests for all government members and senior civil servants that is regularly updated.
Improving labour utilisation and reducing poverty	
Despite recent progress, the long-term unemployment rate remains comparatively high, especially among low-skilled workers.	Avoid across-the-board rises in hiring subsides, limiting them to those at high risk of long-term unemployment and those at risk of poverty. Expand well-designed vocational training programmes (i.e. "*Aprendizagem*" and *"Cursos de Educação e Formação de Adultos"*), so that they reach more of the low-skilled population. Consolidate the two vocational education systems into a single dual VET system with strong workplace training and perform a thorough evaluation of all vocational training programmes.
Recalibrating the economy for greener growth	
The transport sector is responsible for a large share of Portugal's energy consumption and CO2 emissions, which have not been declining in recent years. Portugal uses a high proportion of passenger cars relative to public modes of transport.	Encourage public transport use and the development of new shared transport solutions, accompanied by appropriate supervision and regulation.
Pricing of carbon emissions remains low and uneven. More consistent pricing of energy consumption according to its environmental impact would prepare Portugal for meeting longer-term environmental targets.	Raise taxes on diesel fuel, and increase energy taxes on coal and natural gas.

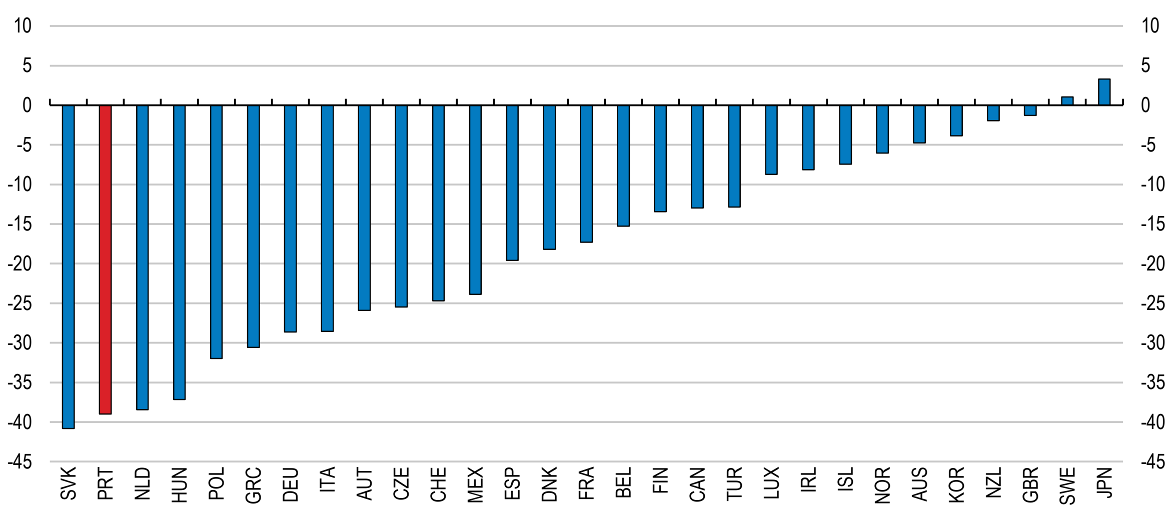
KEY POLICY INSIGHTS

The Portuguese economy continues to recover, with past structural reforms and more favourable global economic conditions contributing to the upswing. The economy has largely been sustained by strong export performance since 2010, but domestic demand is now also growing solidly. After receding in the five years following the crisis, employment has picked up and the unemployment rate has fallen from 17% to below 7%. Over the same period, the economy has notably increased its reliance on some renewable energy sources, such as wind power.

Portugal has been very active in pursuing important reforms. These have included cutting unnecessary red tape for businesses (*Simplex* and *Simplex+* programmes), improving the firm restructuring and insolvency framework (*Capitalizar* programme), facilitating innovation collaborations (*Interface* programme), amending labour regulations to reduce duality and promoting greater use of digital services among the population (*INCoDe 2030* and *Partnership Digital Skills+* programmes). Between 2003 and 2013, Portugal witnessed the second largest decline among OECD countries in the OECD Product Market Regulation indicator (Figure 1). Nevertheless, some product market regulations remain overly strict compared with other OECD member countries and the gap between the rigidity of employment protection legislation for permanent and temporary workers is relatively large, contributing to a high level of labour market duality. Furthermore, there is room for improving the efficiency with which reforms are implemented, notably through the judiciary.

Figure 1. Past structural reforms helped the recovery

Percentage change in the OECD Product Market Regulation Indicator, 2003-13



Source: OECD Product Market Regulation Indicators.

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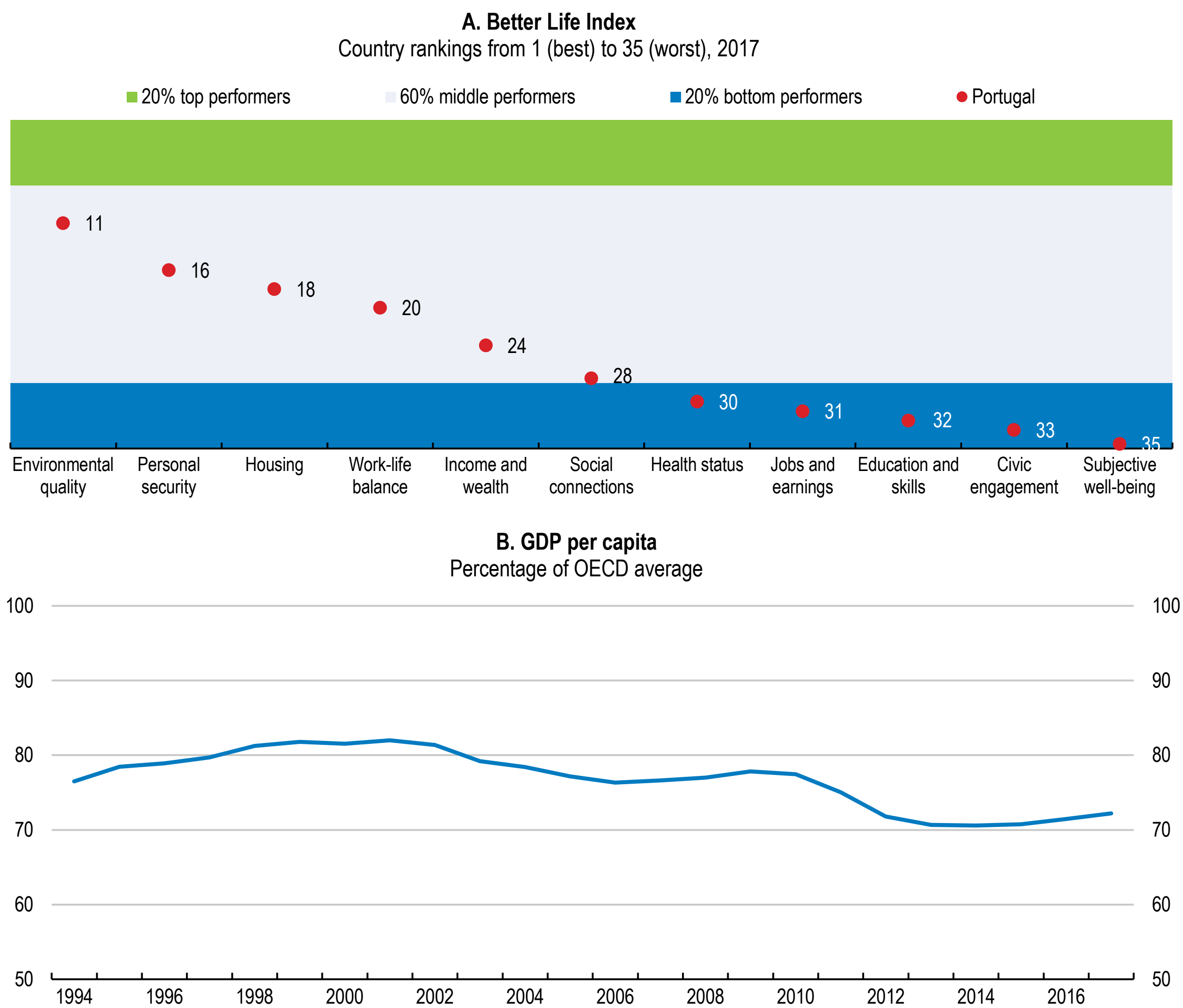
Indicators of wellbeing are mixed (Figure 2, Panel A). Portugal ranks above the OECD average along dimensions such as environmental quality and personal security. However, citizens have a surprisingly low self-perception of their wellbeing. This partly stems from wide gaps in wellbeing relative to other OECD countries in the areas of health, skills and civic engagement. Wellbeing through jobs and earnings also remains low, reflecting a lack of economic convergence with OECD countries over the past few decades (Figure 2, Panel B). Furthermore, poverty rates are high compared with other OECD countries, suggesting that some members of the population are finding life considerably tougher than those represented by the average.

Figure 2. Wellbeing can be improved along multiple dimensions



Note: Each well-being dimension is measured by one to four indicators from the OECD Better Life Index set. Normalised indicators are averaged with equal weights.
Source: OECD (2017), OECD Better Life Index, www.oecdbetterlifeindex.org, and OECD Compendium of Productivity Indicators.

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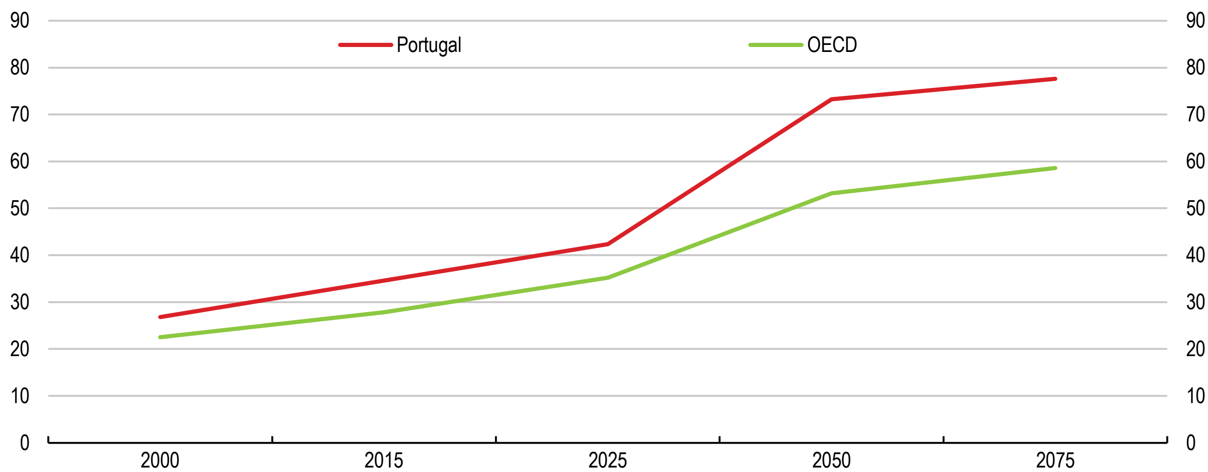
At the same time, the population is ageing rapidly, with the ratio of old-age to working-age population anticipated to rise from around 35% in 2015 to just below 80% by 2075 (Figure 3).

Holding all else constant, this trend will have a significant impact on public finances and lead to a reduction in economic growth over the coming years.

Figure 3. The population is expected to age rapidly

Projected old-age dependency ratio, %



Note: The old-age dependency ratio is defined as the number of individuals aged 65 and over per 100 people of working age defined as those aged between 20 and 64.
Source: United Nations, *World Population Prospects – 2017 Revision*.

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The capacity for fiscal policy and the financial sector to support the economy may be challenged by the legacies of the financial crisis in the form of a very high stock of public debt and an elevated level of non-performing loans on bank balance sheets. The latter partly reflects inefficiencies in the judicial system and the insolvency regime that may have contributed to a high level of forbearance by banks. Diminished fiscal and financial buffers relative to the pre-crisis period increase the fragility of the economy in a time of heightened uncertainty and global economic risks.

Looking forward, Portugal should capitalise on its very impressive recent export performance by continuing to promote firms conducting international trade and entering new markets. To do so, productivity growth across the business sector must be revived through policy settings that facilitate the expansion of high potential enterprises. That said, such policies must be coupled with well-functioning institutions that ensure their efficacy. In particular, the efficiency of the judicial system should be improved to ensure timely contract enforcement, which is crucial for market transactions.

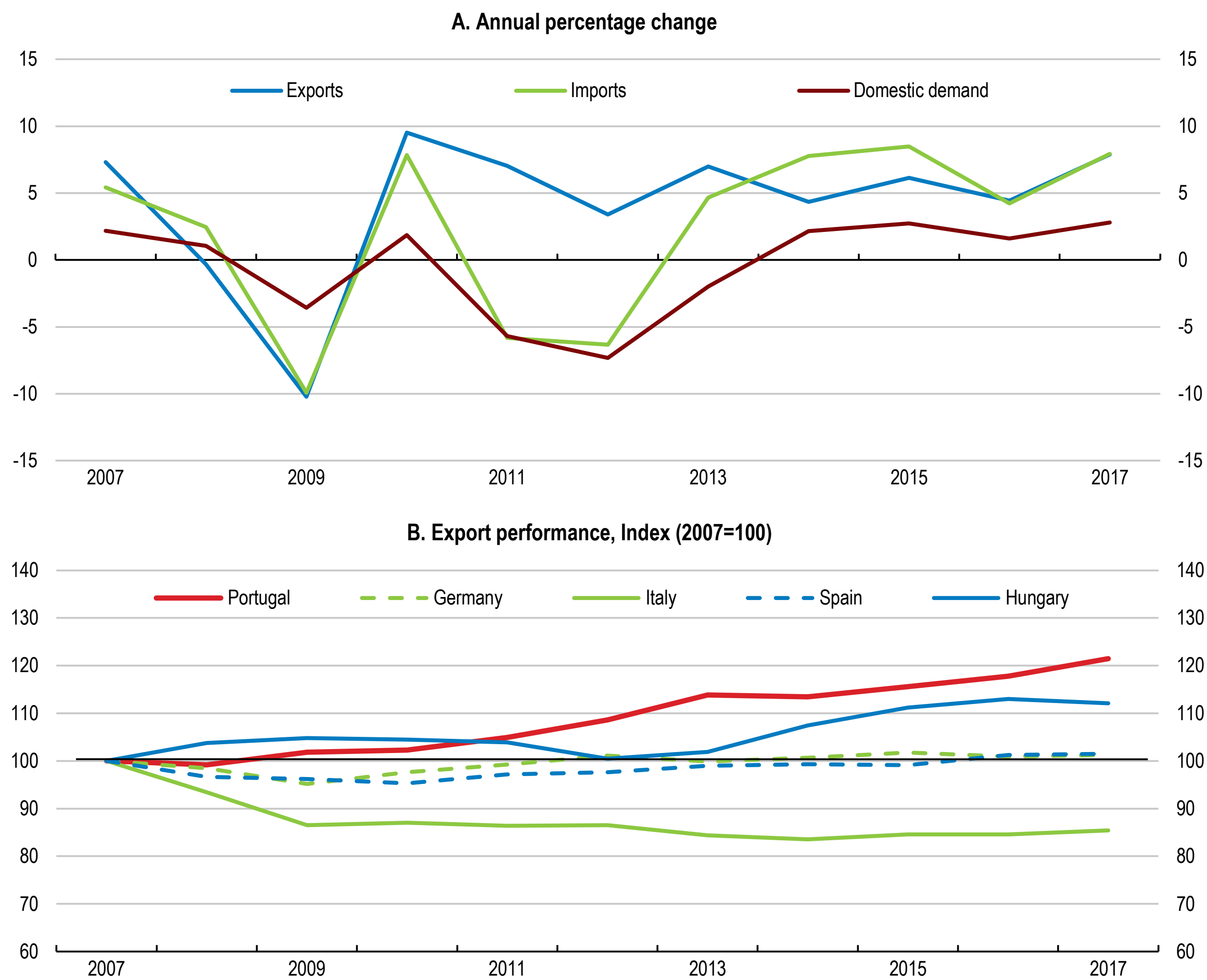
Against this background, the main messages of this *Survey* are:

- There has been progress in improving public finances, reducing private debt and the health of the banking system, but further efforts can improve resilience to economic shocks.
- The economy is still less outward-oriented than many other small European economies. Export performance can be further improved through policy settings that better enable exporters to innovate and grow.
- There is scope for further reforms that promote the efficiency of the judicial system, thereby spurring business activity.

Recent macroeconomic developments and short-term prospects

The Portuguese economy continues to grow at a solid pace. Strong exports sustained economic activity in the years immediately following the financial crisis, but both rising investment and private consumption have recently also positively contributed to growth (Figure 4, Panel A and B).

Figure 4. Strong exports sustained activity



Note: In Panel B, export performance measures the expansion of a country's exports relative to the expansion of import demand from its trading partners. Improvements in export performance reflect rising market shares in the imports of trading partners.
Source: OECD Economic Outlook (database), September 2018.

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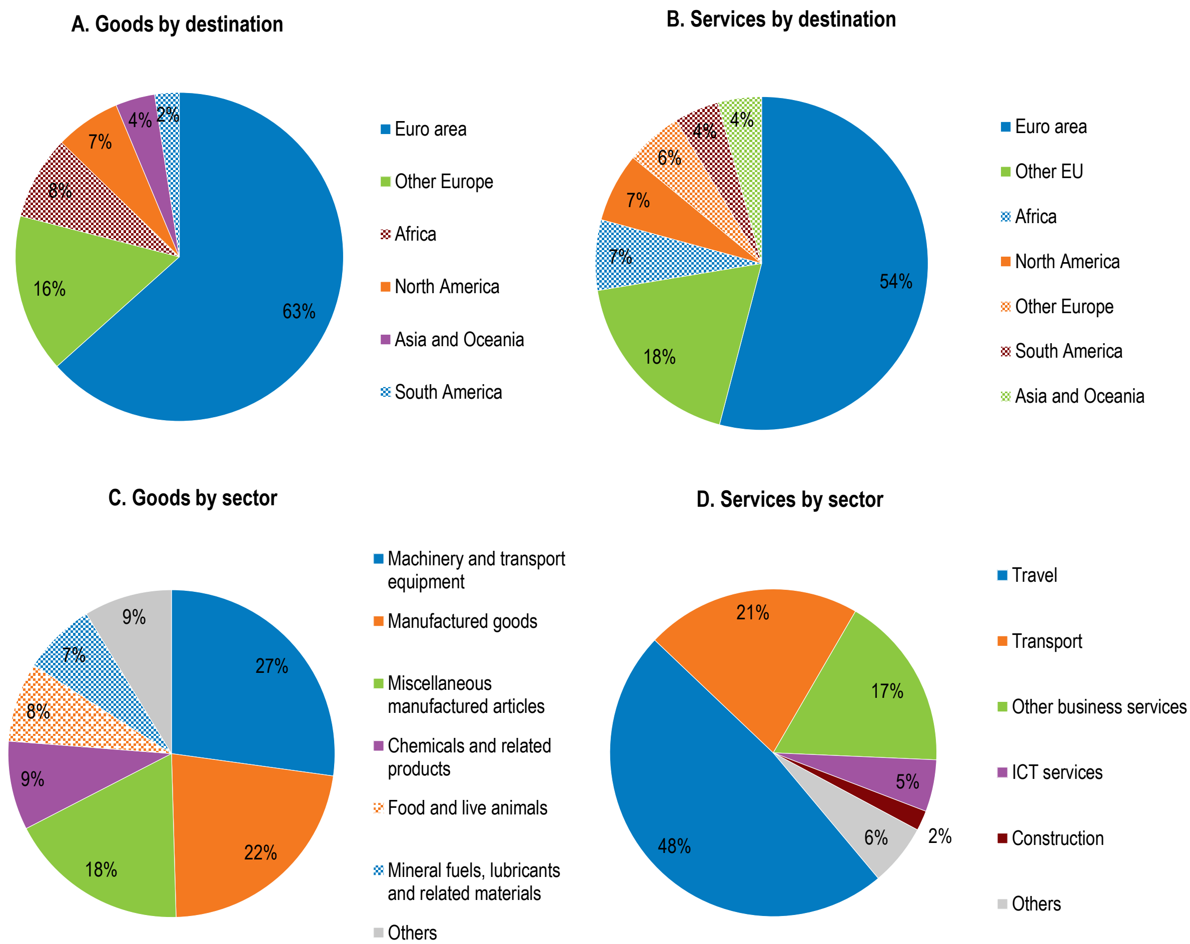
Exports have been bolstered by the strong performance of the tourism sector. Between 2010 and 2017, average annual growth in travel and tourism exports was above 10%. By that time, tourism accounted for close to half of all services exports (Figure 5). Strong growth in tourist arrivals has coincided with an increase in the supply of tourist accommodation and low-cost airlines flying to Portugal as well as some increase in security risks in some competitor markets (Chapter

1). Nevertheless, there have also been strong gains in exports of goods industries such as chemicals and machinery.

Figure 5. Travel and tourism now accounts for almost half of services exports

Share of exports by sector and destination, 2017



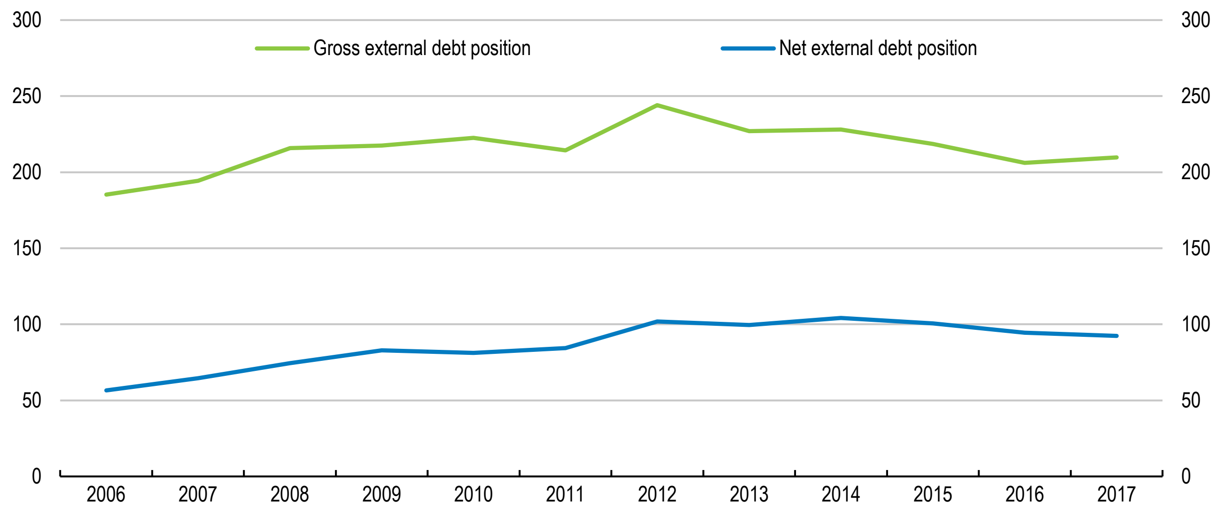
Note: In Panel C, Others include crude materials, beverages and tobacco, animal and vegetable oils, and commodities and transactions. In Panel D, Others include insurance and pension, construction services, and other services.
Source: OECD International Trade Statistics.

StatLink https://doi.org/10.1787/888933911364

An improvement in cost competitiveness has played a role in the export recovery, with export prices relative to Portugal's competitors depreciating by around 6% since 2009. However, improvements in export product quality (Gouveia et al., 2018) have also been important (see Chapter 1). Furthermore, in the last few years, foreign demand has stabilised: weighted according to importance for Portuguese exports, average annual trading partner growth was 3½% from 2013-17 compared with close to zero in the 2009-12 period. The sustained strong performance of exports has pushed the trade balance positive, helping begin reverse external imbalances. Nevertheless, net external debt remains around 90% of GDP (Figure 6) and imports have been rising strongly since 2013.

Figure 6. External imbalances remain high

Percentage of GDP



Source: World Bank Quarterly External Debt Statistics, OECD Economic Outlook (database), and Statistics Portugal.

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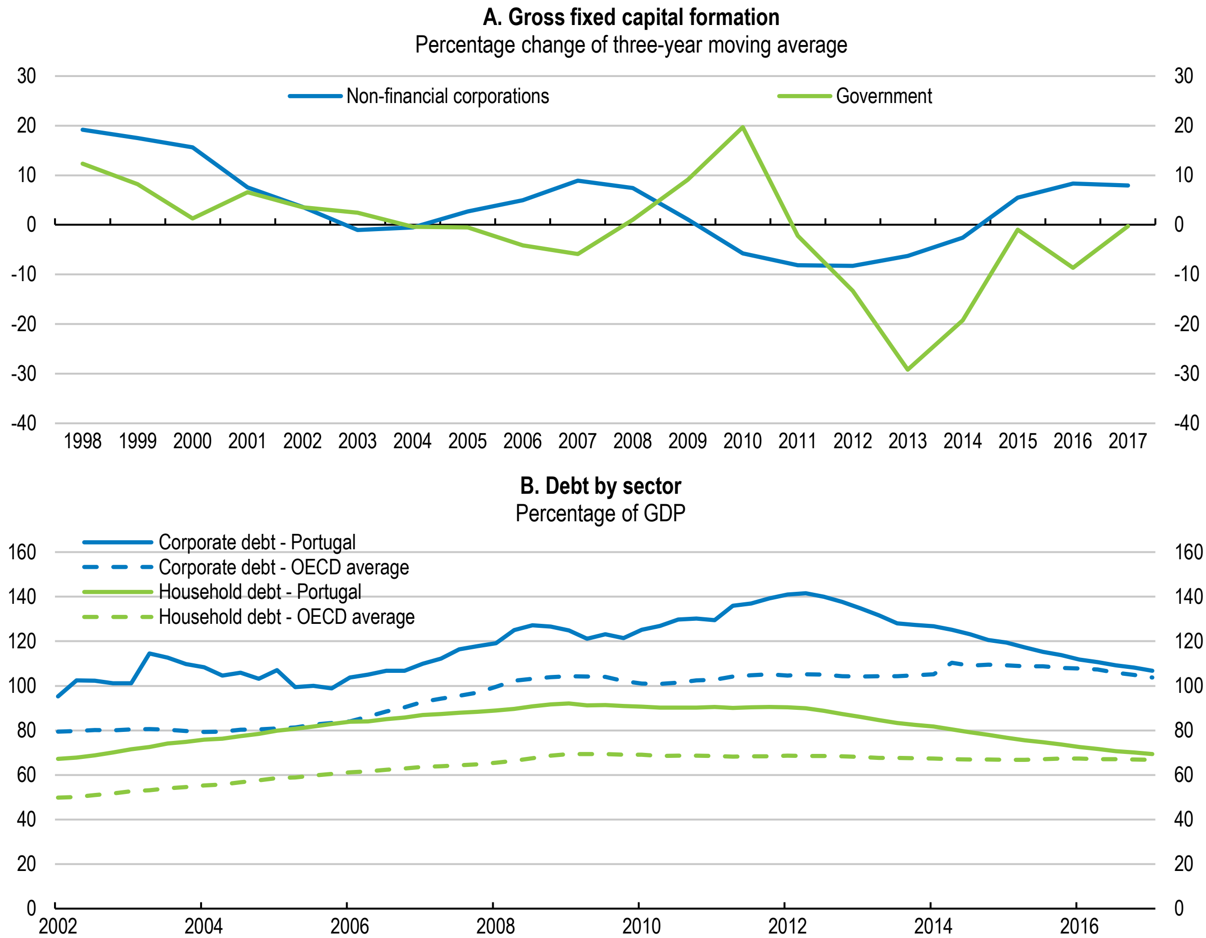
Investment has begun to rise again after receding each year between 2009 and 2013. The recovery has been driven by an increase in spending by non-financial corporations combined with public investment exerting less of a drag on growth (Figure 7, Panel A). Machinery and equipment investment has recovered particularly strongly. In the past few years, such investment has been supported by new contracts from foreign-owned firms for vehicle manufacturing in the country. Between 2017 and mid-2018, capacity utilisation in the vehicle manufacturing sector jumped from 60% to 96%.

Credit to the non-financial corporate sector continues to recede, despite significant deleveraging already having occurred. Corporate debt as a share of GDP has now declined to around OECD-average levels (Figure 7, Panel B), with an increased share of investment funded from retained earnings. In 2016 and 2017, strong growth in European Union funding has also supported investment growth.

Figure 7. Investment has recovered despite ongoing corporate sector deleveraging

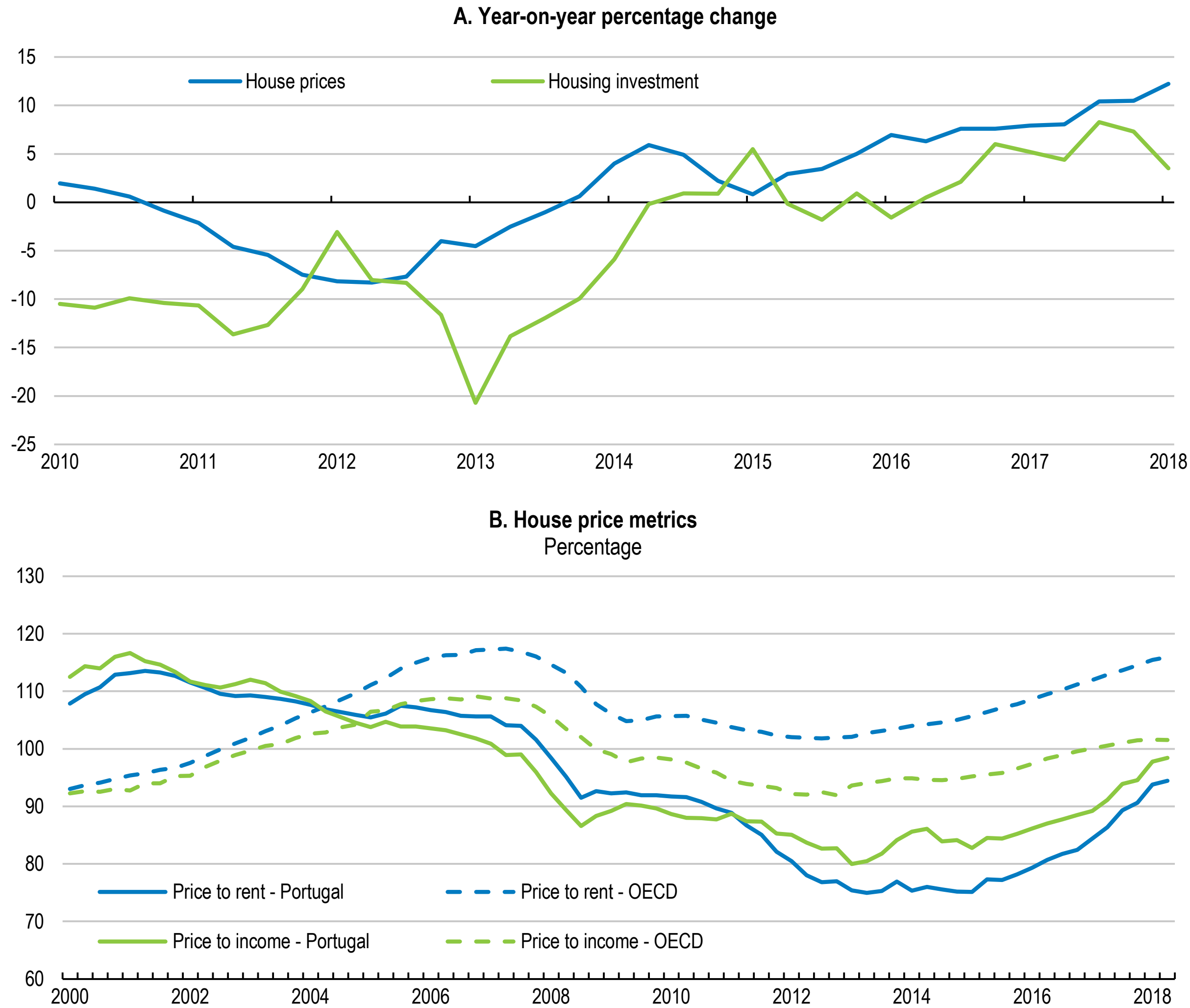


Source: Statistics Portugal.

StatLink https://doi.org/10.1787/888933911402

Housing investment has also recovered, responding to strong growth in both new and existing dwelling prices (Figure 8, Panel A). So far, rising house prices have not been accompanied by an increase in the stock of housing credit, though the flow of new loans has been increasing since 2013. The boom in the tourism sector and demand by non-residents (responding to government incentives tying visas to dwelling purchases) have been significant factors behind the strong growth in house prices in some locations (Bank of Portugal, 2018). Nevertheless, measured as a ratio of household incomes or rents, a proxy of an equilibrium price, the level of house prices is not elevated compared to the average OECD country (Figure 8, Panel B). While a steep increase in borrowing costs could pose a risk to dwelling prices, the central bank introduced new macroprudential regulatory measures in early 2018 that should help reduce the probability of new household borrowers becoming overly indebted. In particular, new caps on the loan-to-value ratio for property loans, the debt service-to-income ratio and loan maturity have been implemented.

Figure 8. House prices have risen strongly



Source: Statistics Portugal, OECD Analytical House Price Indicators.

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Private consumption activity has been solid since the end of 2013, growing by around 2% per year. This reflects growth in private sector earnings: employment has benefitted from the robust recovery, especially in some labour-intensive sectors, and wages have risen as the labour market has tightened.

The fiscal stance is expected to be slightly expansionary in 2018 before being broadly neutral in 2019 and 2020. The authorities must continue to balance the objectives of improving the fiscal position at the same time as sustaining the economic recovery. In doing so, they must ensure adherence to counter-cyclical fiscal policy: in case growth surprises on the upside, all windfall revenues should be used to reduce the public debt ratio faster than currently planned.

Economic activity over the next few years will be supported by the recovery in the labour market. An anticipated slowdown in the pace of activity in Portugal's major trading partners, such as Spain, Germany and the United Kingdom, will be a headwind to growth. In 2019 and 2020, GDP growth is expected to be 2.1% and 1.9% respectively (Table 1). A gradual further reduction in economic slack will prompt a slight increase in inflation over the coming years.

Table 1. Macroeconomic indicators and projections

Annual percentage change, volume (2011 prices)

	2015 Current prices (billion EUR)	2016	2017	2018	2019	2020
Gross domestic product (GDP)	**179.8**	**1.9**	**2.8**	**2.1**	**2.1**	**1.9**
Private consumption	117.7	2.4	2.3	2.2	1.8	2.0
Government consumption	32.6	0.8	0.2	1.0	0.2	-0.3
Gross fixed capital formation	27.8	2.3	9.2	4.6	6.0	5.0
Housing	4.4	5.1	6.4	1.7	5.0	4.8
Final domestic demand	178.2	2.1	3.0	2.4	2.2	2.1
Stockbuilding[1]	0.6	-0.1	0.0	0.0	0.0	0.0
Total domestic demand	178.8	2.0	3.0	2.4	2.2	2.1
Exports of goods and services	72.6	4.4	7.8	5.8	4.3	4.0
Imports of goods and services	71.6	4.7	8.1	6.2	4.8	4.5
Net exports[1]	1.0	-0.1	0.0	-0.1	-0.2	-0.2
Other indicators (growth rates, unless specified)						
Potential GDP	..	0.9	1.2	1.3	1.3	1.1
Output gap[2]	..	-5.2	-3.7	-2.9	-2.2	-1.3
Employment	..	1.2	3.3	2.3	1.1	1.1
Unemployment rate	..	11.1	8.9	7.1	6.4	5.7
GDP deflator	..	1.8	1.5	1.4	1.4	1.4
Harmonised consumer price index	..	0.6	1.6	1.3	1.5	1.4
Harmonised core consumer price index	..	0.9	1.2	1.1	1.4	1.4
Household saving ratio, net[3]	..	-3.7	-4.1	-5.2	-5.8	-6.0
Current account balance[4]	..	0.6	0.5	-0.9	-0.4	-0.1
General government fiscal balance[4]	..	-2.0	-3.0	-0.7	-0.2	0.1
Underlying general government fiscal balance[2]	..	0.9	1.0	0.8	0.9	0.7
Underlying government primary fiscal balance[2]	..	4.6	4.6	4.2	4.1	3.8
General government gross debt (Maastricht)[4]	..	129.2	124.8	121.1	118.4	115.0
General government net debt[4]	..	104.0	108.1	105.1	101.8	98.4
Three-month money market rate, average	..	-0.3	-0.3	-0.3	-0.2	0.2
Ten-year government bond yield, average	..	3.2	3.1	1.8	2.0	2.3

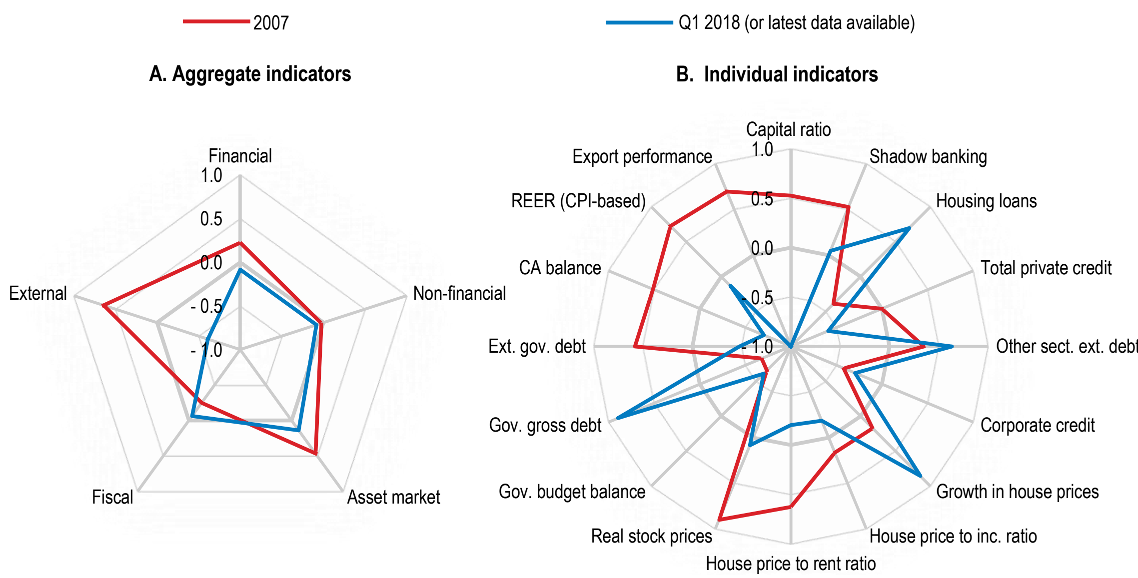
1. Contribution to changes in real GDP.
2. As a percentage of potential GDP. Based on OECD estimates of cyclical elasticities of taxes and expenditures. For more details, see OECD Economic Outlook Sources and Methods.
3. As a percentage of household disposable income.
4. As a percentage of GDP.
Source: OECD (2018), OECD Economic Outlook: Statistics and Projections (database).

Risks to the outlook include a tightening in financial conditions. In particular, an increase in interest rates, potentially stemming from the normalisation of monetary policy by the European Central Bank, may negatively impact business and household spending (Figure 9). On the upside, further improvements in the competitiveness of Portuguese exports could manifest in larger export market share gains than is currently factored into the projections.

Portugal is also potentially vulnerable to exogenous shocks that are not factored into the central forecast scenario (Table 2). A trade war that results in a significant increase in policy barriers to trade between the EU and other large countries, such as the US, could derail the recovery given the economy's increased reliance on the external sector. Similarly, turbulence that is transmitted across emerging markets could have a negative impact on the Portuguese business sector. For example, Brazil and Angola account for over 10% of the stock of Portugal's outward foreign direct investment. In addition, a disorderly conclusion to negotiations around United Kingdom's planned departure from the European Union could reduce exports.

Figure 9. Macro-financial vulnerabilities remain high in some areas

Index scale of -1 to 1 from lowest to greatest potential vulnerability, where 0 refers to long-term average, period



Note: Each aggregate macro-financial vulnerability dimension is calculated by aggregating (simple average) normalised individual indicators from the OECD Resilience Database. Individual indicators are normalised to range between -1 and 1, where -1 to 0 represents deviations from long-term average resulting in less vulnerability, 0 refers to long-term average and 0 to 1 refers to deviations from long-term average resulting in more vulnerability.
Source: Calculations based on OECD (2018), OECD Resilience Database, September; and Thomson Reuters Datastream.

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Table 2. Possible shocks to the Portuguese economy

Vulnerability	Possible outcome
Brexit	A significant increase in policy barriers governing relations with the United Kingdom in the areas of trade, investment and labour markets could have negative economic effects on Portugal. The direct effects could be material, given the United Kingdom is Portugal's fourth largest export market.
Turbulence in emerging market economies	Financial or political shocks in important emerging-market economies, such as Angola and Brazil, could negatively impact the profits of Portuguese firms and the export sector.
Rising protectionism	As a small open economy, any significant increase in policy barriers to international trade would have a detrimental impact.

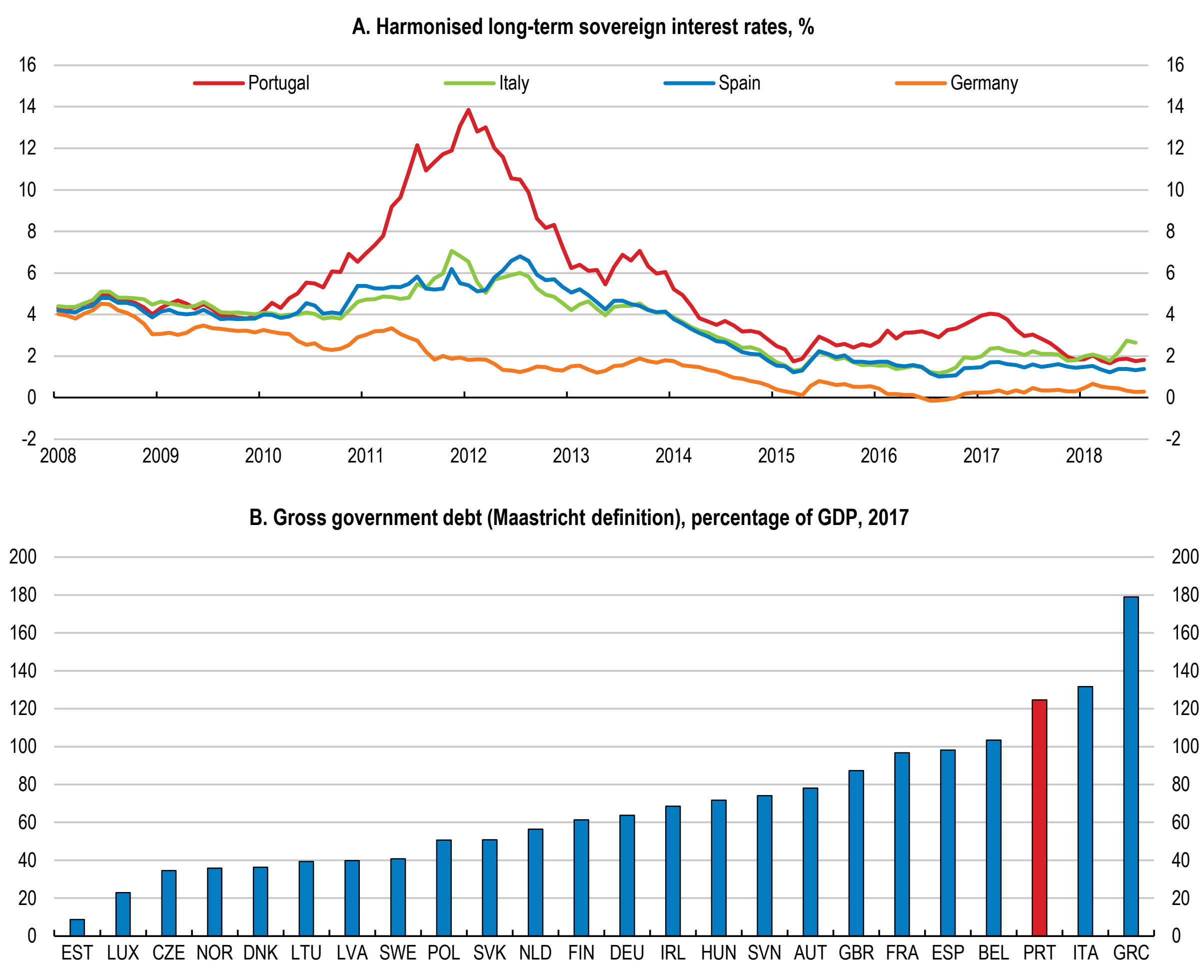
Strengthening the sustainability of public finances

Portugal's fiscal position has improved significantly; after peaking at 11.2% of GDP in 2010, the fiscal deficit gradually declined to 2% of GDP in 2016 and it would have been even less than 1% of GDP in 2017 if not for the recapitalisation of the state-owned bank. Indicators of the structural budget balance suggest that there was a significant discretionary fiscal contraction between 2010 and 2014.

With the economy expanding and credit rating agencies upgrading their rating of Portuguese sovereign debt, interest costs have declined. After peaking at 14% at the beginning of 2012, long-term interest rates on government bonds are now below 2% (Figure 10, Panel A). Debt-servicing costs have also been reduced by the ongoing amortization of bonds that were issued at very high interest rates during the financial crisis.

With the improvements in fiscal balances, public debt has fallen from its peak of 130.6% of GDP in 2014 to around 121.1% of GDP in 2018 (according to the Maastricht criterion). Nevertheless, the public debt burden remains very high compared with other OECD countries (Figure 10, Panel B). This severely limits the capacity for fiscal policy to respond in the event of future economic shocks. Currently, the cost of debt servicing represents around 8% of public expenditures. A rise in interest rates could increase this cost. Nevertheless, under a scenario of stable interest rates, debt-servicing costs will decline given there is still a pipeline of high-cost public debt that is scheduled to mature over the coming years.

Figure 10. Sovereign borrowing costs have eased but public debt remains high



Source: OECD Economic Outlook Database; OECD calculations.

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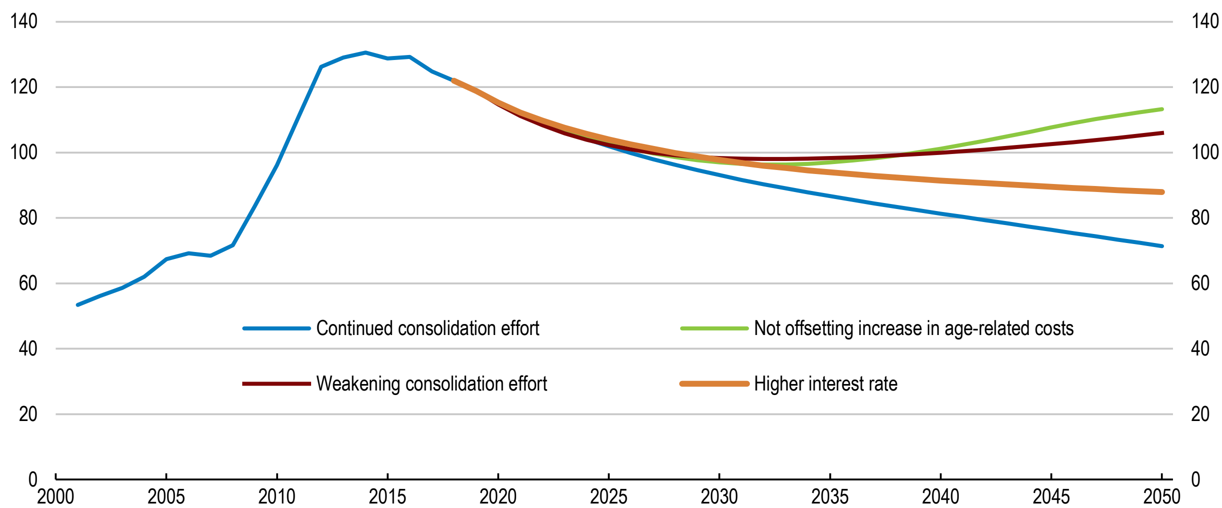
Under the government's current plans, the public debt ratio will decline quite rapidly, to 102% of GDP in 2022. Thereafter, the path of public debt will be highly dependent on the pace of fiscal consolidation and the government's ability to introduce new measures that offset the rising costs of ageing (Figure 11). Indeed, incorporating the increase in ageing-related costs currently projected by the European Commission into a public debt simulation analysis, the public debt burden would rise above 110% of GDP by 2050 holding all else constant.

Figure 11. Sustained primary budget surpluses are needed to durably lower public debt

Gross government debt as a share of GDP



Note: After 2020, the "continued consolidation" scenario assumes a continuation of the policy stance of 2020 with a structural primary surplus of 2.2% of GDP each year over the projection period, inflation of 1.5% and real GDP growth averaging 1.4% in line with assumed productivity growth. The "not-offsetting increase in age-related costs" scenario takes the continued consolidation scenario and then includes European Commission projections for public pensions, long-term care, health, education and unemployment benefits (European Commission, 2018a). These projections suggest ageing-related costs will add 1.5 percentage points of GDP (using the projections of GDP from the "continued consolidation" scenario as the denominator) to annual government spending at their peak in 2045 compared with 2016. The "less consolidation" scenario assumes that the structural primary surplus gradually declines from 2.2% of GDP in 2020 to 1% of GDP in 2030 and is held constant thereafter. The 'higher interest rate' scenario assumes that interest rates rise by 0.5 percentage point, taking five years to fully flow through to debt-servicing costs.
Source: Adapted from OECD (2018), OECD Economic Outlook: Statistics and Projections (database), June; Guillemette, Y. and D. Turner (2018), "The Long View: Scenarios for the World Economy to 2060", OECD Economic Policy Paper No. 22., OECD Publishing, Paris; and European Commission (2018a), "The 2018 Ageing Report - Economic and budgetary projections for the 28 EU Member States (2016-2070)" Directorate-General for Economic and Financial Affairs.

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Improving the efficiency of public spending

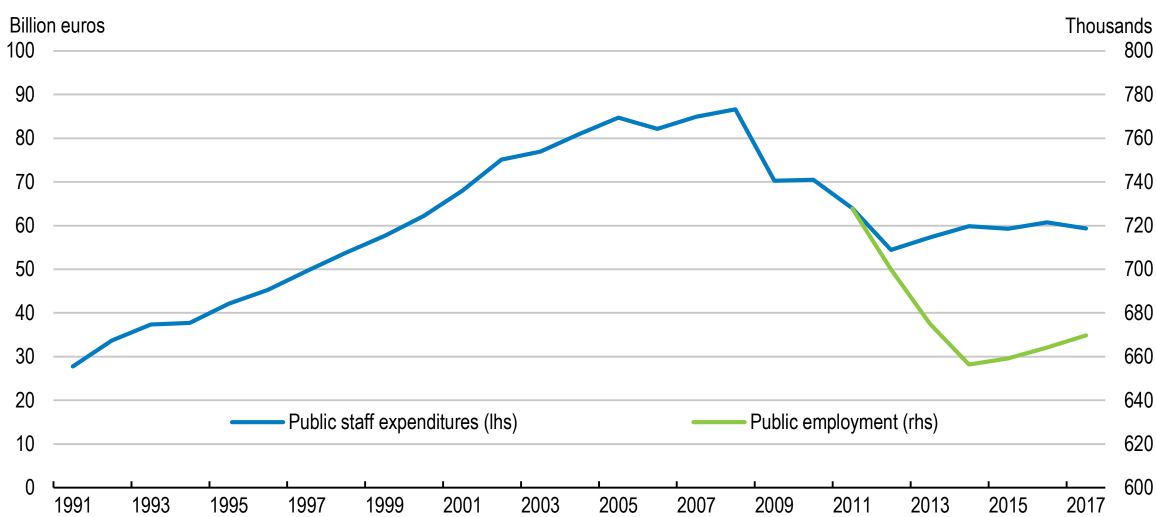
Both the revenue and expenditure side of government accounts present opportunities for improving fiscal sustainability. On the expenditure side, the government has embarked upon a "bottom-up" public expenditure review, designed to prompt line ministries to generate efficiency gains that can work towards containing expenditure. The government's ability to achieve the anticipated reduction in the overall public debt burden substantially depends on savings identified through this ongoing review, in addition to sustained favourable economic conditions (Portuguese Public Finance Council, 2018).

The ongoing expenditure review is intended to be a permanent feature of the government's fiscal framework, with multiple policy initiatives running in parallel and at different stages of formulation and implementation. The review is currently focused on a set of priority areas including health, education, justice, public real estate management, state-owned enterprises, public procurement, internal administration and human resource management but will expand to cover new elements over time. Each year, the State Budget provides an update of the various strands of work associated with the review. This includes plans for future policy initiatives and quantitative estimates of the fiscal impacts associated with some of the initiatives that have been undertaken.

At the same time as identifying cost-savings within the existing policy framework, the authorities must undertake more fundamental structural reforms that improve the efficiency of public spending. The deep temporary cuts to public sector wages in the 2010-15 period have now been reversed and public employment is rising again (Figure 12). However, public sector wages still depend mostly on years of experience, rather than the performance of the worker (IMF, 2018). The premium in public sector pay for high-skilled civil servants is also relatively low, making it difficult to attract highly qualified staff from the private sector (IMF, 2018).

To improve efficiency and ensure that the public service is an attractive career option for talented individuals, reforms should strengthen the relationship between public sector pay and the performance of the individual worker. Over the coming years, there will also be a need to reallocate employment across the public sector to reflect nascent demographic changes. For instance, resources devoted to the school system should be rationalised as the population ages at the same time as those allocated to the health system are reinforced.

Figure 12. Public staff expenditures are rising at a slower pace than prior to the crisis



Source: Bank of Portugal, and Statistics Portugal.

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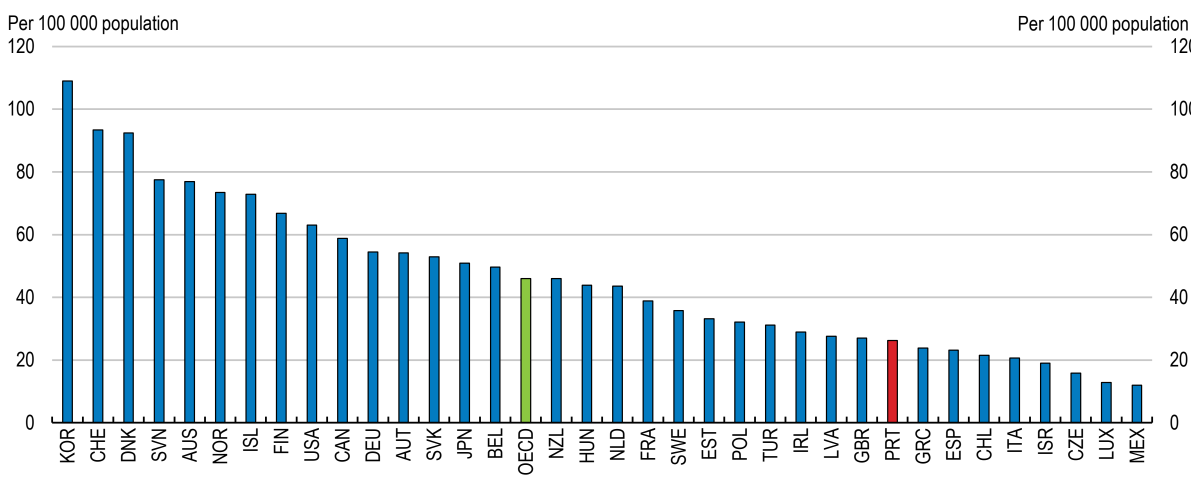
As the share of the old age population increases, public health spending will too. Government spending on health is anticipated to rise very fast compared with other European countries, from 5.9% of GDP in 2016 to 8.3% in 2070 (European Commission, 2018a). Private healthcare coverage is low and out-of-pocket payments for healthcare in Portugal are some of the highest in the OECD (OECD, 2017a). As such, there is little potential to increase the share of private contributions to future healthcare costs without jeopardising healthcare access for low-income households.

The government has already been active in improving the efficiency of public health spending, partly in response to the recommendations of the EU-IMF financial assistance programme. Initiatives have included pharmaceutical pricing reforms that reduced costs and improved transparency. In addition, efficiency gains by health providers have been encouraged by the introduction of performance-related remuneration in primary care (OECD and European Observatory on Health Systems and Policies, 2017). Nonetheless, Portugal lacks a comprehensive strategy to tackle the health-related costs of ageing (European Commission, 2018b).

Part of the solution will be to further move treatment to primary care settings, as has been done in many other OECD countries. However, the availability of nurses is key to providing primary and home care. While there has been a strong increase in the number of nurses over the past decade in Portugal, shortages persist. Furthermore, the number of nursing graduates in recent years has been low (Figure 13), partly reflecting a reduction in the volume of students accepted by nursing programmes through the financial crisis (Moreira and Lafortune, 2016). Going forward, the authorities should ensure that enrolment restrictions in nursing programmes (i.e. "numerus clauses") take into account the rapidly ageing population and the necessary reorientation of treatment toward primary care. Not to do so risks a deterioration in health care quality or increase in health costs.

Figure 13. A low number of nursing graduates compounds existing shortages

Nursing graduates, 2017 or nearest year



Source: OECD Health Statistics 2017.

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A cycle of hospitals building up arrears that are subsequently financed by central government transfers has been a consistent pattern in the health system over many years. Their accumulation impedes the efficient operation of hospitals, not least via the impact on supply chain relationships, raising costs. Such arrears reflect both inadequate budgeting and, in many cases, poor hospital management. In response, a new joint unit overseen by the Ministry of Finance and Ministry of Health is working on measures to raise the accountability of hospital management and to find efficiency savings through centralised procurement. This unit was responsible for new initiatives announced in the State Budget 2019 that coupled an increase in the annual budget of hospitals with increasing their accountability through new performance monitoring and managerial evaluation procedures.

Public expenditures on old-age benefits as a share of GDP have grown rapidly compared with the average OECD country over the past few decades. Furthermore, the increase in the old-age dependency ratio would be set to raise pension expenditures by 10½% of GDP by 2050, holding all else constant (Ministry of Finance, 2018). Portugal has a public pay-as-you-go earnings-related pension scheme, including a minimum pension as well as an additional means-tested safety net. There are also some voluntary private pensions, which can be defined benefit or defined contribution, though their share in overall pensions is small.

Significant reforms to the public pension system taken up until December 2017 have improved the sustainability of the system in the face of these demographic challenges, according to estimates by the European Commission (European Commission, 2018b). For example, the statutory retirement age in the public pension system was raised from 65 to 66 in 2014 and future increases linked to the evolution of life expectancy, bringing the current retirement age to 66 and 4 months. Pathways into early retirement have also been restricted, although significant differences in the penalty for early retirement depending on workers circumstances creates inequities in the system (OECD, 2019). Early retirement options for the unemployed over the age of 57 are also still available, which may disincentivise the reintegration of older unemployed workers into the labour market (OECD, 2019).

The improvement in the sustainability of the pension system has come at the cost of shifting much of the burden onto future generations. The use of "grandfathering clauses" partly shielded existing retirees from pension reforms that reduced the generosity of pension formulas.

Raising revenues in a growth-friendly manner

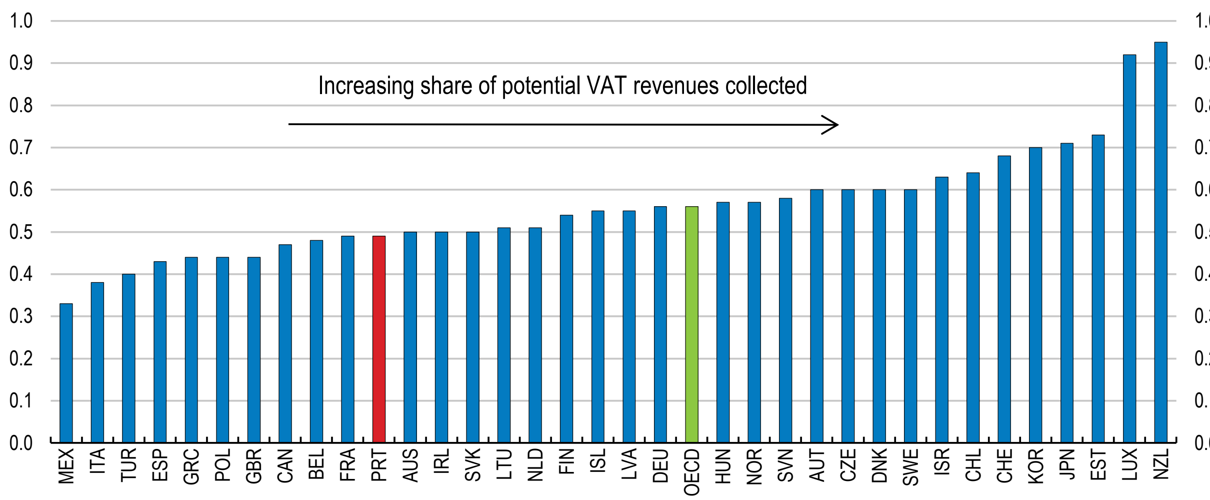
On the revenue side, total general government receipts increased from 40.4% of GDP in 2009 to 42.7% of GDP in 2017. Recent revenue-raising measures have included a tax on sugary drinks and an additional real estate tax. These initiatives have contributed to better pricing of negative externalities (in the case of the former) and a more efficient tax mix through increasing the share of revenues derived from the taxation of immovable property, which is one of the least distortive types of taxation for long-run GDP per capita (Johansson et al., 2008). The increased revenues will help fund a reform to the personal income tax system that will include an increase in the number of tax brackets which the government expects will reduce tax receipts modestly.

There is the potential for additional tax reforms that improve the efficiency of the tax system as well as fiscal sustainability (for an estimate of the short-run effects of selected tax reforms, see Box 1). For example, the share of government revenues derived from property taxation could be further increased. To the extent that revenues are raised by increasing tax rates, the distributional consequences of such adjustments should be evaluated and offsetting measures introduced where necessary.

The value added tax (VAT) in Portugal is characterised by a range of goods and services that are exempt or taxed at a reduced VAT rate. More than half of the potential VAT revenue in Portugal goes untaxed as a result of exemptions, reduced VAT rates and weak tax enforcement and tax evasion. The VAT performance is lower than the OECD average (Figure 14). Weakening the revenue-raising capacity of consumption taxes, such as VAT, is undesirable given that such taxes are less harmful for economic growth than those on personal income and corporates (Johansson et al., 2008). The introduction of a reduced VAT rate for restaurant and catering services in 2016 narrowed the tax base and such changes can favour high-income households who are more prone to consuming restaurant meals. Moreover, the experience of other European countries, such as France, suggest that the stimulatory impact of such measures on employment are modest (Benzarti and Carloni, 2017).

Figure 14. Most potential VAT revenues are untaxed

VAT Revenue Ratio



Note: The VAT Revenue Ratio is the ratio between the actual value-added tax revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption.
Source: (OECD, 2016[13])

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Fuel excise taxes continue to be lower for diesel fuel than for petrol. However, the former typically produce more emissions of particulate matter and the nitrogen oxides most relevant for air pollution. The government is undertaking a gradual convergence in the excise taxes; and raised the tax on diesel by 2 cents per litre and reduced the tax on petrol by 2 cents per litre in January 2017. Even so, this convergence process has some way to go, given that the excise tax gap between petrol and diesel remains over 20 cents per litre. Furthermore, additional reductions in the petrol tax should be reconsidered given that the current level of taxation may insufficiently reflect the full environmental consequences of petrol use (Santos, 2017). There is also scope for raising taxes on other energy sources, including coal and natural gas, where pricing does not adequately reflect their environmental impact (discussed further below).

Box 1. Quantifying the fiscal impact of selected policy recommendations

These estimates roughly quantify the annual fiscal impact of selected recommendations in this Survey, as some of them are not quantifiable given available information or the complexity of the policy design.

Table 3. Illustrative annual fiscal impact of recommended reforms

	% of GDP
Expenditures	
- Increased spending on active labour market programmes	-0.5
Additional revenues	
- Impact of structural reforms	+0.4
- Improve the design and the enforcement of the VAT	+1.4
- Increase in environmental taxation	+1.3
TOTAL	+2.6

Note: The estimated effects abstract from behavioural responses that could be induced from policy changes, in line with past OECD work modelling long-term scenarios (Johansson et al., 2013). The estimates are short-run effects and are based on: i) the assumption of an increase in active labour market spending as a share of GDP to the average of the top quintile of the OECD (from 0.6% to 1.1% of GDP): ii) the annual GDP impact of the structural reforms quantified in Box 2 (five-year effect): iii) the assumption of an increase in the VAT revenue ratio to the OECD average; iv) the assumption of an increase in environmental taxation as a share of GDP to the average of the top quintile of the OECD (from 2.2% to 3.5% of GDP).
Source: OECD calculations

Some aspects of the corporate income tax system may not support aggregate productivity growth. Larger firms, that are on average more productive in Portugal (OECD, 2017b), face a higher statutory corporate income tax rate as a result of surcharge rates that rise with the level of taxable profits. Furthermore, small and medium-sized enterprises can benefit from a slightly lower statutory CIT rate.

The government is also planning to introduce a preferential tax rate for companies located in the interior of the country. While such measures have been introduced in some other OECD countries, such as France, a potential unintended effect of this type of policy is to encourage profit-shifting within the country or to divert activity to interior regions from substantially more productive areas (such as Lisbon in the case of Portugal). Public policy interventions that support small firms and lagging regions are desirable where market failures exist. However, the authorities should be cautious about undertaking such interventions by introducing distortions into the corporate tax system. A more advisable approach would be to reallocate the public funding to other policy interventions that are currently in existence and that could have longer-term effects on the economic development of interior regions. For example, public investment in complementary public assets in these regions could be boosted. The government has established a working group that will review existing tax exemptions and report their findings by the end of March 2019 (Table 4).

As discussed further in Chapter 1, tax administration is an area that remains particularly cumbersome for businesses. Both tax accountants and businesses highlight frequent changes in tax laws as the most significant contributor to complexity in the tax system (Borrego et al., 2015). Other factors include the extensive use of special provisions and ambiguity in the tax law language. In this context, the authorities should simplify the tax system, partly through reducing the use of exemptions and special provisions. Once this is achieved, ensuring the stability of the tax system should be the key priority.

Table 4. Past recommendations related to improving fiscal sustainability

Recommendation	Action taken since the February 2017 Survey
Reduce tax exemptions, special rates and tax expenditures.	The Minister of Finance has created a working group to review existing tax benefits (i.e. exemptions, special rates etc.) through a cost-benefit analysis of current tax expenditure. The working group shall present a report by the end of March 2019.

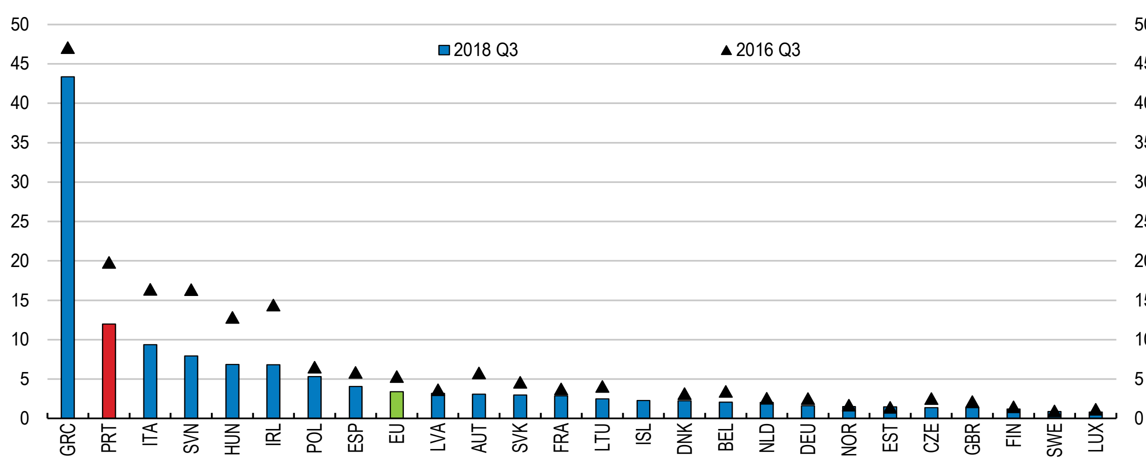
Enhancing financial stability

Portugal has emerged from a severe banking crisis with a deleveraged, recapitalised and restructured banking sector. Loans to customers have declined significantly over the past 10 years and they currently account for around 60% of total assets. At the same time, the banking sector's funding structure has become more stable, with increased deposits and equity-financing and less reliance on funding from securities and interbank markets.

The quality of assets in the banking system has been improving over the past years. The stock of non-performing loans (NPLs) in the Portuguese banking sector has decreased more than 35% (around 18 billion euros) from June 2016 to June 2018 (Figure 15). Additionally, the NPL ratio has also decreased by about 6.2 percentage points in a context where the deleveraging effort has been reducing its denominator. The loan-loss coverage ratio in the banking sector is high (Figure 16), as impairment provisions against NPLs have increased in the past few years. Banks have enhanced their risk assessment on new loans, with interest rate spreads reflecting stronger differentiation by the risk profile of borrowers than prior to the crisis (Bank of Portugal, 2017). The value of loans to low-risk firms in recent years has been markedly higher than that to high-risk firms (Bank of Portugal, 2017). Nonetheless, the stock of non-performing loans remains one of the highest across OECD countries, despite having declined notably in the past few years (Figure 15), weighing on banks' profitability and solvency (see below).

Figure 15. The NPL ratio in Portugal remains elevated

Non-performing exposures by country as a ratio of total outstanding exposures



Note: The following 7 banks are considered: Banco BPI SA; Banco Comercial Português SA; Caixa Central de Crédito Agrícola Mútuo, CRL; Caixa Económica Montepio Geral; Caixa Geral de Depósitos SA; Novo Banco; Santander Totta.
Source: European Banking Authority (EBA), "EBA Risk Dashboard".

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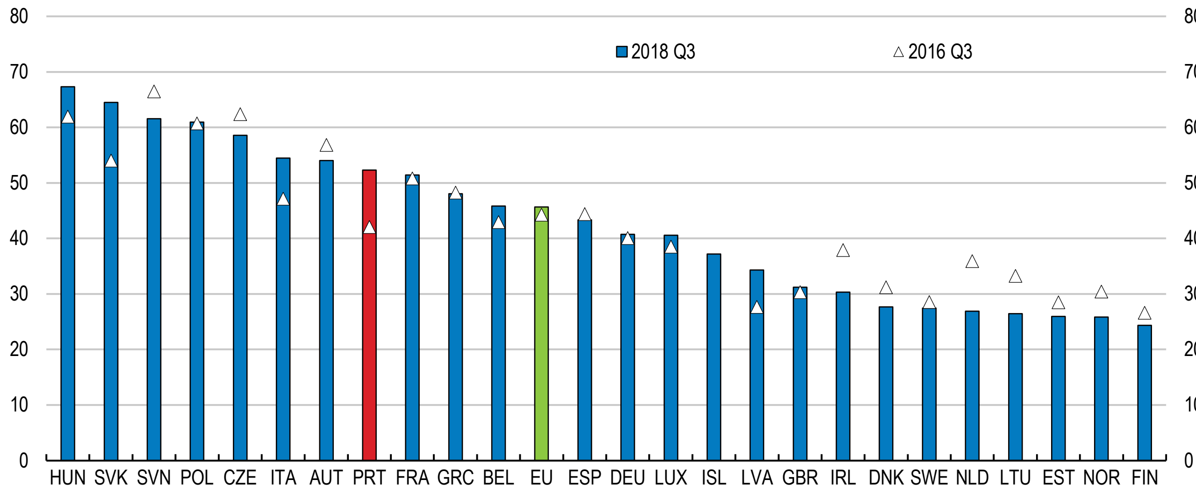
Figure 16. The loan-loss coverage ratio is high in Portugal

The coverage ratio as a percentage of NPLs



Source: EBA, European Banking Authority (EBA), "EBA Risk Dashboard".

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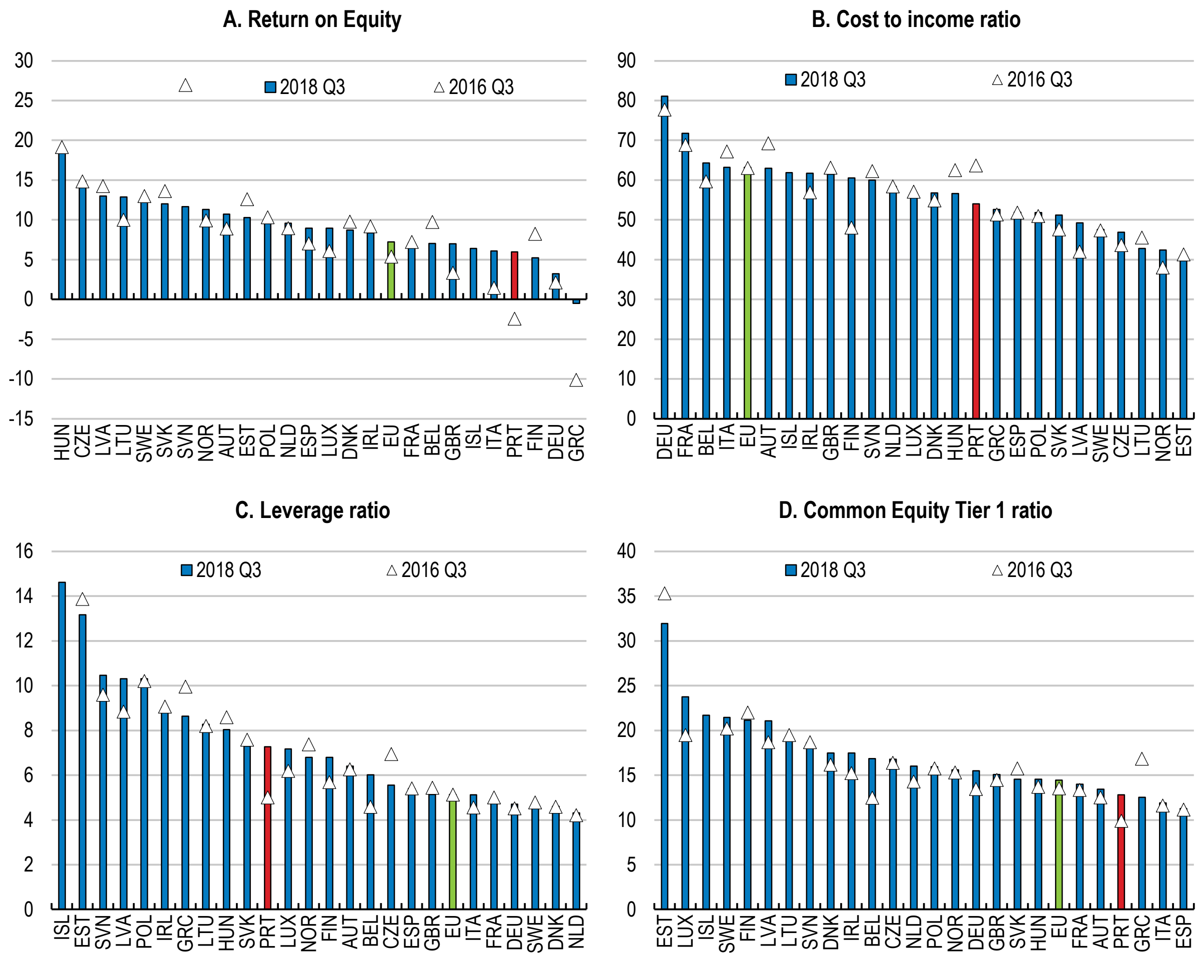
The profitability of Portuguese banks has improved, but remains low compared with institutions in other EU countries (Figure 17, Panel A). Banks have reduced operation costs by 27% since 2010, partly reflecting a decline in the number of branches and staff. There have also been efficiency improvements and the cost-to-income ratio is now below the EU average (Figure 17, Panel B). Net interest income, the most important revenue source for Portuguese banks, increased by 4.6% in 2017. Nonetheless, bank profitability continues to be impeded by additional impairments against NPLs.

Figure 17. Vulnerabilities remain in the Portuguese banking sector



Note: The calculation of the leverage ratio and the Common Equity Tier 1 ratio is based on the Basel III rules that will apply at the end of the transition period in 2019.
Source: European Banking Authority (EBA) "EBA Risk Dashboard".

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As long as banks' profitability remains low, the organic increase in their own funds will be limited. However, a number of banks injected new capital in 2017 and issued Tier 2 and AT1 instruments, improving their capital position. The sector-wide leverage ratio (the ratio of core capital to assets) is well above the EU average (Figure 17, Panel C). Nonetheless, the Common Equity Tier 1 ratio (an indicator of bank solvency measured as a ratio of banks' own funding to risk-weighted assets) remains low (Figure 17, Panel D), due to the existence of risky assets, including NPLs. The relatively low level of bank solvency leaves the sector vulnerable to negative shocks.

Improving bank and firm profitability and solvency

In order to durably raise banks' profitability and solvency, it is essential to continue decreasing NPLs. The authorities are tackling NPLs within a comprehensive European action plan and based on the national strategy, which consists of three pillars: i) legal, judicial and tax; ii) supervisory action; iii) NPL management options. Particular measures include those implemented under "*Programa Capitalizar*", prudential supervisory action within the SSM and including the NPL reduction plans submitted by banks to supervisors. Furthermore, a platform for the integrated management of NPLs has been established.

Over the past years, significant progress has been made in terms of the regulatory framework to address NPLs, in the context of the Single Supervisory Mechanism (see Annex 1). It includes, notably, the monitoring of compliance with the NPL reduction plans submitted by banks that have high NPLs. These plans include specific operational goals by asset class and time frame and the reduction goals initially stipulated have reportedly been met (Bank of Portugal, 2018). However, the targets and timetable on NPL reduction are not publicly known, thus their stringency cannot be evaluated and instances where banks deviate from the plans identified by the public. Communicating the plans and the progress in meeting them could boost the credibility of the banks and add pressure for meeting targets. However, it may compromise the prices at which banks are able to sell distressed assets if market participants are aware of the sales that any specific bank needs to make to meet their plan by a set date. Regardless, these plans should continue to be strictly monitored and competent authorities should translate performance in achieving targets into changes in capital requirements. NPL write-offs should continue to be encouraged, taking into account the measures being implemented, also at the European level, to reinforce the provisions required against NPLs on balance sheets.

In tandem with changes to supervision, the authorities could consider playing a more active role in developing distressed debt markets to assist banks in cleaning up their balance sheets. While there can be scope for the public sector to be involved in the development of distressed asset markets by, for instance, setting up public asset management companies (OECD, 2017c), current EU regulations related to state aid pose difficulties for such a reform. Furthermore, the Portuguese authorities recently conducted a study which found that the potential for a bulk transfer of the NPLs in the banking system to an asset management company is low given the characteristics of the underlying assets (Table 5).

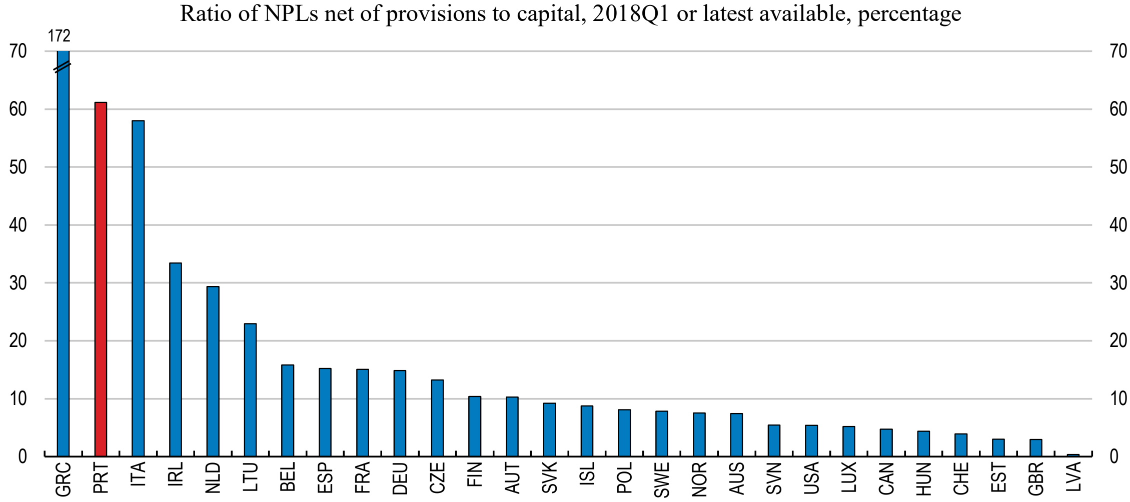
A number of policy measures have been introduced since 2016 with the aim of reducing corporate indebtedness and strengthening loan recovery. These have been under the *Programa Capitalizar* and have included promoting the use of out-of-court restructuring mechanisms as well as efficient and transparent court proceedings, partly to improve the recovery rates of creditors. The *Programa Capitalizar* also includes an early warning mechanism, which aims to inform companies of their financial situation, which is coordinated by the Portuguese government and is being developed by the Portuguese SME Public Agency (IAPMEI), in collaboration with Bank of Portugal and the Tax Authorities. These developments go in the right direction. However, most of the recent policy measures have been aimed at corporate restructuring, which is most effective for firms temporarily in distress but otherwise viable.

Further NPL resolution continues to be a challenge. The NPL ratio is particularly high for the non-financial corporations (NFC) sector, which accounts for some 65% of the total NPL stock. Since some NPLs are unlikely to be recovered, NPL write-offs should continue to be encouraged, taking into account measures adopted at the European level. Banks are still vulnerable to any reduction in the value of collateral, despite the increase in the coverage ratio (Figure 18).

More generally, high private sector indebtedness is a concern. Although having declined steadily, the stock of private sector debt remains high (Figure 7, Panel B). While about half of NFCs are not indebted at all, some NFCs are heavily indebted. Around 35% of NFCs with financial debt have an interest coverage ratio below one, leaving them sensitive to rises in interest rates. Some of these NFCs could be a source of new NPLs if faced with a negative shock.

Figure 18. The NPL net of provisions to capital ratio is high in Portugal

Ratio of NPLs net of provisions to capital, 2018Q1 or latest available, percentage



Note: The chart showing the ratio of NPLs net of provisions to capital gauges how banks would be affected in an extreme scenario where all NPLs are written off and assuming no collaterals.
Source: IMF Financial Soundness Indicators.

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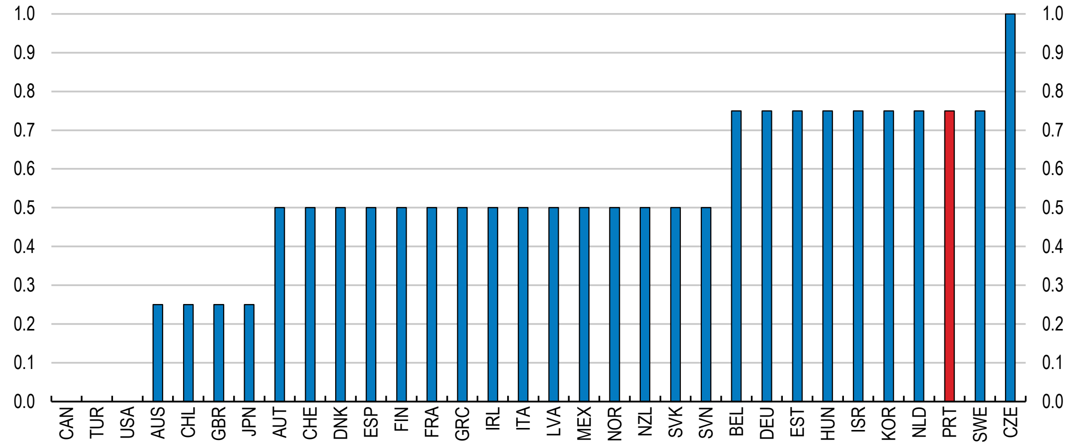
Optimising the insolvency regime

An efficient insolvency regime, allowing rapid debt resolution, improves the operation of credit markets (Andrews and Petroulakis, 2017). Along with efficient judicial processes, it is also an important condition for the resolution of NPLs. Portugal's insolvency regime for firm restructuring has become more efficient since early 2010, owing to the *Processo Especial de Revitalização*. However, the bankruptcy law is very stringent for bankrupt persons (Figure 19; (Adalet McGowan, Andrews and Millot, 2017). The time to discharge (when the exemption from pre-bankruptcy debt repayment becomes available) is 5 years, in contrast with other European countries where it is often 3 years. The exemptions from the insolvency assets (those assets left to the bankrupt entity at the time of bankruptcy) are limited to vital items only. This has resulted in the number of personal bankruptcy cases being very limited.

Figure 19. Personal bankruptcy law is stringent in Portugal

OECD insolvency indicator: Treatment of failed entrepreneurs, 2016



Note: The indicator is constructed based on the OECD questionnaire on insolvency regimes. It ranges from zero (least stringent) to one (most stringent). "Treatment of failed entrepreneurs" takes into the following aspects: time to discharge; and bankruptcy exemptions.
Source: Adapted from Adalet McGowan et al. (2017).

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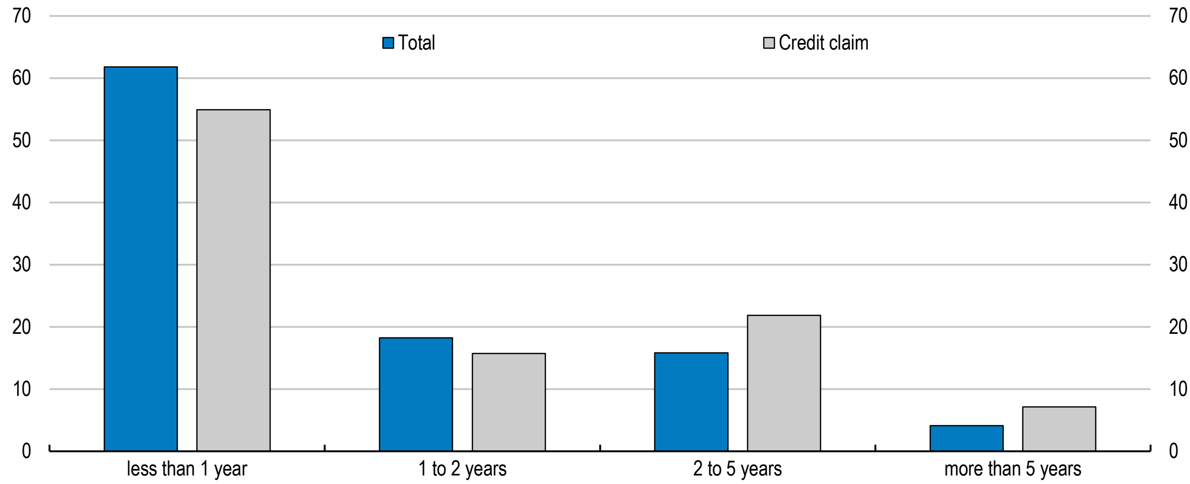
Bankruptcy law often has greater importance than corporate insolvency regimes for small businesses (Armour and Cumming, 2008). Entrepreneurs often use personal finances prior to incorporating and obtaining limited liability protection (Berkowitz and White, 2004; Cumming, 2012) and lenders often require them to make personal guarantees. In Portugal, such guarantees are common practice: while collateral requirements are among the highest across OECD countries (around 80% of the cases; OECD, 2018a), the collateral usually takes the form of business assets and personal guarantees of business owners. Such collateral requirements help banks to screen out risky businesses, but once the firm defaults, banks can be negatively impacted as repossession of collateral is not easy in practical terms. Rather, banks should adopt a business model focusing more on the assessment of the business plan and cash flow.

Such personal guarantees of business owners make insolvency proceedings very complicated. This is because an owner of a failing firm that has given personal guarantees becomes liable, causing them to risk bankruptcy if they cannot pay out all liabilities. Such collateral enforcement often requires court proceedings, which can be long in Portugal (Figure 20, see also Chapter 2). Such proceedings are costly and the collateral value can decline markedly during the proceedings. This is reflected in a very low recovery rate; just 5% on average (Ministry of Justice, 2017).

Figure 20. Court proceedings for credit claims can take a long time

Share of court proceedings by duration, %



Source: Ministry of Justice.

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Bankruptcy law should be made less stringent, thereby making bankruptcy a viable solution for some highly indebted people. Such a reform typically involves reducing the time to discharge, as was recently the case in other European countries such as Spain and Ireland. In these countries, such reforms resulted in a rise in the number of persons choosing to file for bankruptcy. Less stringent bankruptcy regulation may negatively affect credit supply (due to creditors having less rights in legislative terms), as shown in Berkovitz and White (2004), but it would effectively ensure the right of creditors who otherwise continue forbearance instead of pursuing long and uncertain court proceedings for credit claims.

At the same time, it is worth considering introducing an out-of-court regime for firm liquidation. Such a system has recently been introduced in other OECD countries, such as Japan (OECD, 2017d). An out-of-court regime for firm liquidation should aim to start debt resolution proceedings at an early stage, to prevent the deterioration of the debtor's assets, and to make the financial state of the debtor transparent, which often reveals hidden assets. Increases in the value of collectable assets should be shared with the debtor, incentivising them to be engaged in the debt resolution process. This would complement measures implemented as part of Budget 2018 that allowed creditors to deduct losses incurred as part of the debt resolution process from their corporate taxes, thus encouraging their participation.

Table 5. Past recommendations related to improving financial stability

Recommendation	Action taken since the February 2017 Survey
Strengthen current regulatory incentives for reducing non-performing loans, including through write-offs and sales.	A comprehensive strategy to reduce NPLs has been in force since late 2016. It encompasses initiatives in 3 key pillars, coordinated among all relevant stakeholders: i) Legal/judicial, tax and other relevant reforms; ii) Prudential supervisory action; iii) NPL management options, including the possibility to develop system-wide solutions.
Support the development of a market for distressed debt, notably through the creation of asset management companies.	The Portuguese authorities conducted a study which found that the potential for a bulk transfer of the NPLs in the banking system to an asset management company is low.

Addressing medium-term challenges for the economy

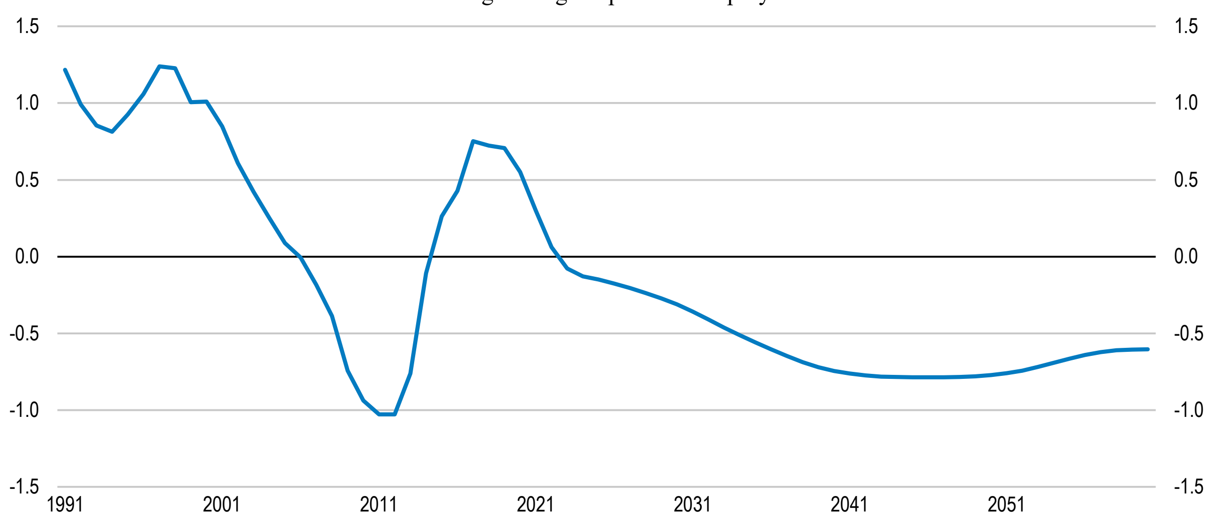
As noted earlier, wellbeing along most dimensions remains well below that in other OECD countries and there has been limited convergence in living standards over the past few decades. To further narrow these gaps, the Portuguese authorities must continue to reinvigorate the economy. Two key channels will be through ensuring that the working age population have the capability and opportunities to participate more effectively in the labour market and reawakening productivity growth.

Improving labour utilisation and reducing poverty

The pool of available labour will begin to decline from 2023 as the population ages (Figure 21). This will result in weaker economic growth, unless there are improvements in the utilisation of the existing labour resources, especially through getting unemployed or marginalised workers back into jobs. Measures that ensure that such workers have better opportunities to find jobs, improve their skills and derive the benefits from increasing their productivity will also raise the inclusiveness of the Portuguese society and overall wellbeing.

Figure 21. The pool of labour is expected to decline over the long run

Percentage change in potential employment



Note: Potential employment takes account of working age population, trend labour force participation and the equilibrium unemployment rate.
Source: OECD Long-term baseline model.

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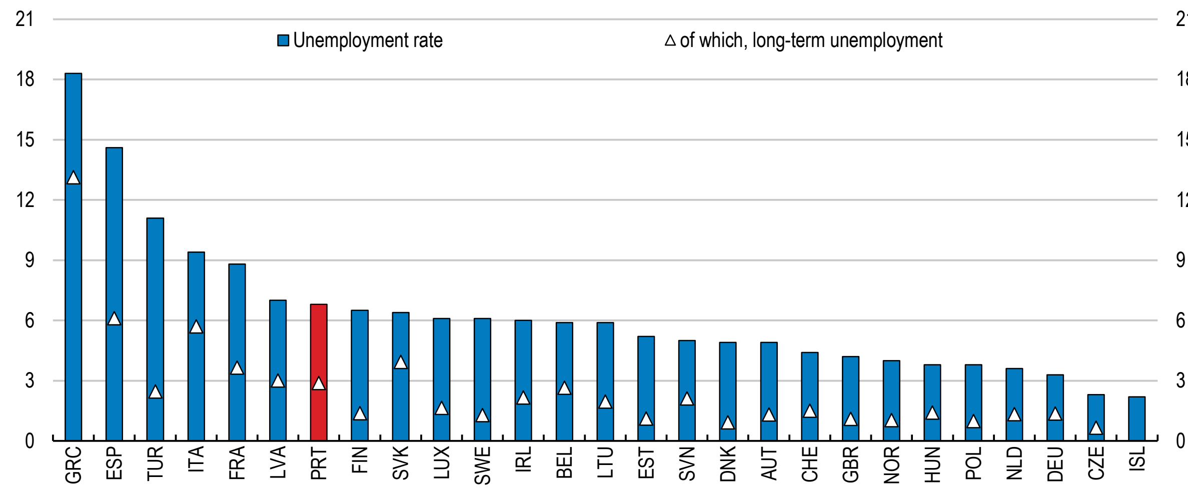
Although declining rapidly, unemployment among the youth and the low-skilled remains elevated in Portugal. This is especially the case for young people with no previous work experience. Many other young workers have only intermittent employment, moving in and out of short duration jobs. The long-term unemployment rate remains high (Figure 22), with the low-skilled representing around two-thirds of all long-term unemployed adults (Düll et al., 2018). Indeed, poor skills is among the most common employment barriers faced by the unemployed (Figure 23; Düll et al., 2018).

Figure 22. Incidence of long-term unemployment is high in Portugal

As a percentage of total labour force, 2018 Q3



Source: Eurostat Labour Force Survey database.

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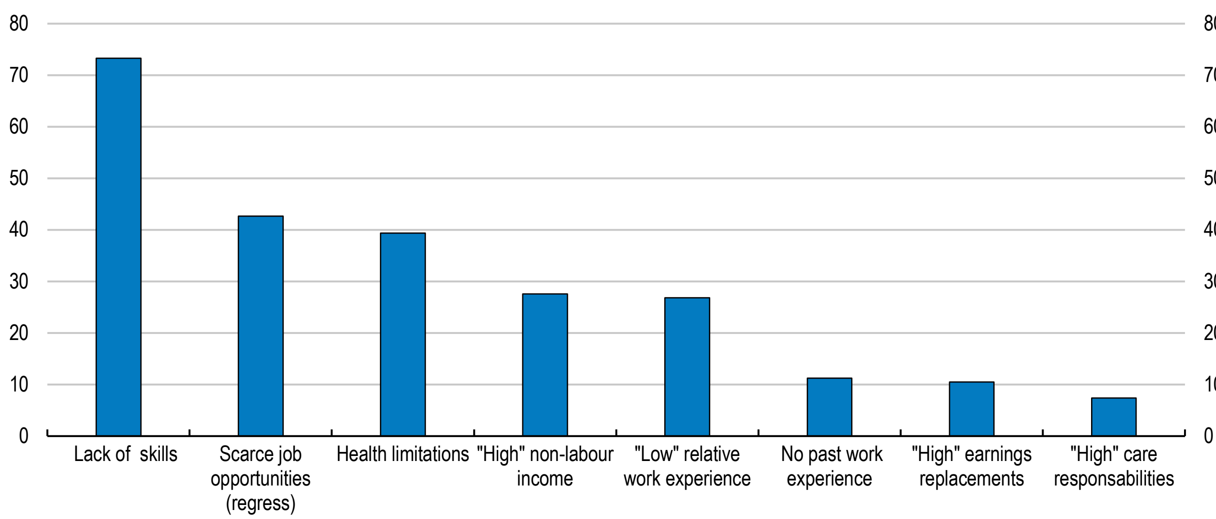
Figure 23. Low-skilled people face significant employment barriers

Percentage of those unemployed or weakly attached to the labour market facing each identified employment barrier



Note: Unemployed people often face a number of employment barriers that prevent them from returning to work. OECD (2018) attribute/estimate such employment barriers to each unemployed person. The chart reports the proportion of unemployed or people marginally attached to the labour market that face each employment barrier. An individual can face multiple employment barriers, thus the blue bars in the figure do not sum to 100.
Source: OECD (2018), "Faces of joblessness in Portugal".

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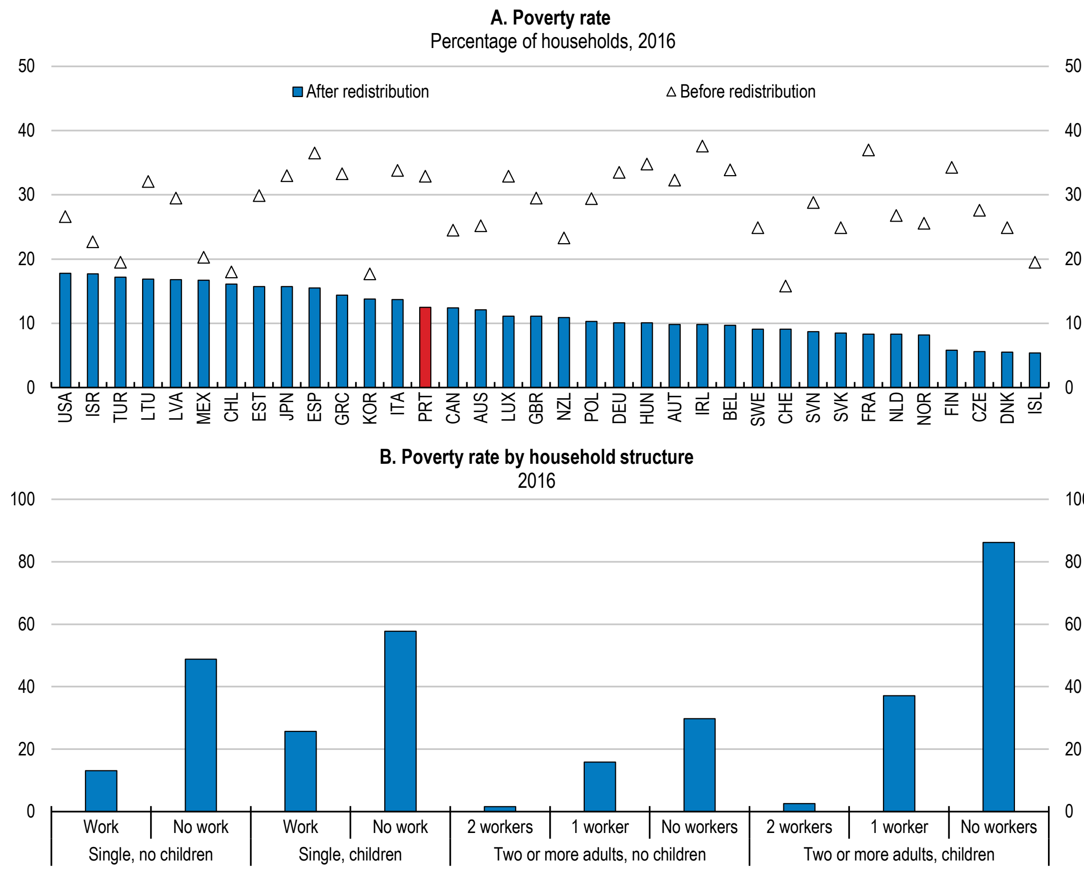
Poverty in market income is high in Portugal (Figure 24, Panel A), concentrated on jobless households with children (Figure 24, Panel B). Poverty is greatly reduced when measured in disposable income (Figure 24, Panel A), largely due to income support. The *Subsidio de desemprego*, standard unemployment benefit, is relatively generous. Those who are not eligible for unemployment insurance may benefit from various other support measures, including the *Rendimento Social de Inserção* minimum income support which is subject to a means test. This support was reduced in early 2010s in the context of the fiscal crisis, in particular for households with dependents and children. This reduction will be fully reversed by 2019, which will help alleviate poverty in such households. Such benefits should continue to be strictly conditional on active job search, which will be effective as long as relevant activation and employment support measures are in place (see below).

Figure 24. Poverty is high in jobless households



Source: OECD Income Distribution and Poverty Database.

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Public employment services have increased their support to jobseekers

Since 2012, the *Instituto do Emprego e da Formação Profissional* (public employment service) has been reformed in a comprehensive way under the programme "*Programa de Relançamento do Serviço Público de Emprego*". It has been further enhanced by the recent "One-stop-shop for Employment" project as part of the SIMPLEX+ programme. These policy initiatives enhanced coordination with other public services, notably with the Institute for Social Security and improved online services for users with digital skills. The public employment service also strengthened its job-broking function, upgrading the online vacancy database and strengthening the co-operation with employers, namely by introducing dedicated case managers for relevant employers ("Gestor+"). These measures can help jobseekers who are relatively job-ready.

At the same time, the public employment service enhanced its supports to jobseekers. It has provided a range of labour market programmes based on the individual assessment of jobseekers, including counselling, internships, hiring subsidies, training, employment on public works and referral to a job interview. In exchange, it has strictly implemented the requirements to meet with caseworkers, in particular, for the two target groups: those aged 45 years and above and those unemployed for six months and longer. This strengthened conditionality significantly raised the employment prospects of jobseekers (Martins and Pessoa e Costa, 2014). Since 2016, this approach has been strengthened to make labour market programmes more personalised and developed in collaboration with jobseekers. As part of this, greater flexibility in the frequency with which users must engage with public employment services has been introduced (i.e. depending on individual circumstances) and the criteria for the assignment of managers to jobseekers have been revisited.

Labour market programmes should raise the employability of jobseekers

Traineeship programmes, including on-the-job training, can help individuals to acquire relevant job skills and to enter the labour market. A stronger emphasis on training measures recently translated into an increase in the coverage of registered jobseekers in traineeships, from below 10% in early 2016 to above 14% in the second half of 2018. Nevertheless, participation rates in adult education and training are particularly low in Portugal, especially for those that are unemployed or inactive.

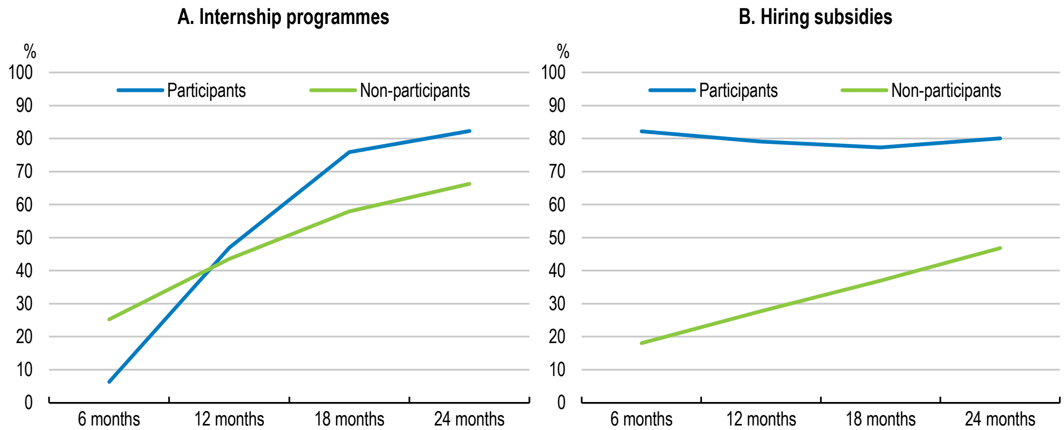
The government is strengthening professional traineeship programmes. *Estágios Emprego*, introduced in 2013, targets mainly youth aged 18-30 or those who recently completed school. Its objective includes facilitating school-to-work transition. The programme lasts for 9 to 12 months. OECD (2017e) shows that the programme significantly improves the employment outcomes of training participants (Figure 25). In 2017, the government introduced new professional traineeships ("*Estágios Profissionais*") targeted at young people that included a one-off payment to employers that hired a trainee after the traineeship had concluded (Table 6).

Some jobseekers need intensive up-skilling and re-skilling programmes. Such training programmes include "*Aprendizagem*", a dual initial vocational training programme, and "*Cursos de Educação e Formação de Adultos*" (Adult Education and Training) that provides general and technological education. These two longer-duration programmes have positive employment effects, though such effects tend to appear only several years after participation (Düll et al., 2018). It is important to note that both *Aprendizagem* and *Cursos de Educação e Formação de Adultos* are associated with a qualification level at the end of the course (MTSSS, 2018). These programmes should be expanded to reach as many low-skilled people as possible.

Qualifica, an adult education and training package programme, came into force in January 2017. It aims at raising the qualification level of adults and their employability by tailored training pathways, mainly targeting low-skilled adults and young NEETs. It is built on the Recognition Validation and Certification of Competences, which ensures a formal recognition of non-formal learning and skills acquired through work experience. Participants in *Qualifica* are referred to relevant programmes including *Aprendizagem* and *Cursos de Educação e Formação de Adultos*. *Qualifica* is a promising programme, which combines many policy measures already proven effective at raising the employment prospects of jobseekers and ensuring as many NEETs as possible stay in touch with the labour market.

Figure 25. Labour market programmes differ in effectiveness for re-employment

Estimated employment ratios over time after the start of the programme



Note: Individuals who enrolled in one of these programmes at time t are compared to a set of "control" or similar individuals who did not enrol in that programme at time t. The control group is formed using propensity score matching techniques. More specifically, individuals are matched on the basis of age, gender, marital status, number of children, years of schooling, date of registration with the PES and previous employment history. The chart compares the employment outcome between the two groups t+6, t+12, t+18 and t+24. For Panel A, the employment outcome of the participants at t+6 should take account of the fact that most of them are still enrolled in the internship programme, which is not considered to be in employment ("lock-in" effects).
Source: OECD (2017), "Labour Market Reforms in Portugal 2011-15: A Preliminary Assessment".

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Employment outcomes will also benefit from improvements in the adult education system. As detailed in the 2017 OECD *Economic Survey of Portugal*, there is particular scope for further reforms to vocational education and training (VET) arrangements (OECD, 2017c). Although the offering of VET education has greatly expanded over the recent decade, the system is fragmented with both the governance of the VET system and VET provision divided across ministries. This increases the risk of overlaps and inefficiencies in the use of resources and reduces the effectiveness of quality control.

At present, the Ministry of Education is responsible for VET courses designed for youth at secondary education level. In addition, the Ministry of Labour coordinates and delivers VET courses through the IEFP (the Institute for Employment and Vocational Training), which also provide secondary-level education attainment (e.g. *Sistema de Aprendizagem*). The IEFP courses have a stronger dual training element, combining classroom teaching with practical experience in industry. Across OECD countries, programmes with such a work-based component tend to be associated with better employment prospects (OECD, 2015a), having been implemented in countries including Austria, Germany and Switzerland. In addition to the public VET courses, private providers also offer a variety of VET programmes. However, in some instances, there have been concerns about the quality of training provided. As recommended in the 2017 OECD *Economic Survey of Portugal,* the two VET systems under the responsibility of the government should be consolidated into a single dual VET with strong workplace training. This should be accompanied by a thorough evaluation of all the existing VET education programmes offered across the public and private sectors.

At the same time as bolstering adult education and training programmes, the authorities should focus on encouraging participation by those most in need. The OECD recently published guidance on the implementation of a skills strategy for strengthening the adult-learning system in Portugal (OECD, 2018b). This emphasised the need to overcome the motivational barriers to participating in training. To do this, information on the returns to different types of education should be disseminated, especially to those unemployed and with low skills. However, this will require the government to collect better quality data about the skills of the adult population and the returns, in terms of income and employment prospects, of accumulating different types of skills.

Hiring subsidies are another focus of the government in facilitating the transition of jobseekers into employment. *Contrato-Emprego*, in place since 2017, targets difficult-to-place workers, such as youth and long-term unemployed, and is basically reserved for permanent contracts. As also found in OECD (2017e), the impact of hiring subsidies on employment is immediate and significant. However, it is not clear if the impact is durable and tends to disappear often when subsidies terminate. It is worth evaluating the current provisions (OECD, 2017e). This is especially the case given prevailing fiscal constraints. Employment prospects can be strengthened differently, for instance, through work experience being validated by a formal qualification (such as through the Recognition Validation and Certification of Competences system). Subsidies tend to induce employers to substitute between those employees who benefit from them and those who do not (Crépon et al., 2013). Thus, hiring subsidies need to be limited to those most in need, such as those at a very high risk of long-term unemployment and extreme poverty.

Improving employment conditions for more and better quality jobs

The incidence of hiring on temporary contracts is still high. Around 18.5% of employees are on temporary contracts, one of the highest proportions in the EU. Employment protection for permanent workers remains very strict when compared with temporary workers. This is in spite of a reform undertaken in the 2011-14 period, which included a reduction in severance pay for regular workers while also introducing changes in the legal framework for fixed-term contracts. The reform did increase hiring on permanent contracts, and facilitated job flow generally (OECD, 2017e).

A Tripartite Agreement in July 2018 aimed to reduce labour market dualism by limiting the legal framework of temporary contracts, namely by lowering the maximum accumulated duration of fixed-term contracts and by narrowing the conditions under which fixed-term contracts were authorised for permanent tasks. This was a step in the right direction for reducing labour market duality while still allowing flexibility for the business sector to grow as new opportunities arose. Past reforms had established an individual bank of hours that allowed employers and individual employees to increase normal working hours by up to two hours per day (up to a limit of 150 hours per year). However, these reforms are expected to be amended, no longer allowing such agreements at the individual-worker level. The June 2018 Tripartite Agreement foresaw the elimination of the individual bank of hours, while establishing that the bank of hours can be adopted by collective agreements or by group agreements reached by consultation with workers. This policy reversal may have a negative impact on employment and business investment.

Collective bargaining has become more frequently utilised in the past few years, after having weakened in the aftermath of the crisis. Recent tripartite agreements between the government and social partners have aimed to further revitalise collective bargaining, through making it acceptable to as many parties as possible. For instance, a maximum period for analysis, consultation and issuance of extension orders was established, that contributed to decreasing the risk of having delayed extensions that required the payment of sizeable pay arrears, which was perceived to be particularly costly for firms (OECD, 2017e). Going forward, collective bargaining should remain flexible so that wages are aligned with productivity developments at the firm level. As discussed in the 2017 OECD *Economic Survey of Portugal*, one aspect of achieving this would be to introduce more stringent representativeness requirements for administrative extensions of collective bargaining agreements and opt-out possibilities for individual firms (OECD, 2017e).

Table 6. Past recommendations related to improving labour utilisation and reducing poverty

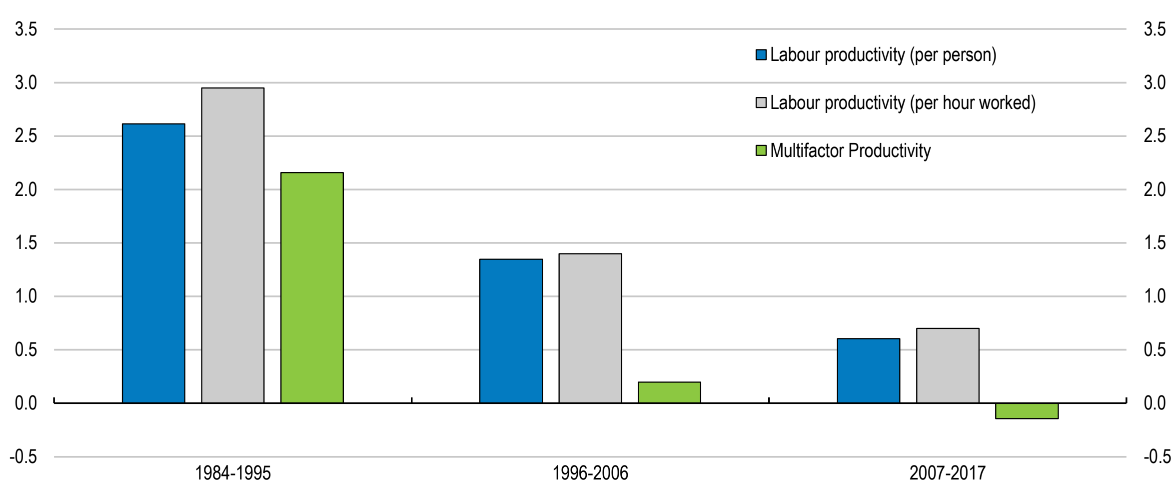
Recommendation	Action taken since the February 2017 Survey
Systematically monitor the outcomes of the different active labour market programmes with a view to concentrating resources on the more effective programmes.	A study of active labour market programmes identified that some programmes had low employability outcomes and led to poor quality employment outcomes. These findings prompted a reorientation of the main active labour market policies with the aim of promoting greater efficiency of employment supports by public employment services.
Reduce labour market duality to improve the job quality and strengthen learning incentives.	A tripartite Agreement signed by the Government and the majority of Social Partners in July 2018 aimed to reduce the maximum accumulation duration of fixed-term contracts from 3 years to 2 years. It also aimed to increase the financial contribution of employers that use fixed-term contracts excessively. Decree Law 72/2017 extended the duration of the exemptions of social security contributions for young people obtaining their first job (for a period of five years) and the long-term unemployed (for a period from three to five years), in order to promote permanent contracts.
Consolidate the two VET systems into a single dual VET with strong workplace training and perform a thorough audit of all vocational training programmes.	No action taken

Reinvigorating productivity growth

Productivity growth has notably slowed in the past two decades (Figure 26). This is a major policy challenge, since gains in living standards are driven by productivity growth in the long-run. The main determinants of a country's long-run level of productivity include regulations, governance, institutions and human capital (Guillemette et al., 2017). Implementing the related reforms recommended in this *Survey* are estimated to have marked positive effects on GDP per capita over the coming years (Box 2).

Figure 26. Productivity growth has slowed in Portugal

Annual average growth (%)



Note: For multifactor productivity, data are only available up to 2015.
Source: OECD Productivity Indicators.

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Box 2. Quantification of the structural reforms recommended in this survey

This box quantifies the effect of some of the structural reforms for Portugal recommended in this Survey based on the OECD's most recent quantification framework (see Égert and Gal, 2017). The effects are derived from a range of time-series cross-country reduced-form panel regressions on a sample of OECD countries. The estimated effects are allowed to vary across countries as a result of differences in factor shares, the level of the employment rate and a country's demographic composition. The approach is illustrative and results should be interpreted with care.

Table 7. Illustrative impact of structural reforms on GDP per capita

	Total effect on GDP per capita		
	5-year effect	*10-year effect*	*long-term effect*
Product market regulations			
Regulations in energy, transportation, communications (ETCR)	0.2%	0.3%	0.7%
Regulations in professional services	0.15%	0.3%	0.7%
Quality of institutions			
Strengthening contract enforcement	0.75%	1.5%	3.9%
Labour market policies			
Improve active labour market policies	0.15%	0.2%	0.4%
Trade openness			
Reduce barriers to trade	0.9%	1.3%	2.8%
Total	2.1%	3.6%	8.5%

Note: Calculations are based on a 10% policy change scenario, which corresponds to lowering the sub-indicator for the transport sector from 3.04 to 2.74, resulting in a reduction in the OECD indicator of Regulations in Energy, transportation, communications (ETCR) by 0.101 point; lowering the sub-indicator for the legal service sector from 3.88 to 3.49, resulting in a reduction in the OECD indicator of Professional Services from by 0.097 point; increasing the Rule of Law indicator from the World Bank "Worldwide Governance Indicators" from 1.13 to 1.24; and increasing ALMP spending per unemployed as a ratio to GDP per capita from 8.1% to 8.9%. The effects of trade openness are estimated by assuming the typically observed change of an increase by 4 percentage points in the trade to GDP ratio (the "typically observed change" is measured as the average improvement in the variable over all two year windows that showed improvements in both periods across OECD countries in the past).
Source: OECD calculations.

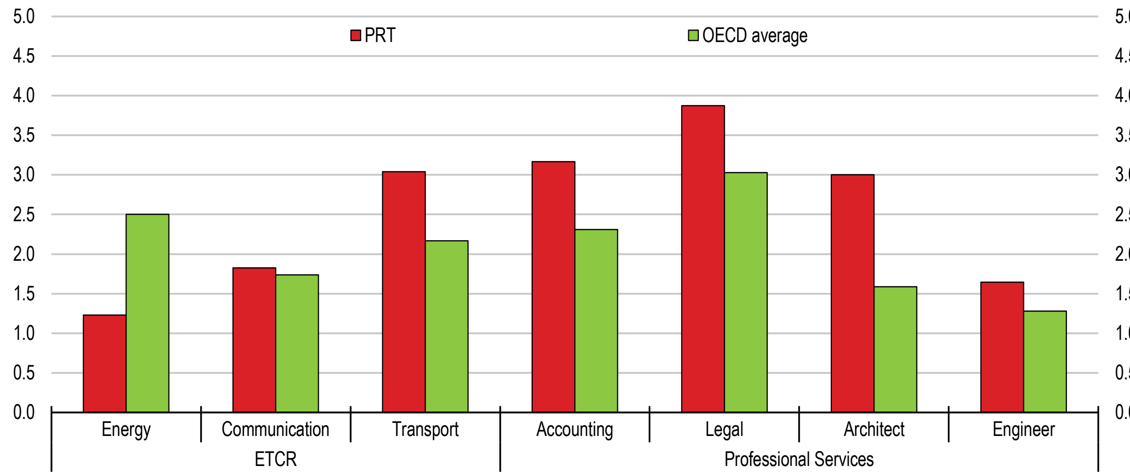
The regulatory framework can be further improved

Well-functioning product markets enhance the market selection mechanism and the efficiency of resource allocation, boosting aggregate productivity (OECD, 2015b). Firm-level empirical analysis has highlighted the strong relationship between a regulatory environment that promotes competition and productivity growth in Portugal (Carvalho, 2018).

Regulations in the services sector have direct effects on productivity as well as indirect effects on downstream industries that use services as intermediate inputs to production (Conway and Nicoletti, 2006). Indeed, tackling inefficient regulations in the services sector can reduce the price of intermediate inputs and raise the quality of products. OECD indicators of regulation in non-manufacturing sectors identify excessively stringent regulations in various professional services and the transport sector (Figure 27). Of the professional services, regulatory settings in the legal sector are particularly strict.

Figure 27. Regulation remains stringent in some sectors

OECD indicators of regulation in non-manufacturing sectors



Note: The OECD Indicators of Product Market Regulation are a comprehensive and internationally comparable set of indicators that measure the degree to which policies promote or inhibit competition. The indicator ranges from zero (least stringent) to six (most stringent).
Source: OECD Product Market Regulations Statistics (database).

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The Bar Association both represents its members and regulates the exercise of the profession. For the legal profession, a certain degree of regulation is warranted to ensure the quality of services offered. However, self-regulation tends to identify with the interests of the regulated profession, rather than the public interest (Canton, Ciriaci and Solera, 2014). Such self-regulation in the legal profession covers exclusive rights for lawyers and restrictions on entry, lawyers' fees, and the form of business (OECD, 2018c).

While the Bar Association maintains its role as self-regulator, the implementation of self-regulation can be ensured by an independent supervisory body. In Portugal, the law states that lawyers' fees are freely negotiated between the parties. The law specifies the criteria on which the fee structure should be based, including the number of hours worked, the value of claims, the lawyer's qualifications, and the complexity of cases. These criteria are very detailed and exhaustive, and not easily understood by clients, which can hamper competition in the legal services market (OECD, 2018c). The establishment of an independent supervisory body could allow for impartial assessment of legal costs and make them more transparent. Such an independent body could also deal with disputes over the legal contract brought by clients.

Productivity growth within enterprises benefits from well-functioning transport infrastructure (Kemmerling and Stephan, 2008). This is especially the case for exporting firms that rely on such infrastructure to reach end markets. Nevertheless, perception-based indicators highlight that the quality of transport infrastructure in Portugal is low compared with other southern European countries such as Spain and Italy (see Chapter 1). A particular area of focus should be improving the efficiency of the port system, which is currently impeded by a host of regulatory settings that reduce competition between operators (OECD, 2018d).

Portuguese ports follow the "landlord port" model whereby the port authority manages and invests in the main port infrastructure, while private entities are able to operate port activities. This arrangement is sometimes formalised through the concession of exclusive rights to a single private operator for a period of time, usually when ongoing private competition is not viable or substantial investment is required by the operator. However, the duration of port concession contracts in Portugal are frequently excessive, reducing the potential for market entrants that can provide higher quality services at a lower price to service the business sector. Furthermore, there is a very weak correlation between the investment spending of private operators and the length of concession contracts awarded (OECD, 2018d).

When awarding such concessions, a competitive awarding procedure should be undertaken to ensure transparency and that the best operator is given the contract. However, some concessions have been renewed at the end of a contract for an extended period without a new competitive awarding procedure, reducing the potential for the most efficient operator to provide port services (OECD, 2018d). The criterion for awarding port concessions also gives insufficient consideration to the bidder who will charge the lowest price to port users. Given the importance of these services for business sector productivity and future export performance, the likely impact of a provider on end user costs should be more carefully considered.

Improvements to the port system can achieve their maximum potential productivity benefits if combined with better connections to international rail freight services. Rail density is low in Portugal and rail links between the Portuguese and Spanish freight market have been too limited. Furthermore, differences in the rail gauge and lower maximum train lengths compared with other key European markets, such as France and Germany, reduces the potential volume of trade. In recent years, better rail connections with Spain have been prioritised, including the planned Évora-Elvas-Caia rail line that will connect parts of Portugal with Spanish transport hubs. Differences in the signalling system to other countries and sections of the train network along the Iberian Peninsula which are not electrified are also key challenges for inter-European rail connections with Portugal. These are well recognised by the Portuguese authorities and overcoming them should continue to be a priority.

Some important institutions and governance need to be strengthened

Productivity developments in the long run are not only shaped by regulation, but also by governance and institutions which implement the legislation. They comprise such elements as the rule of law, regulatory quality, government effectiveness, and control of corruption. According to recent OECD research (Guillemette et al., 2017), there is still significant scope for Portugal to raise productivity by improving governance and institutions.

Perceptions of corruption matter, not least for foreign direct investment. To improve confidence in core institutions, the authorities are committed to investigating and punishing wrongdoing. For example, the Public Prosecution Office has strengthened the collection and analysis of evidence to improve the effectiveness of anti-corruption investigations and the cooperation with audit and control bodies to improve the detection of graft (European Commission, 2018b). Associated projects were partly financed by European structural funds at a time when the budget of the Public Prosecution Office was cut. There has also been a parliamentary committee established, with the aim of improving transparency in public offices.

Trust in public procurement among Portuguese firms is low, with firms often perceiving problems with direct awards and non-competitive procedures (Eurobarometer, 2017). Of all contracts, the majority have typically been direct awards. Such contracts are sometimes justified based on extreme urgency. However, in the past, this concept was often interpreted broadly, contributing to excessive procurement through direct awards. In early 2018, a reformed Public Procurement Code entered into force, transposing European Directives. The reformed Code aims at promoting transparency and better management of public contracts, making stricter restrictions on direct awards and other conditions for higher value non-competitive procedures. To ensure that it is effectively enforced, the government has strengthened the Court of Auditors' auditing powers and capacity to perform ex-ante and ex-post control of public contracts (European Commission, 2014).

There is also a need to continue ensuring that the judiciary has the capacity to prosecute economic and financial crimes. The Public Prosecution Office and the Criminal Investigation Police must be allocated adequate resources to continue undertaking forensic investigations of economic and financial crimes, which can be long, complex and resource-intensive. When adjusting for price differences across countries, the funding of the public prosecution office on a per capita basis in Portugal is comparable with most other European jurisdictions, although it is notably lower than in some countries such as Switzerland and the Netherlands in which the available indicators suggest perceived corruption is very low. It should be noted that such comparisons of budget allocations do not take into account cross-country differences in the remits of public prosecution offices. The government has pledged to create a public registry of interests for local government officials, which should help the public prosecution office perform its duties, though this has not yet been implemented (European Commission, 2018b). Such a registry should be kept in electronic form, regularly updated and monitored.

In the next few years, a significant proportion of the current stock of public prosecutors will be retiring, meaning that there needs to be a strong effort in recruitment. In tandem, adequate specialised training for public prosecutors on economic and financial crime should continue to be provided. The Prosecutor General should require public prosecutors to attend such training and set aside funding for this purpose. Strengthening the capacity of the Prosecutor General should help deter corruption from occurring.

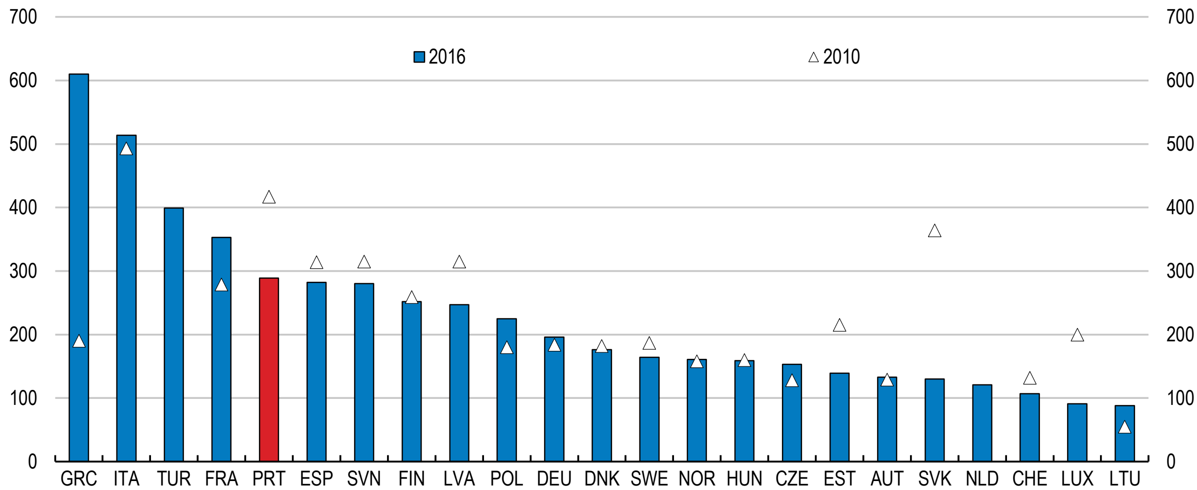
Reliable judicial systems are crucial to make sure laws and regulations are actually enforced. In this respect, court judgement should be speedy and effective. To do so, court resources should be allocated efficiently through strengthening the governance structure and workload assessment (see Chapter 2). Also, specialised courts with national jurisdiction for corruption could be considered. Such courts currently operate in some other OECD countries, such as the Slovak Republic. The appeal procedures should also be reviewed to prevent abuse.

Portuguese firms report judicial inefficiency as one of the most severe constraints to their operations (INE, 2018). Judicial efficiency, as measured by trial length, facilitates market transactions by ensuring timely contract enforcement and reducing transaction costs, thus promoting competition. It also facilitates financial transactions by ensuring creditors' rights, promoting investments and innovation. It is a critical aspect of the framework conditions needed for doing businesses and attracting FDI (Chapter 1).

Court congestion has been declining due to recent reforms, but the time to resolve a case in the court system remains long (Figure 28). In 2013, the government introduced a new Code of Civil Procedure that simplified a number of court procedures. It also introduced the Law for the Judicial System Organisation in 2014, which reformed the organisation of courts and aimed to increase the managerial responsibility of courts. Court resources have also been increased over the past few years. However, there remain significant bottlenecks in some courts (Figure 29), pushing up the average trial length.

Figure 28. Court proceedings are shorter than before, but still long

Average time needed to resolve civil and commercial cases, first instance courts, in days

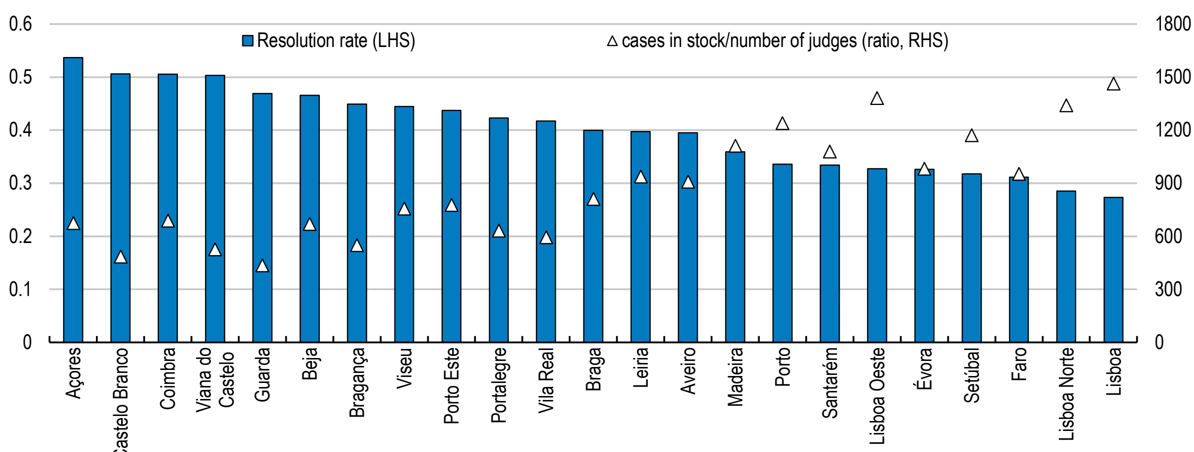


Source: CEPEJ.

StatLink http://dx.doi.org/10.1787/888933911763

Figure 29. Significant bottlenecks remain in some court districts

Civil cases, 2017



Note: The resolution rate = the number of resolved cases / [the number of pending cases from previous year + the number of incoming cases].
Source: Ministry of Justice and High Council for the Judiciary.

StatLink http://dx.doi.org/10.1787/888933911782

The efficiency with which the existing resources are allocated is a key factor to explain overall court performance (Palumbo et al., 2013). Inefficiencies can result from problems in workload assessment and a lack of effective management of resources. A significant challenge for judges is to identify which cases should be prioritised in order to alleviate court congestion. A new information system, CITIUS, was introduced in 2007 in order to electronically store all information belonging to a proceeding. When functioning properly, such an information system can be a powerful tool in assessing judges' caseloads. Although CITIUS was unable to identify blockages in judicial proceedings previously, the system has evolved and now includes such features as the detection of cases that have been in the system for several years. These features can serve as early warning devices, which can be more fully utilised to identify problematic cases and those that should be prioritised, so that resources can be allocated accordingly.

The governance structure of courts is a critical element for the allocation of resources. In each court, the Court President, who is a judge that is appointed by the High Council for the Judiciary, is accountable for court performance. The 2014 reform on the organisation of courts created a global managerial model including a Court President in each district court, who supervises court performance. The Court President can propose to the High Council for the Judiciary a reallocation of judges, but this reallocation may be limited by the total number of judges in the system and by the fact that the number of judges in each court district is determined by law, although allowing flexibility. In this context, the courts should be given increased operational autonomy in order to achieve the objectives for which they are responsible.

Further recalibrating the economy for greener growth

Portugal's CO_2 emissions per unit of GDP are below the OECD average (Figure 30, Panel A). However, the country has not made further progress in decoupling emissions from GDP in recent years. Portugal is on course to reach its target, agreed with the European Union, to reduce greenhouse-gas emissions not covered by the EU Emissions Trading System (ETS) by 17% by 2030 relative to 2005 levels. However, further reductions will be needed beyond this point, as net emissions worldwide need to move close to zero on a net basis around 2060.

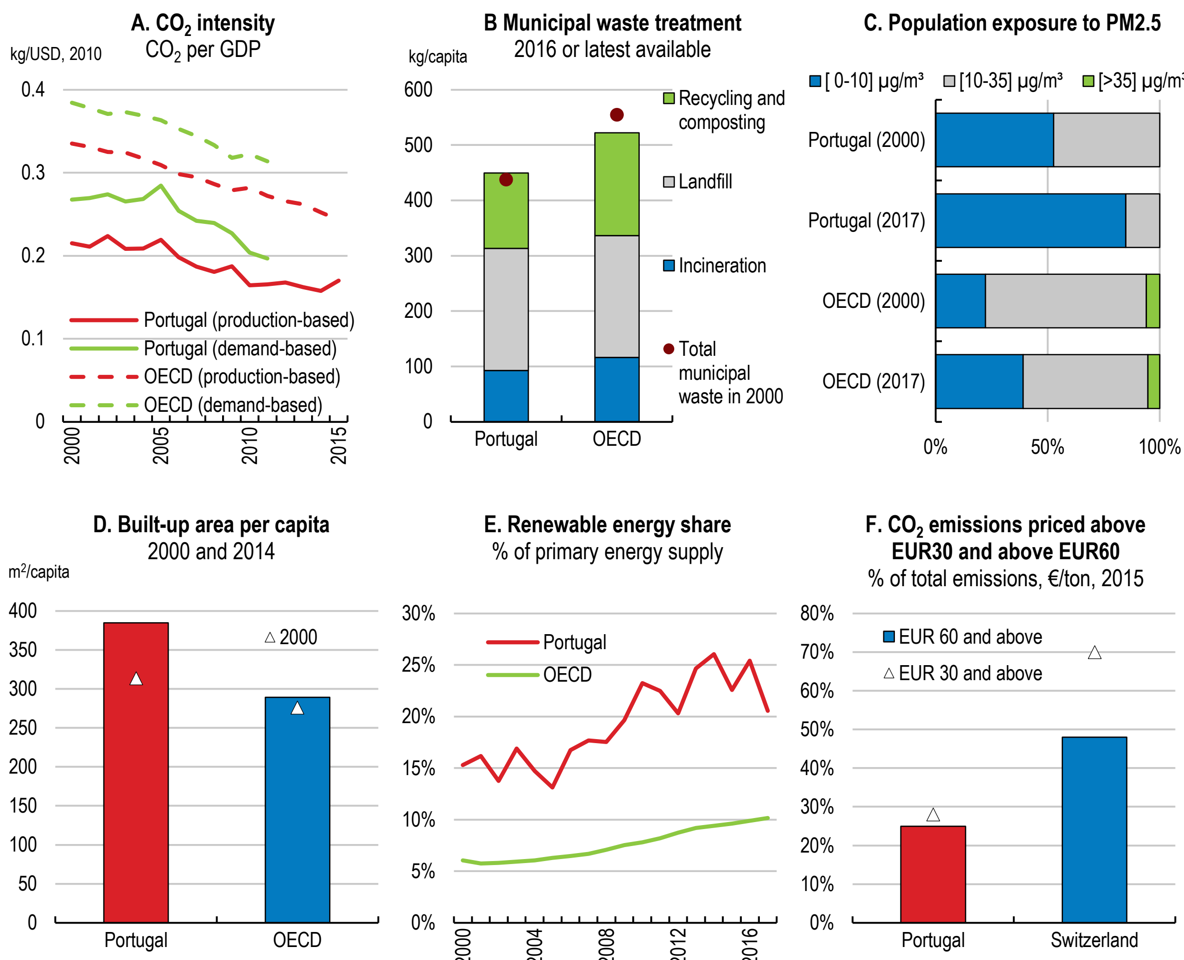
Portugal disposes close to half of its municipal waste through landfill, even though landfill generates environmental costs in terms of water and air pollution. Little waste is recycled, foregoing opportunities for reusing materials and reducing energy cost of materials processing (Figure 30, Panel B). Landfill taxes and fees in Portugal are among the lowest across the EU. Gradually and predictably raising taxes, for example in a way similar to that recently observed in the United Kingdom, will reduce landfill and encourage recycling.

Exposure to small particle emissions in Portugal is lower than in most OECD countries (Figure 30, Panel C). Nevertheless, more than 3500 Portuguese die prematurely as a result of ambient particulate matter per year, with the rate rising since 2010 (Roy and Braathen, 2017). Built-up surfaces per capita have increased markedly since 2000 (Figure 30, Panel D). Urban sprawl, with low-density housing in suburban areas, raises pollution and CO2 emissions substantially, by lengthening urban trips and making it more difficult to meet urban transport demand with public transport. Average population density in Portuguese cities is close to the OECD average but is uneven, with a high share of low-density residential areas (OECD, 2018e). Tourism may also have contributed to rising built-up areas.

Renewable energy sources account for a significant share of energy supply (Figure 30, Panel E) and Portugal is on track to meet the target of 31% of renewables in final energy consumption by 2020. The majority of fossil fuel-based energy is imported. Imports account for over 70% of energy demand, substantially higher than the OECD average. Energy supply from renewable sources increased by almost 70% between 2005 and 2016 and accounted for 55% of electricity generation in 2016 (OECD Green Growth Indicators). The surge has been driven mainly by the expansion of wind energy generation, which increased 14-fold between 2004 and 2015.

The development of renewables in Portugal has been impressive, but the high rate of widespread feed-in tariffs for such technologies has contributed to a significant tariff deficit in the electricity sector. The accumulated tariff debt reached 4.69 billion euros in 2014 (IEA, 2016). While the tariff deficit has decreased since then and the government plans to phase out all feed-in tariffs by 2020, it should ensure that efficient market mechanisms are in place for further sustainable expansion of renewables. Given Portugal's dependence on imports of fossil fuels, further investment in renewable energy not only has the potential to lower GHG emissions but also to improve energy security. Reforming electricity markets to provide high-resolution prices, better allocation of transmission and distribution networks costs, the integration of storage and more inter-connected grid systems favour the cost-effective expansion of renewable energy (IEA, 2016).

Figure 30. Green growth indicators: Portugal



Source: OECD (2018), Green Growth Indicators (database).

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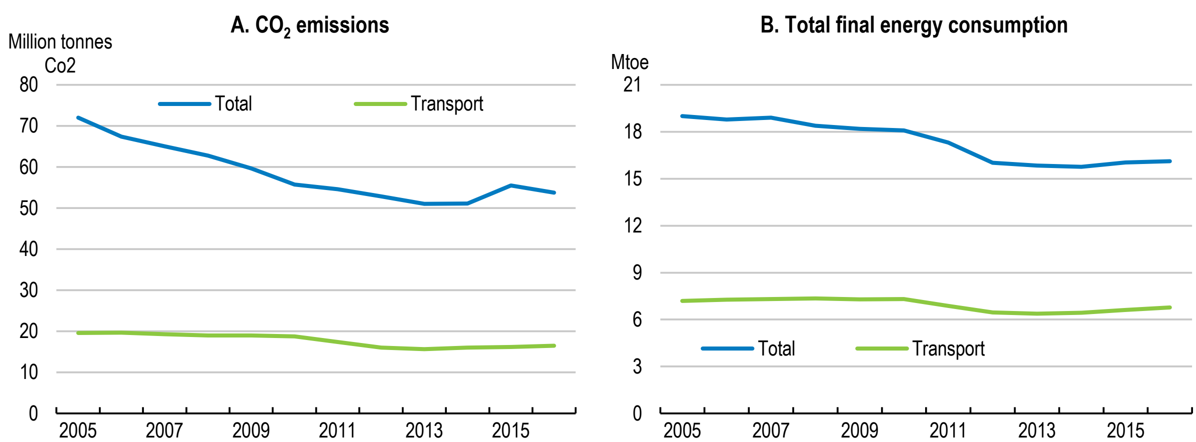
More consistent pricing of energy consumption according to its CO_2 intensity would prepare Portugal for meeting longer-term emission reduction requirements in a cost-effective manner, including by boosting incentives to reduce energy consumption and to produce more renewable energy. It could also raise more tax revenue. Pricing of carbon emissions remains low and uneven. Only 28% of emissions from energy use in Portugal are priced above EUR 30 per tonne (Figure 30, Panel F), the low-end estimate of carbon costs today (OECD, 2018f). Outside the transport sector, emissions are priced at a much lower rate. This partly reflects relatively low ETS prices in these other sectors, but domestic taxation of energy use also remains uneven. In industrial, commercial and residential use, coal and natural gas are taxed less than petrol (OECD, 2018f). As discussed earlier, in transport, diesel is taxed 40% less than petrol.

The transport sector accounts for 42% of Portugal's total final consumption of energy, higher than the EU average, and a third of CO_2 emissions. Both energy consumption and emissions in the transport sector have declined since peaking in 2005, although at a rate much lower than overall energy consumption and CO_2 emissions reductions (Figure 31). Nevertheless, energy and CO_2 intensities have hardly fallen in the last years, in contrast to the downward trend observed among other OECD countries. The Portuguese government has recently introduced a number of initiatives aimed at improving transport efficiency. These measures include a revision of the taxation for private car ownership to encourage low CO_2 emissions vehicles, development of a network of charging stations for electric vehicles and introduction of a Low Emissions Zone in Lisbon which bans high emissions vehicles from entering the inner city centre. Nevertheless, further measures are needed in order to promote greater use of public transport and its efficiency, as Portugal is currently ranked second highest in the EU in terms of the proportion of passenger cars used relative to public modes of transport (Eurostat Statistics).

Figure 31. CO2 emissions and energy consumption from transport have declined relatively slowly



Source: IEA Energy Statistics.

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Efficient collective transport schemes can contribute to lower congestion and emissions. They can also reduce the use of public space for parking. Recent simulations using micro data from Lisbon has highlighted that a shift from private car use to ride-sharing could have substantial benefits for reducing CO2 emissions, freeing up public parking and eliminating congestion (International Transport Forum, 2016). When combined with public transport, ride sharing also has the potential to provide more efficient and environmentally-friendly transport solutions at lower cost. While large-scale introduction of such modal shift would be a long-term project, the government should encourage both public transport use as well as the development of new shared transport solutions accompanied by appropriate supervision and regulations. This would improve efficiencies in the transport sector and reduce its environmental impacts.

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Annex. Progress in structural reform

This Annex reviews actions taken on recommendations from the previous Survey. Recommendations that are new to this Survey are listed at the end of the Executive Summary and the relevant chapters.

RECOMMENDATION	ACTION TAKEN SINCE THE FEBRUARY 2017 *SURVEY*
Macroeconomic policies	
Maintain momentum for structural reforms, in conjunction with a continuous ex-ante and ex-post evaluation of reforms.	The results of ex-post evaluations of the policy changes outlined in the annual National Reform Programme are now being published in subsequent National Reform Programme publications.
Continue gradual fiscal consolidation to ensure the decline of public debt without jeopardising the recovery.	The fiscal balance has improved and gross public debt (Maastricht definition) has moderated.
Reduce tax exemptions, special rates and tax expenditures.	The Minister of Finance created a special working group to review existing tax benefits. The working group shall present their report by the end of March 2019.
Strengthen current regulatory incentives for reducing non-performing loans, including through write-offs and sales.	Measures have recently been adopted to reinforce the comprehensive 3-pillar strategy to reduce NPLs which has been in force since late 2016. In particular; • Introduction of the "Platform for Integrated Management of Bank Loans" in 2018 to manage the negotiation of non-performing loan claims and guarantees on behalf of three major Portuguese lenders (CGD, BCP Millennium and Novo Banco); • The reform of the Special Revitalisation Proceedings (PER) regime in 2017 as part of "Programa Capitalizar"; • NPL reduction plans were submitted by three banks with high NPLs to regulators following the "Guidance to banks on non-performing loans" published by the ECB in March 2017.
Support the development of a market for distressed debt, notably through the creation of asset management companies.	The authorities conducted a study which claims the potential for a bulk transfer of NPLs to an asset management company is low.
Strengthening business investment	
Improve the workings of insolvency rules by: Reconsidering the privileged treatment of public creditors. Enlarging the scope for simple-majority decisions among creditors. Shortening out-of-court settlement procedures.	A one-stop-shop is being established and will enhance the coordination among public creditors to facilitate insolvency proceedings. A new out-of-court process (Regime Extrajudicial de Recuperação de Empresas, RERE) was introduced in 2018, replacing the previous one (SIREVE). The Special Revitalisation Proceedings (PER) regime, aiming at corporate restructuring, was reformed in 2017 to strengthen its effectiveness.
Revise land use regulations and limit discretionary powers of municipalities in licensing procedures.	No action taken
Ease entry requirements for professional services.	OECD Competition Assessments of the transport sector and the regulated professions were published with the cooperation of the Portuguese Competition Authority in July 2018. Specifically concerning the construction sector, measures have been implemented under the Simplex program.
Further reduce trial length and the backlog of pending court cases by expanding court capacity and assigning specialised judges to specialised courts.	No action taken
Phase out electricity generation schemes with guaranteed prices sooner than currently planned.	No action taken
Improve the efficiency of ports by renegotiating concession contracts, attaching service level agreements to any new concessions and promoting intra-port competition between terminals.	No action taken
Promote wage bargaining at the firm level, including by placing more binding limits on administrative extensions of wage agreements.	The Resolution of the Council of Ministers No. 82/2017 established the maximum period for consultation and the issuance of extension ordinances to be 35 working days.
Consider allowing refunds of research and development tax credits for low-making firms or extending the carry-forward period significantly.	SME now have an extended carry-forward period of 12 years. In the context of *Programa Capitalizar*, a more flexible regime for tax credits was settled.
Raising skills	
Target life-long learning programmes towards the low-skilled.	The Qualifica programme aims to raise the qualification level of adults. There is also a specific programme which targets those with the lowest qualification called Vida Ativa Qualifica+.

Systematically monitor the outcomes of the different active labour market programmes with a view to concentrating resources on the more effective programmes.	A study of active labour market programmes identified that some programmes had low employability outcomes and led to poor quality employment outcomes. These findings prompted a reorientation of the main active labour market policies with the aim of promoting greater efficiency of employment supports by public employment services.
Progressively reduce grade repetition in primary and secondary education by identifying students at risk early on and developing early individualised support.	The current government is targeting a reduction of 50% of school failure by 2020.
Consolidate the two VET systems into a single dual VET with strong workplace training and perform a thorough audit of all vocational training programmes.	No action taken
Strengthen the links between research and the business sector through better incentives for academics to co-operate with industry.	The Interface Programme, launched in February 2017, aims to accelerate technology transfer from universities to companies via Interface Centres
Collect and publish indicators of labour market outcomes (employment, unemployment rates, wage premiums) by level of education and area of study and at the regional level to allow for better-guided education and career choices.	The Institute of Employment and Training publishes data related to registered unemployment by level of education and field of study and at the regional level.
Ensure adequate coverage of early childhood care across the country, including for children younger than 4 years of age and with a particular focus on those from disadvantaged socio-economic backgrounds.	Additional pre-schooling classes were opened in 2017. A new legal framework that dictates children's allocation to schools takes into account the socioeconomic vulnerability of a family.
Strengthen teacher training and exposure to best practices and enlarge the probationary induction period for beginning teachers.	In 2018/2019, the Ministry of Education will provide a full-time teacher to coordinate each of the the 81 School Associations Training Centres.
Create incentives to attract the most experienced teachers and principals to disadvantaged schools.	No action taken
Take better account of students' profiles and specific needs when allocating resources across schools and provide more autonomy to schools to adjust class size accordingly.	Class size was reduced 2 students per class in the schools of more vulnerable contexts in 2017. In 2018, this reduction was extended to all schools in the country.
Reduce labour market duality to improve the job quality and strengthen learning incentives.	A tripartite Agreement signed by the Government and the majority of Social Partners in July 2018 aimed to reduce the maximum accumulation duration of fixed-term contracts from 3 years to 2 years. It also aimed to increase the financial contribution of employers that use fixed-term contracts excessively. Decree Law 72/2017 extended the duration of the exemptions of social security contributions for young people obtaining their first job (for a period of five years) and the long-term unemployed (for a period from three to five years), in order to promote permanent contracts.
Raise managerial skills by developing specific training courses for managers.	No action taken

Thematic chapters

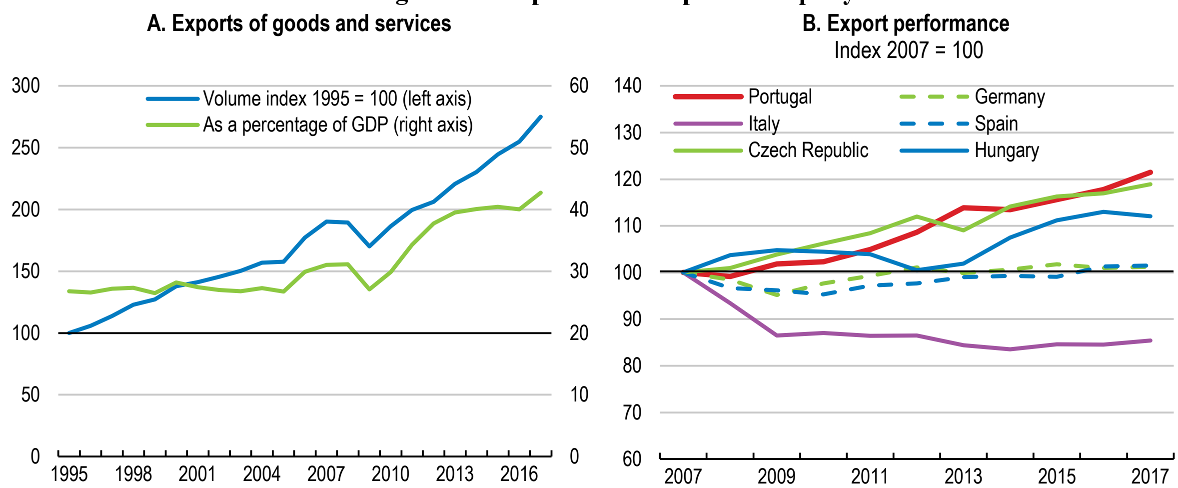
Chapter 1. Public policy reforms to further improve export performance

Portugal's export performance over the past decade has been impressive, helping to reduce external imbalances. This partly owed to a sequence of structural reforms that benefited the productivity of the export sector and led to an increase in its size. Nonetheless, exports as a share of GDP and the stock of foreign direct investment remain below that of other comparable small European economies. Further shifting the orientation of the economy to the external sector is vital for Portugal given the strong link between trade openness and GDP per capita. To do this, policymakers must ensure that policy settings incentivise exporting firms to expand and improve their competitiveness, both through lower price and improved quality. For example, regulatory barriers that reduce competition in professional services should be lowered to improve the price and quality of intermediate inputs. Increasing the efficiency of domestic infrastructure is also key, especially through competition-enhancing reforms to the port sector. To further differentiate and improve Portuguese export products, skills in the business sector need to be enhanced through better-targeted lifelong learning opportunities. At the same time, there is a need to focus innovation policies on raising the participation of small and medium enterprises in innovative activities.

Introduction

Portugal's export performance has been impressive, sustaining the economy through years of weak domestic demand in the wake of the banking and sovereign debt crisis. Between 2009 and 2017, the volume of exports expanded by over 60% (compared to around 20% during the 2001-2009 period), causing the share of exports in Portugal's GDP to rise from around 30% to 44% during a period of weak economic growth (Figure 1.1, Panel A). This has been associated with an expansion in exports' market share, an indication of improved competitiveness (Figure 1.1, Panel B). Inward foreign direct investment as a percentage of GDP also trended higher over the period.

Figure 1.1. Exports have expanded rapidly



Note: Export performance measures the expansion of a country's exports relative to the expansion of import demand from its trading partners. Improvements in export performance reflect rising market shares in the imports of trading partners.

Source: OECD (2018), OECD Economic Outlook: Statistics and Projections (database).

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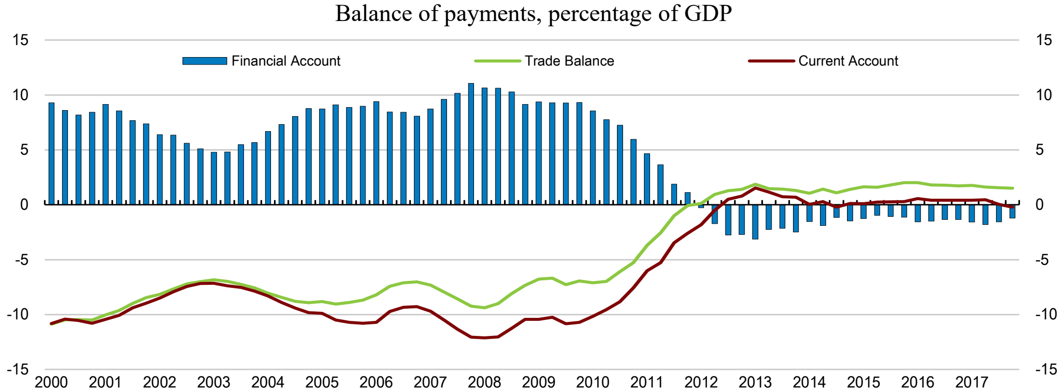
The strong performance of the external sector has helped Portugal begin to reverse external imbalances (Figure 1.2). Such imbalances built up prior to the financial crisis as export competitiveness stagnated and private debt for consumption, housing and construction purposes grew rapidly. External liabilities narrowed from their peak in 2012 of just below 250% of GDP to around 210% by the end of 2017.

Figure 1.2. External imbalances have declined

Balance of payments, percentage of GDP



Source: Eurostat.

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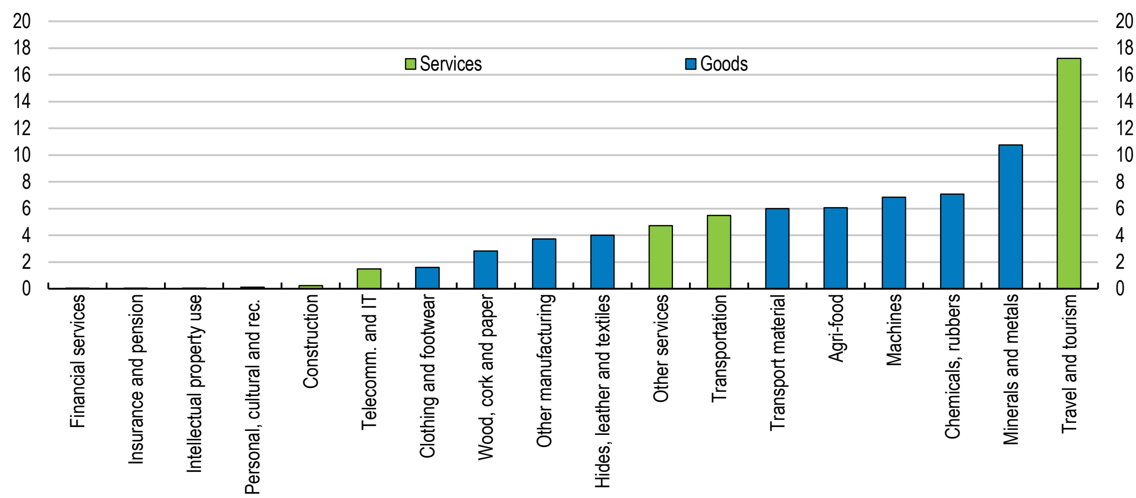
Part of the improvement in exports has been due to strong growth in travel and tourism. Over one-fifth of the growth in exports between 2009 and 2017 was directly attributable to the tourism industry, with other closely related sectors such as transportation also having a strong positive effect (Figure 1.3). The growth in tourism has been particularly marked since 2013. This has coincided with an increase in the supply of tourist accommodation (IMF, 2017) and in the capacity of low-cost airlines flying to Portugal (European Commission, 2018). An escalation of perceived security risks in competing markets has been a contributing factor to the surge in tourists, though one that may prove transitory (Box 1.1). However, the boom in tourism has only been part of the story. A number of manufacturing sectors also contributed strongly to Portugal's export growth in the post-crisis period. These included minerals, chemicals, machinery and agri-food (Figure 1.3).

Figure 1.3. Tourism has accounted for a large share of recent export growth

Contribution to total export growth over the 2009-2017 period, percentage



Source: Bank of Portugal, OECD calculations.

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Box 1.1. The durability of the tourism upswing

Some signs of diversification in Portugal's tourism sector bode well for its durability over the medium-term. However, a segment of tourist flows may have become more exposed to sudden reversals given that it has been motivated by security concerns in competitor markets that could fade.

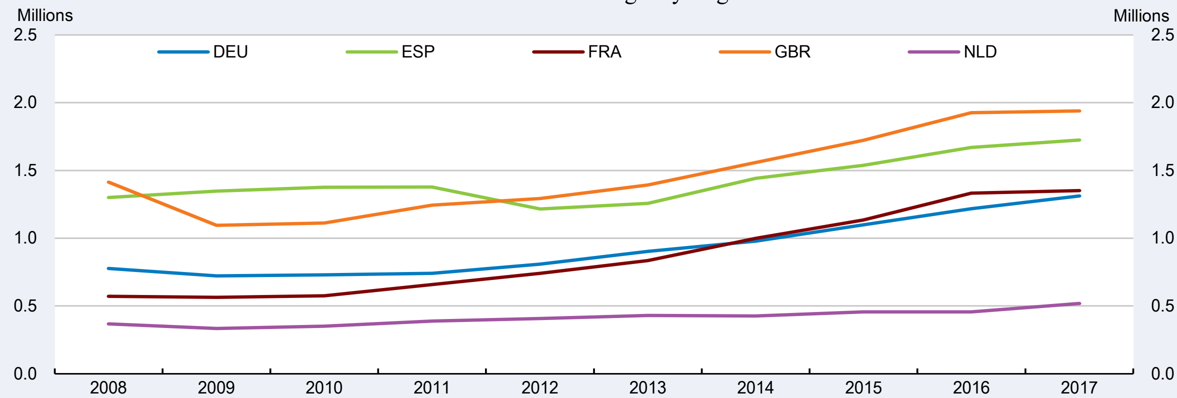
The number of overnight tourists visiting Portugal rose 64% between 2009 and 2016. Since 2009, the age profile of tourists in Portugal has gradually broadened beyond the core 25-64 age group. The proportion of all tourists aged above 64 rose from 9% to 17% between 2008 and 2016. There have also been signs of greater geographic diversification of tourist flows within Portugal, with the proportion of tourists destined for the three main tourist regions (Algarve, Northern and Central Portugal) having slightly declined from 73% to 70% over the 2008-16 period. The share of local tourists also declined over the period, with the majority of tourists now being non-residents.

At the same time, the origin of overseas tourists has become slightly less concentrated. Overseas visitors from Portugal's top four country markets fell from 53% to 50% between 2013 and 2017. Since 2009, there was a notable increase in visitors from the

United Kingdom, causing British visitors to overtake Spaniards as the main visitors (Figure 1.4).

Figure 1.4. The United Kingdom has become an increasingly important origin of tourists

Number of tourists to Portugal by origin market



Source: OECD (2018) OECD Tourism Trends and Policies; Statistics Portugal.

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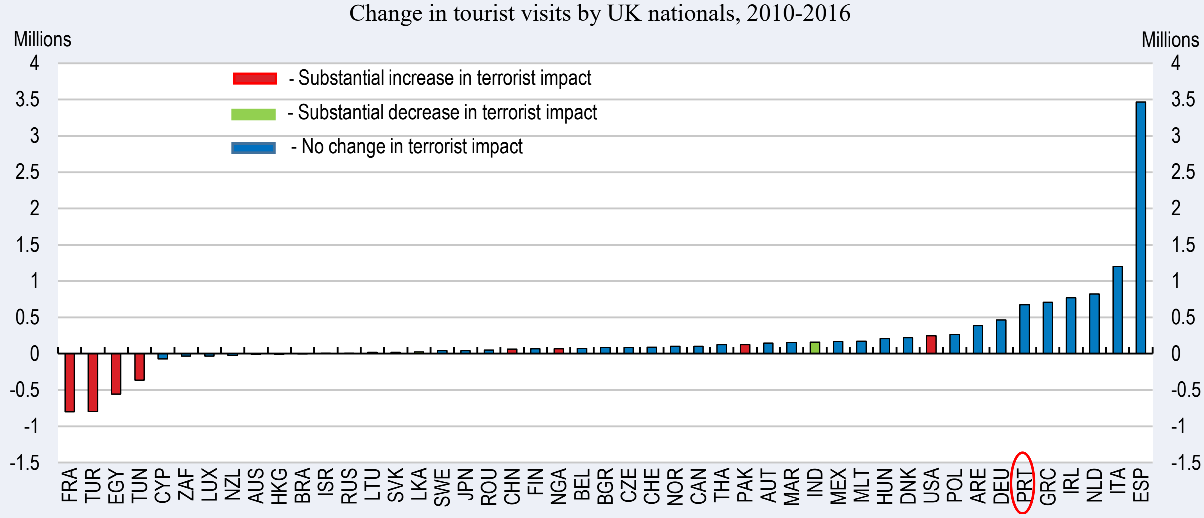
One factor cited for the pick-up in tourist flows to Portugal has been heightened perceptions of security risk in competitor markets (Economist Intelligence Unit, 2018). Focusing on German tourists in the early 2000s, (Ahlfeldt, Franke and Maennig, 2015) highlighted the potential for terrorist activities in a destination country to prompt tourists to substitute towards other similar locations they perceive to be more safe. Data on the destination of outbound tourists from the United Kingdom does signal that recent tourist flows have been sensitive to terrorist events (Figure 1.5).

Figure 1.5. Increased security risk in some destinations appears to have discouraged some tourists

Change in tourist visits by UK nationals, 2010-2016



Note: A "substantial increase in terrorist impact" is defined as an increase of at least 30% in the number of terrorist-related deaths in the country in the 2011-2016 period compared with the 2005-2010 period and an absolute increase of at least 100 terrorist-related deaths. Similarly, a "substantial decrease in terrorist impact" is defined as at least a 30% decline in terrorist related deaths and an absolute decrease of at least 100 terrorist-related deaths over the same period.

Source: Office for National Statistics, Global Terrorism Database.

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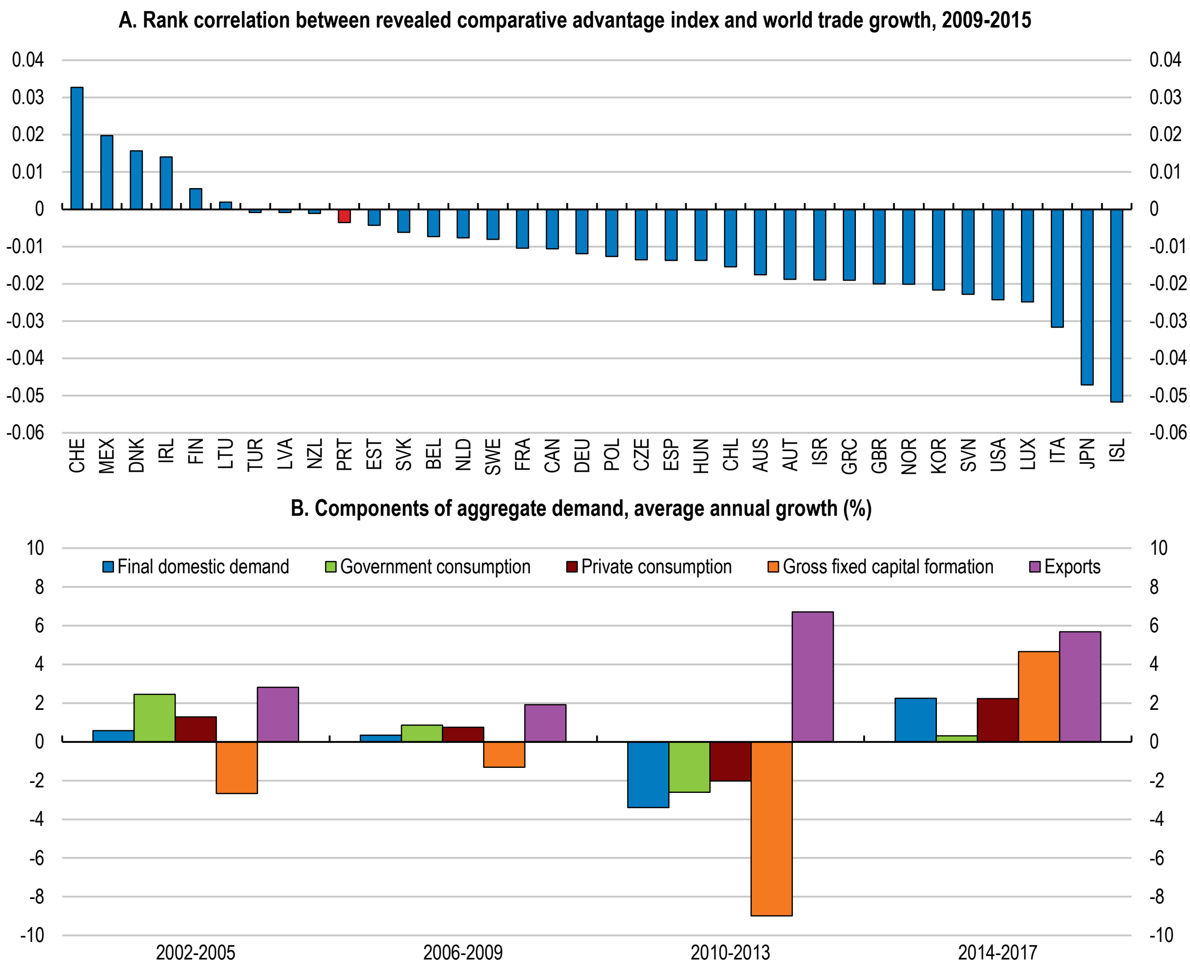
The decline in United Kingdom tourists between 2010 and 2016 to countries that faced an increased impact of terrorism such as France, Turkey, Egypt and Tunisia coincided with a rise in travellers to Portugal and some other southern European countries such as Spain, Italy and Greece.

Given these patterns, the capacity for a decline or stabilisation in perceived security risk elsewhere could lead some tourist flows that were redirected to Portugal to reverse. One illustrative historical example is the recent case of Turkey. There was a notable drop in tourists from the United Kingdom to Turkey in 2012 and 2013, coinciding with a substantial increase in the terrorist activities of the Kurdistan Workers Party. However, an appeasement in such activity over the following few years was accompanied by a stabilisation of tourist flows in 2014 before an increase of visitors by more than 10% in 2015. It is very difficult to generalise the impacts on tourist arrivals across heterogeneous security threats. Nevertheless, the Portuguese authorities should plan for the possibility that some of the recent boom in tourism could be unwound.

As part of the government's *Tourism Strategy 2027,* diversification, innovation and training in the tourism sector have been identified as some of the major priorities. The strategy embodies a long-term vision, accompanied by targets related to economic, environmental and social outcomes.

Focusing on manufacturing exports, while growth in foreign demand in those product markets in which Portugal is specialised was modest (Figure 1.6, Panel A), comparatively weak domestic demand growth contributed to more Portuguese firms increasing their efforts to export (Esteves and Rua, 2015). At the aggregate level, the negative relationship between domestic demand and exports appears to have been especially strong in the 2010-13 period (Figure 1.6, Panel B).

Figure 1.6. Both foreign demand for Portuguese exports and domestic demand have been weak



Note: In Panel A, the degree of specialisation in a product is proxied by the revealed symmetric comparative advantage index outlined by (Dalum, Laursen and Villumsen, 1998).
Source: OECD (2018), OECD Economic Outlook: Statistics Projections (database), Araujo, Chalaux and Haugh (2018).

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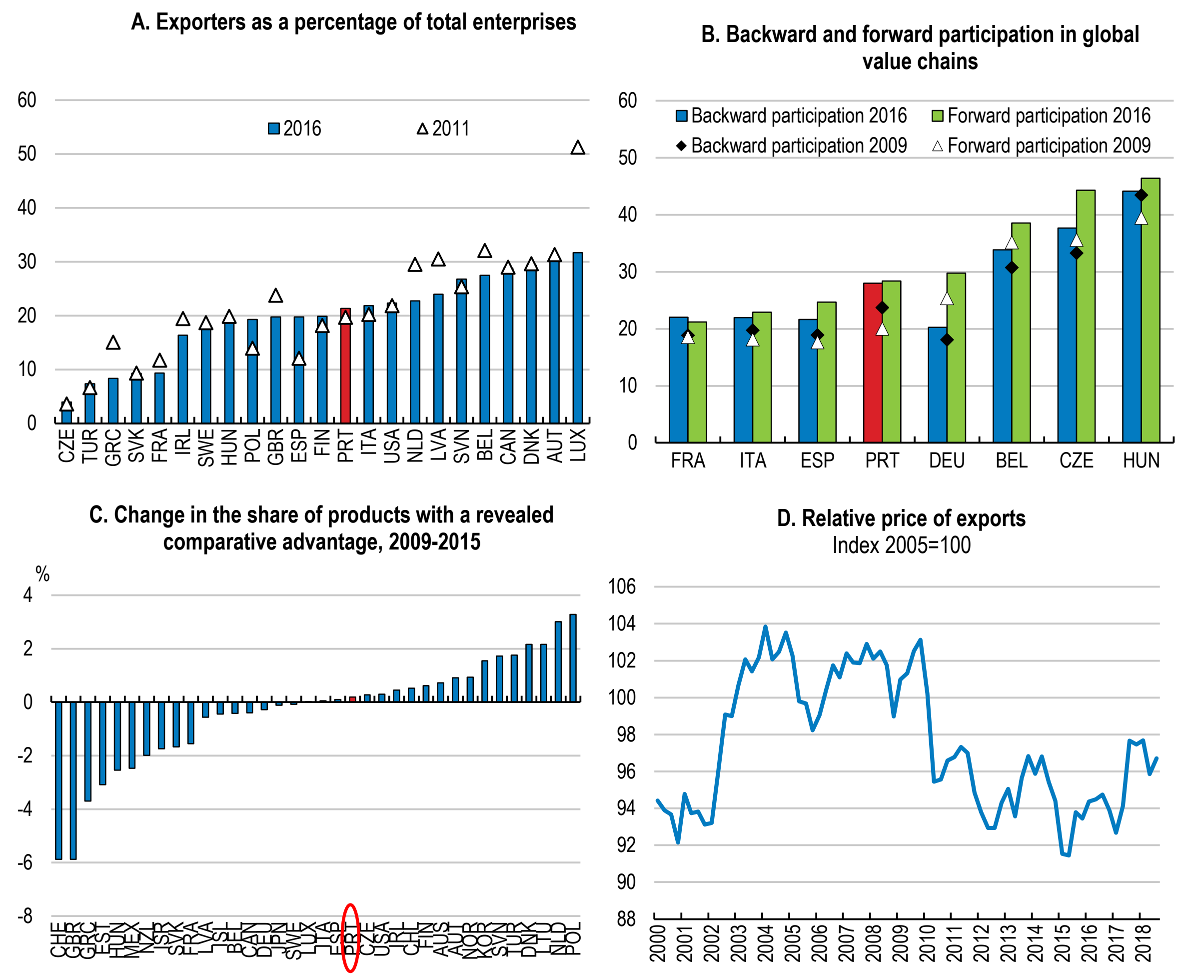
The post-crisis period was characterised by a slightly larger proportion of firms beginning to export (Figure 1.7, Panel A) and increased integration with global value chains (Figure 1.7, Panel B). Manufacturing exporters became specialised in a slightly broader set of product categories (Figure 1.7, Panel C) and notably improved the quality of export products (see Box 1.5 further below). Businesses increasingly cut labour costs and adopted more flexible price-setting behaviour (Martins, 2016). Indeed, despite sluggish productivity growth, Portuguese export prices relative to its competitors declined by around 6% in the 2009-2017 period (Figure 1.7, Panel D). The results of the regression analysis described in Box 1.2 suggest that both improvements in export quality and the decline in relative export prices positively impacted Portuguese exports through the period.

The ability for the business sector to become more outward oriented and undertake the necessary structural adjustments partly owed to a sequence of reforms. These included reductions in administrative burdens on businesses (discussed further below) and the elimination of policy barriers to foreign direct investment.

Figure 1.7. Some businesses adjusted to the cyclical shock



Note: In Panel A, data for Luxembourg refers to 2015, and for Turkey, United Kingdom and United States refer to 2014. In Panel B, backward participation is measured as the foreign value added share of gross exports for each country. In Panel C, the share of products is the number of products with a revealed symmetric comparative advantage on the total number of products exported by each country. A country has a revealed comparative advantage when the export share of product p in their export basket is higher than the corresponding share of product p in world exports. The data underlying Panel C are calculated using six-digit harmonised system product level that comprises 4350 different products. Forward participation is measured as the domestic value added share of foreign final demand. In Panel D, a trade-weighted measure of Portuguese export prices relative to those of competitor economies is presented. Further explanation of the index can be found in (Morin and Schwellnus, 2014).

Source: UN Comtrade database, OECD Structural Business Statistics, OECD Trade by Enterprise Class Database, OECD Compendium of Productivity Indicators, Araujo, Chalaux and Haugh (2018), OECD calculations based on Trade in Value Added (TiVA) Database and OECD Economic Outlook (database).

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Box 1.2. The drivers of Portuguese export performance

To explore the drivers of Portuguese export performance, a regression analysis was undertaken with the dependent variable being the growth in Portuguese exports over the 1995-2016 period. The analysis was performed using highly disaggregated product-level data (HS 6-digit level), which provided a large enough dataset to perform country-specific time-series analysis.

Explanatory variables include world demand, export product quality, relative export prices (those presented in Figure 1.7, Panel D) and domestic demand. Data are taken from various sources. For the dependent variable, export values at the 6-digit product-level are from the UN Comtrade Database. Export quality is proxied by an indicator of unit values at the 6-digit product-level from the CEPII-BACI database. This measure of export quality is also used in the analysis of Araujo, Chalaux and Haugh (2018).

Table 1.1. Determinants of Portuguese export growth

Dependent variable = Δln(exports)

EXPLANATORY VARIABLES	(1) Model 1	(2) Model 2	(3) Model 3
Δln(exports(-1))	-0.25***	-0.25***	-0.25***
	(0.00)	(0.00)	(0.00)
Δln(world demand)	0.23***	0.23***	0.23***
	(0.03)	(0.03)	(0.03)
Δln(export quality)	0.05***	0.05***	0.05***
	(0.01)	(0.01)	(0.01)
Δln(relative export prices (-1))		-3.06***	
		(0.68)	
Δln(domestic demand (-1))			-8.04***
			(1.79)
Constant	-0.07***	-0.17***	0.09*
	(0.02)	(0.02)	(0.05)
Observations	48,305	48,305	48,305

Note: Robust standard errors are in parentheses with *** p<0.01, ** p<0.05, * p<0.1. "ln" refers to the natural log and "(-1)" refers to the lagged value of the variable.

The regression results presented in Table 1.1 suggest that:

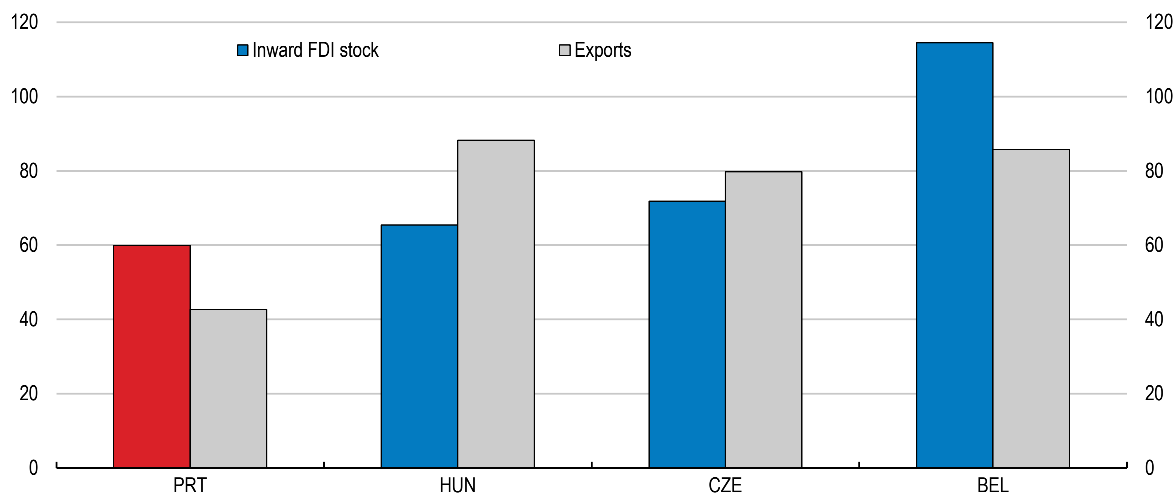
- Portuguese export growth was positively associated with export product quality and world demand.
- Portuguese export growth had a negative relationship with changes in relative export prices and domestic demand.

Based on these regression results, no one single factor can be identified as the overriding reason for Portugal strongly increasing its exports since 2009. While an improvement in price competitiveness played a role, the majority of the increase in exports appears to have been explained by other factors (for further discussion, see Adamczyk and Westmore, 2019).

Despite the rise in Portugal's economic openness over the post-crisis period, exports as a share of GDP and the stock of foreign direct investment remain below that of other comparable small European economies (Figure 1.8). Associated with this, participation in global value chains also remains low relative to these countries (Figure 1.7, Panel B). Ensuring that public policy settings promote further growth in the export sector is important given the strong link between trade openness and GDP per capita (OECD, 2018a). Further shifting the orientation of the economy to the external sector may be especially vital for Portugal given rapid population ageing will provide a headwind to future domestic demand growth. Such a transition will also help reduce the high external imbalances that continue to exist and heighten the fragility of the economy.

Figure 1.8. Export intensity is lower than in other small European countries

As a percentage of GDP, 2017 or latest available year



Source: OECD (2018), Trade in goods and services (indicator); OECD (2018), FDI stocks (indicator).

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The need to further improve export performance is recognised by the government. As part of the *Internacionalizar* programme, the authorities are aiming to raise the number of exporting small and medium enterprises (SMEs) and increase the overall value of exports to 50% of GDP by 2025. Over the medium-term, a more ambitious target is achievable, provided that sound economic policy encourages the necessary further structural adjustments in the economy and that the tourism sector continues to thrive.

A host of policy dimensions are key for promoting future export growth. Firstly, more firms need to be encouraged to export through policy settings that enable them to grow their businesses. Regulatory policies calibrated to allow and incentivise firms to expand must be complemented by a financial sector that efficiently allocates funding to high potential firms. Competitiveness and the attractiveness of the country for foreign direct investment can also be improved through policies that better support the efficiency of domestic transport, housing and digital infrastructure. At the same time, ensuring the population is accumulating useful skills and promoting innovation in the export sector will help further differentiate Portuguese products, promote productivity growth and increase the export value added accruing to the Portuguese economy.

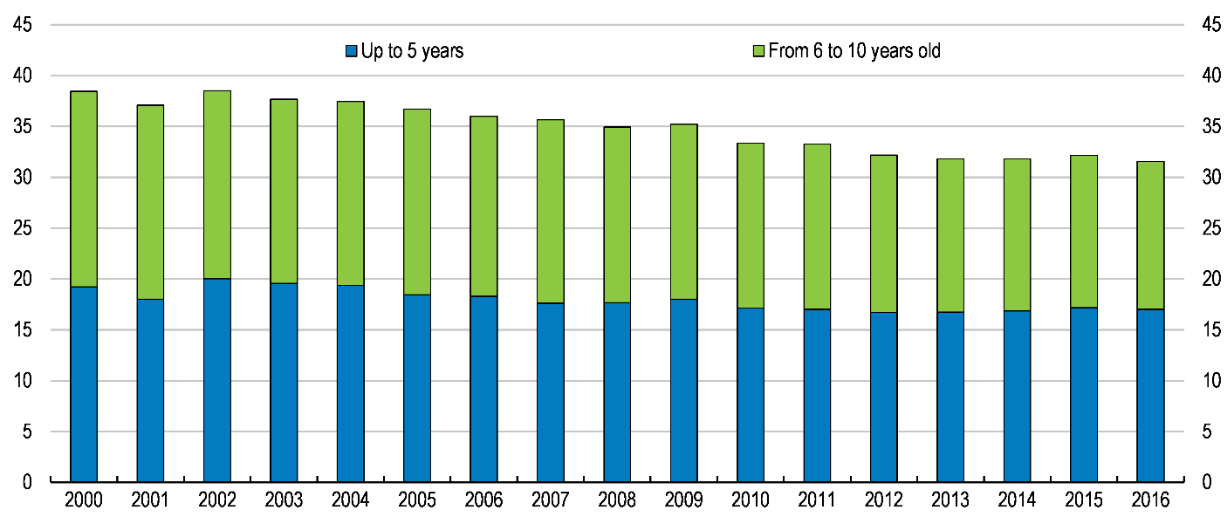
Improving the framework policies for high-potential businesses

Framework conditions that support an adaptable industrial structure enable firms to enter and exit markets in response to changing market conditions and grow unimpeded if they succeed. Such an environment both facilitates a greater share of firms becoming exporters and their ability to raise output if needed. With consumer preferences and technological progress evolving rapidly, such agility is particularly important for a small open economy like Portugal. To the extent that the expansion of high potential firms is facilitated by the reallocation of resources from less productive businesses, aggregate productivity of the export sector can benefit and cost competitiveness improve. Concomitantly, policy settings that foster favourable business dynamics can boost productivity growth in the non-tradable sector, reducing the costs to exporters of locally-sourced intermediate inputs.

Firm-level analysis from a census of Portuguese firms suggests that market entrants tend to have relatively high productivity growth compared to incumbent firms (OECD, 2017a). To the extent that firm entry enhances competitive pressures, new firms also increase the probability of other firms exporting (Correia and Gouveia, 2016). There is evidence that more productive firms increased their market share. Nevertheless, young firms played less of a role in the Portuguese manufacturing export sector in 2016 than in the lead up to the crisis (Figure 1.9).

Figure 1.9. A declining share of exporters are young firms

Percentage



Source: OECD calculations based on the *Comercio Internacional* and *Quadros de Pessoal* datasets obtained from Statistics Portugal.

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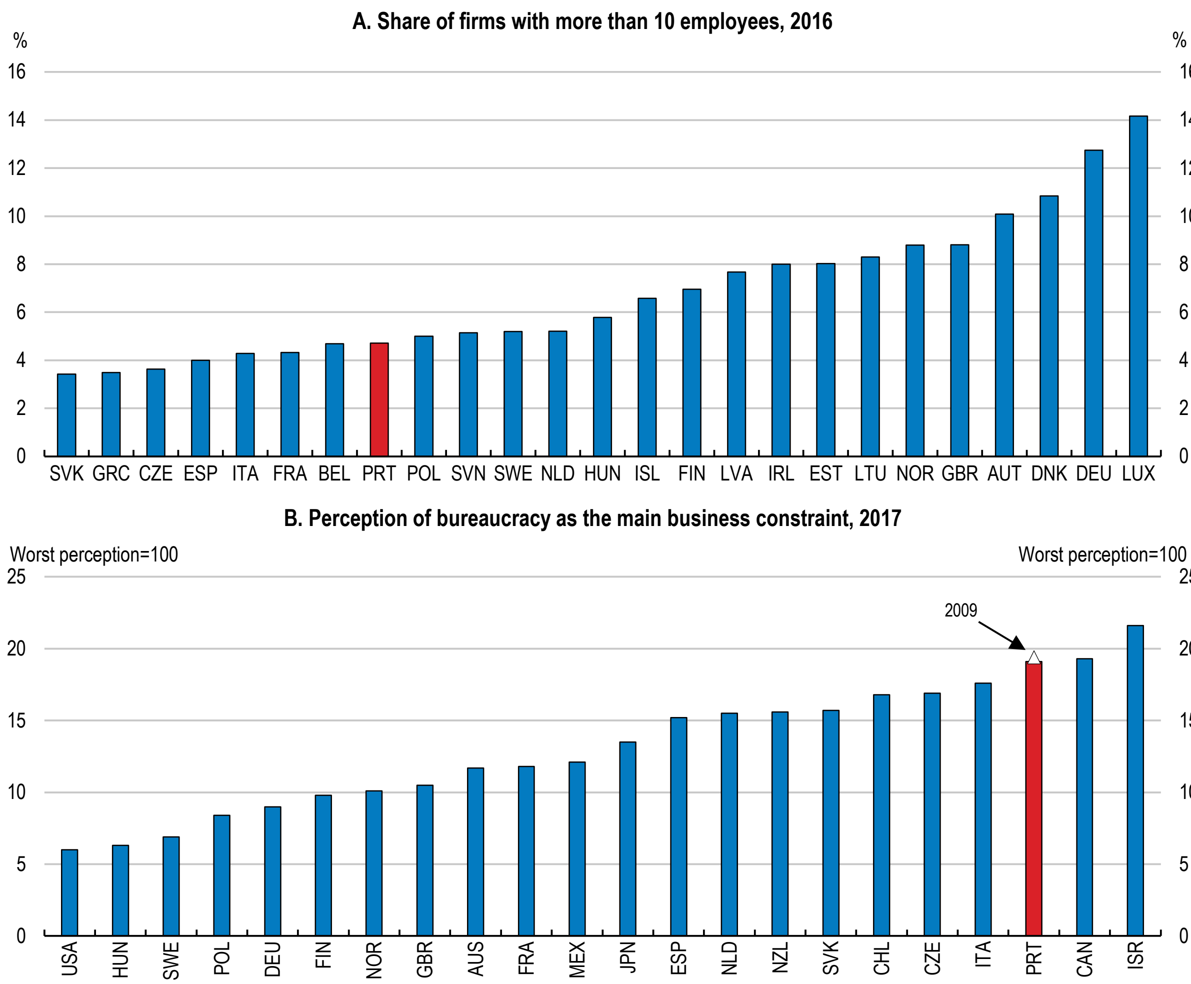
As discussed in Chapter 2, new Portuguese firms also tend to remain small, leading to a low share of large firms (Figure 1.10, Panel A). This share has even been dwindling over the past few years. Recent firm-level analysis highlights the positive relationship between the size of a Portuguese firm and their probability to export (Correia and Gouveia, 2016; Amador, Ringstad and Cabral, 2018).

Against this background, identifying specific areas where public policy can both support market entry and firm growth is integral for achieving further improvements in Portugal's export performance. Lowering administrative burdens on firms, ensuring that the design of existing public policies do not impede firm growth and enabling access to finance are all apposite. The potential for public policy reforms to support firm growth may be especially large in Portugal, given that bureaucracy remains often cited by businesses as an impediment to firm expansion (Figure 1.10, Panel B).

Figure 1.10. There is scope for government reforms to support firm growth



Source: Eurostat, World Economic Forum.

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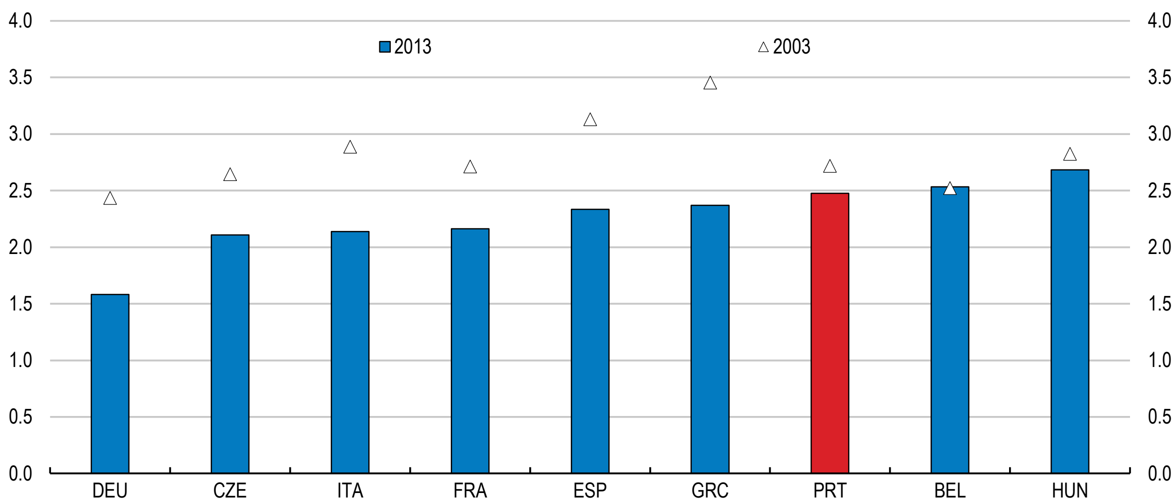
Reducing administrative burdens

Administrative burdens raise compliance costs for firms that hamper their entry into new markets, their expansion and cost competitiveness. Particularly burdensome procedures may also deter new foreign direct investment. Firm level empirical analysis by the OECD has highlighted the negative impact of higher administrative burdens on productivity in the Portuguese business sector (Arnold and Barbosa, 2015).

The administrative load on Portuguese businesses has gradually reduced over time. Between 2003 and 2013, the OECD indicator of administrative burdens on start-ups declined by around 9% (Figure 1.11). Overall, the reduction in policy barriers to entrepreneurship over this period are estimated to have increased Portugal's GDP per capita by 7% over the long-run (Égert and Gal, 2018).

Figure 1.11. Administrative burden on business has declined over recent years

OECD Product Market Regulation Administrative Burdens on Start-ups Sub-indicator



Source: OECD Product Market Regulation Indicators.

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Specific reforms included the active rationalisation of licensing procedures: licensing surcharges levied by municipalities were eliminated, environmental licenses consolidated and the Zero Authorisation initiative implemented. The latter substituted various formal authorisation procedures with businesses making a declaration via the Point of Single Contact e-government portal. Legislation on industrial licensing (SIR) was also adjusted in 2015, following a significant reform a few years earlier. These measures have been associated with a subsequent reduction in the average time for decisions on new licenses.

The ongoing implementation of the Simplex+ programme has also been aimed at reducing the administrative burden on firms and households (Box 1.3). An evaluation of selected measures in the Simplex+2016 programme found that they substantially reduced the time required by businesses to comply with public administration (European Commission, 2018). Further analysis of the economic impact of specific Simplex+ measures is advisable, as such information will provide useful guidance in identifying additional reform priorities.

Box 1.3. Portugal's Simplex+ Programme

Launched in 2016, Simplex+ was a national simplification programme launched to create new online public services, optimise existing ones and de-bureaucratise the relationship between public institutions and civil society. Similar to an earlier programme that ran between 2006-2011 ("Simplex"), the initiative was designed based on a bottom-up diagnosis of the services and laws requiring simplification.

Compared to the earlier version of the programme, Simplex+ was more cooperative in its process, placing the needs of users of public services as the primary criterion for identifying priority areas for action. In this spirit, the diagnosis was performed through broad consultation across citizens, corporates and public officials, facilitated through open events in the 20 national districts, a website and Facebook page and additional meetings with representatives from the main economic sectors and public service. The consultation also involved a competition to reward innovative ideas for products that could be integrated in the public administration ("Startup Simplex").

This process enabled the design of a simplification programme consisting of 255 measures that were implemented by the end of 2017. The implementation of this programme has been subject to monitoring and evaluation by external and independent entities, namely with regards to its impact on businesses. A recent study that evaluated 13 Simplex+ measures estimated that 624 million euros per year in administrative costs were saved by companies as a result of their implementation (Gabinete da Secretária de Estado Adjunta e da Modernização Administrativa, 2017).

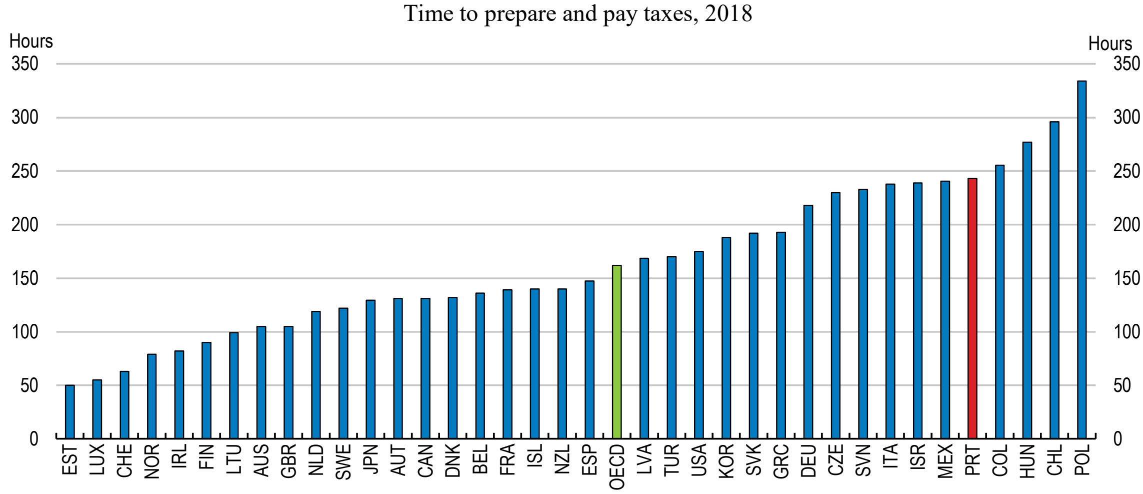
Source: OECD Observatory of Public Sector Innovation

While commendable, the reduction in administrative burdens in Portugal has not been exceptional in the context of other comparable countries: for example, Spain, Italy and Germany had a much larger fall (Figure 1.11). Despite the simplification of bureaucratic procedures, their operation can also be negatively impacted by administrative inefficiencies. For instance, despite single windows to receive applications, behind-the-scenes consultations between different authorities can be slow moving in Portugal (OECD, 2017a). The administration of some policies, such as those governing land use, have also been conditioned by strong discretionary powers of municipal governments which has hindered administrative efficiency in some locations (OECD, 2017a).

Tax administration is an area that remains particularly cumbersome for businesses. While there are various methods for measuring tax compliance costs, the widely used World Bank Doing Business Indicators suggest that preparing and paying taxes consumes an inordinate amount of hours in Portugal compared with other OECD countries (Figure 1.12). Around two thirds of businesses surveyed in 2017 regarded the Portuguese tax system as "complex and ineffective", an increase of around 10 percentage points from two years earlier (Deloitte, 2017). This is despite recent initiatives including the increased digitalisation of tax procedures and automatic filing of information already in the databases of public entities.

Figure 1.12. Tax administration takes significant time for businesses

Time to prepare and pay taxes, 2018



Source: World Bank *Doing Business Indicators*.

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The vast majority of surveyed Portuguese tax accountants (Técnicos Oficiais de Contas) also consider the tax system to have a high level of complexity (Borrego et al., 2015). Both tax officials and businesses highlight frequent changes in tax laws as the most significant contributor to complexity in the tax system. However, other factors include the extensive use of special provisions and ambiguity in the tax law language. The former may be motivated by equity goals, but can generate deadweight losses by encouraging rent-seeking or tax-planning behaviour. In addition, the overuse of special provisions raise tax compliance costs for businesses. OECD empirical work has highlighted the negative effect of such costs on the productivity of Portuguese enterprises, and hence their export prospects (Arnold and Barbosa, 2015).

Reforming other policy settings that discourage or hamper firm growth

In addition to administrative costs for firms, specific features of public policies can negatively impact the growth of firms and, hence, their likelihood of becoming exporters. This may be through regulations exhibiting a bias towards small firms. Further, settings that do not sufficiently promote competition in important industries that produce intermediate inputs, such as professional services, can raise costs for exporters downstream.

Corporate taxation

Differential corporate income tax rates may impede the expansion of Portuguese firms. The statutory tax rate was reduced to 25% in 2015, but there are various differential rates that result in lower effective statutory rates for smaller firms but higher effective statutory rates for more profitable firms. Rate reductions for smaller firms are poorly targeted, given that such enterprises per se do not create more jobs and innovations nor do they face insurmountable financing constraints (Bergner et al., 2017). The rate of the corporate tax surcharge increases as taxable profits rise. The surcharge for companies with taxable profit exceeding EUR 35 million was raised from 7% to 9% in 2018, implying a top statutory corporate income tax rate of 30%. There is also a reduced rate of tax paid by small to medium enterprises (defined as those with turnover below €50 million, which employ less than 250 people and an annual total balance sheet below €43 million) on the first EUR 15,000 of taxable profits, though this relief is very modest compared with similar provisions in other European economies (Bergner et al., 2017).

A reduced corporate tax rate for smaller firms may be adopted on the basis that larger firms are more effective at structuring operations to minimise their corporate tax bill. However, past OECD work suggests that the investment decisions of small firms tend to be less sensitive to corporate taxes than those of larger firms (OECD, 2010). Furthermore, such provisions may incentivise them to cap their growth and misreport taxable income or business size to the authorities (Bergner et al., 2017). The costs and benefits of having a progressive corporate income tax rate system with a preferential tax rate for small and medium firms and rates that are increasing with business profitability should be reviewed.

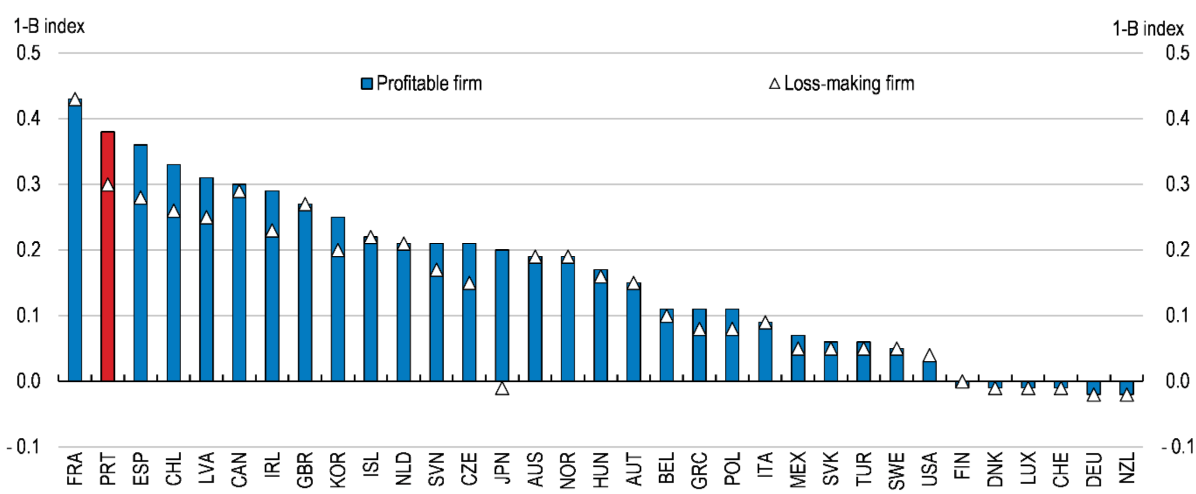
At the same time, the potential effects of a planned introduction of preferential tax rates for companies in the interior of the country should be rigorously evaluated. Under the plan, both existing businesses as well as those that are newly established in interior regions will receive a 20% corporate tax bonus. This may encourage profit-shifting within the country. Furthermore, it is likely to induce a reallocation of resources away from Portugal's substantially more productive regions, such as the Lisbon metropolitan area, weighing on aggregate productivity and the growth of some high-potential exporting firms. There is currently a suit of government policies aimed at developing interior regions in Portugal, including through direct support to enterprises and the delocalisation of public services. To further promote business activity in these areas, it would be advisable for the government to allocate more public funds to investing in the construction of complementary public assets rather than introducing distortions into the corporate tax system.

The growth of new exporters can also be impeded by the design of Portugal's public support for business research and development (R&D). In Portugal, the majority of such support comes in the form of R&D tax credits. Such policy instruments favour less dynamic incumbents at the expense of young businesses because their implicit subsidy rate increases with firm profitability and young firms are often in a loss-making position in the early years of an R&D project (OECD, 2015).

Some features of Portugal's R&D tax incentives aim to reduce the discrimination against small loss-making firms. In particular, unused tax credits can be carried-forward and used against taxable income over the next 8 years. Even so, a claim will have a lower present value to loss-making businesses that receive it at some point in the future than to profitable firms that receive it immediately (owing to time discounting; Figure 1.13). Some firms may also not have sufficient taxable income over the allowed eight years to use the tax credits or the upfront funds to start an R&D project without the government support being made available immediately. The Portuguese authorities could consider reforming the R&D tax incentive to allow unused tax credits to be indefinitely carried forward or for cash refunds of R&D tax credits. Such provisions are commonly used across the OECD, with countries including Belgium, Italy and the United Kingdom having indefinite carry forward of R&D tax credits and others including Australia, Canada and France offering cash refunds of R&D tax credits (OECD, 2018b) However, the benefits of such a reform should be weighed up against the associated fiscal cost. If adopted, it should be coupled with safeguards to prevent abuse and measures that ensure regular ex-post evaluation of the policy.

Figure 1.13. Portuguese R&D tax incentives are more beneficial for profitable firms

Tax subsidy rates on R&D expenditures for small and medium enterprises, 2017



Note: (1-B-index) increases in the generosity of R&D tax incentives. Specifically, the B-index represents the pre-tax income needed for a representative corporation to break even on a marginal monetary unit of R&D outlay taking account of both R&D tax incentives and the corporate income tax rate.
Source: OECD STI Scoreboard 2017 (database).

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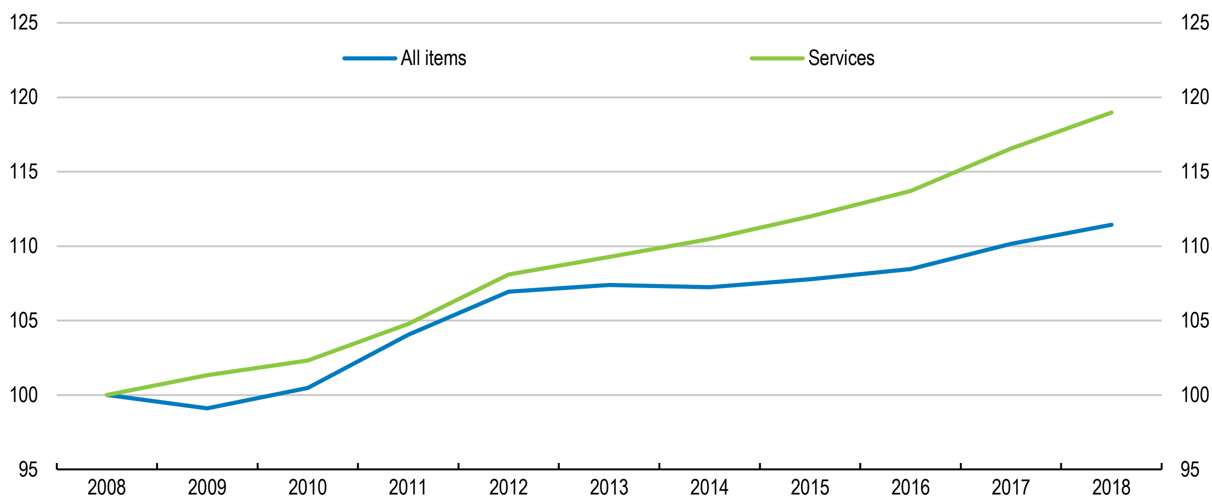
Regulations in services sectors

The price and quality of services inputs can have a strong influence on the competitiveness of Portuguese exporters, since such inputs are often sourced domestically. The fact that services account for 36% of Portugal's gross exports, but 58% in value added terms, highlights the significant reliance of the overall export sector on the services industries. In recent years, the growth in services prices has been stronger than in other parts of the economy (Figure 1.14). This has coincided with especially weak productivity growth in the non-tradable services sector due to weak efficiency in resource allocation (Bank of Portugal, 2018a). Services sectors have traditionally been characterised by low levels of competition in Portugal (Amador and Soares, 2012; Amador and Soares, 2014), partly owing to the stance of regulatory policies. Reforms over the past few years have improved policy settings, but there is scope for further strengthening competition in some areas.

Figure 1.14. Services prices have risen relatively rapidly

Index of consumer prices, 2008=100



Source: Eurostat.

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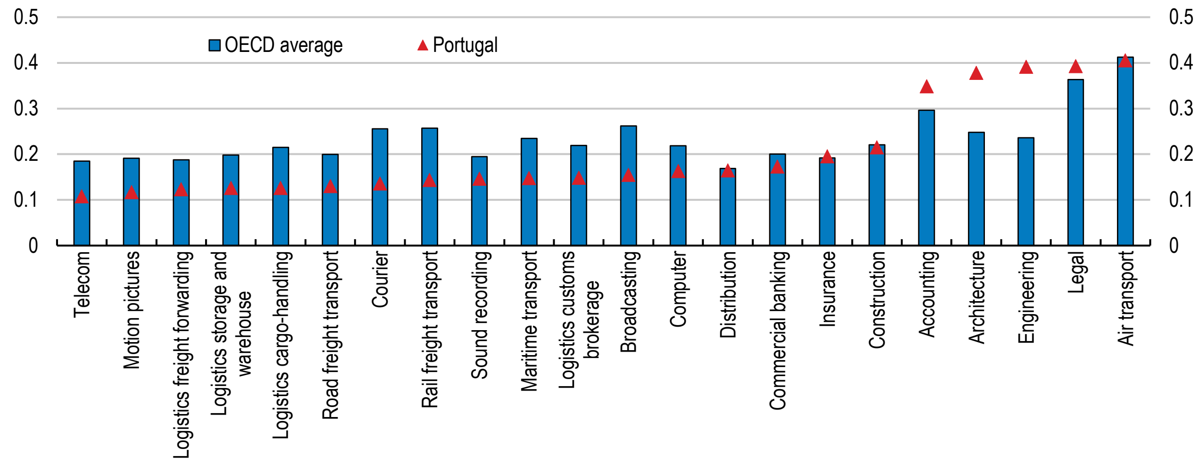
Regulatory settings in some of Portugal's professional services, such as accountants, lawyers, architects and engineers, are more restrictive than in most other OECD economies (Égert and Wanner, 2016). The OECD Services Trade Restrictiveness Indicator (STRI) also highlights barriers to competition through international trade in these services (Figure 1.15). Some of these relate to nationality requirements for owning and practicing in these professions. A propensity for professional bodies to erect barriers to competition in self-regulated service professions is often the foundation of such restrictions.

Figure 1.15. Restrictions on trade in some professional services reduce competition

Services Trade Restrictiveness Index, 2018



Source: OECD (2018), Services Trade Restrictiveness Index (database).

StatLink https://doi.org/10.1787/888933912105

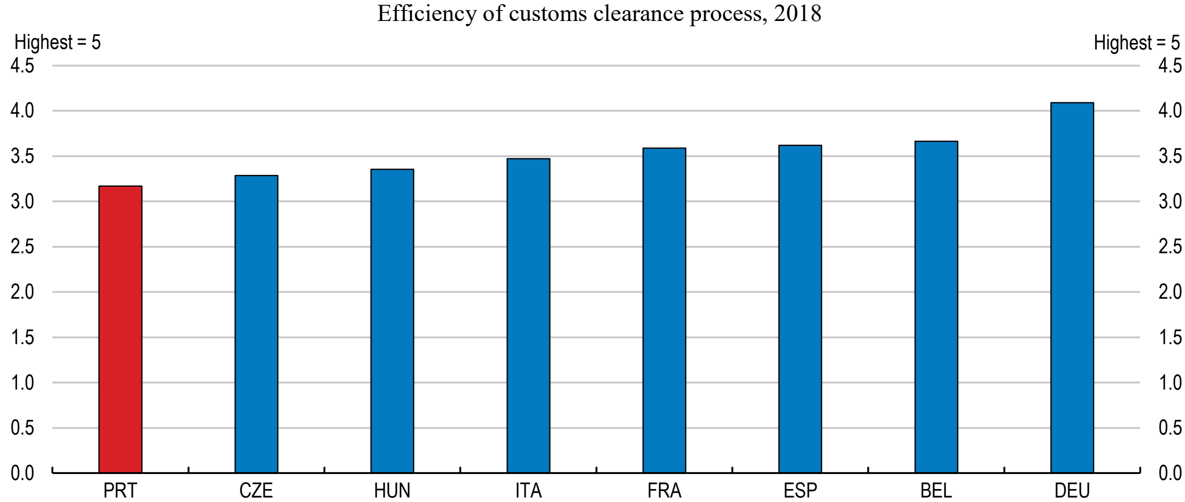
In 2018, the OECD collaborated with the Portuguese Competition Authority to complete an assessment of competition in self-regulated professional services. This highlighted some features of the regulatory framework that stifle competition and contribute to rents accruing to incumbents. Protective powers of the regulatory professional bodies and the use of exclusive rights that reserve certain tasks for members of the profession were two of the main areas singled out as ripe for reform.

The regulatory and representative roles of professional associations should be separated to better promote competition. The Portuguese Constitution currently allows professional associations to both represent its members and regulate access to, and the exercise, of the profession. Under such an arrangement, associations have an incentive to adopt anticompetitive measures that protect the professionals they represent. Such practices have occurred across a number of professions in Portugal over recent years (OECD, 2018c). Instead, separate supervisory bodies should be established that undertake all regulatory functions independent of the representative entity. This may be through the establishment of autonomous supervisory bodies (grouped by sector or trade) or through the creation of independent "boards" within the professional associations. In the latter case, such boards should include experienced individuals from other regulators or organisations, representatives from consumer organisations and academia (OECD, 2018c). Nevertheless, such a setup would need to be coupled by strict "Chinese walls" to safeguard the independence of the entity.

Tight regulations related to academic qualifications for practicing a professional service also restrict competition. Individuals with a different education than a university degree usually have difficulty gaining registration in a professional service in Portugal. A particularly relevant self-regulated profession for exporting firms is customs brokers. At present, to register with the professional association of customs brokers, an applicant must hold a university degree in economics, management or business administration, law, international relations, international trade or logistics and customs. The requirement for customs brokers to hold a university degree was introduced in 2015, but it excludes other individuals who have obtained the necessary skills through their professional activities or an educational path outside university. By limiting the supply of such professionals, the current regulations can increase costs for exporters and add to the perceived inefficiencies in customs procedures that already exist in Portugal (Figure 1.16). They are also likely to reduce diversity in the profession and the services offered, with potential negative implications for innovation.

Figure 1.16. Inefficient customs processes may be exacerbated by barriers to the customs broker profession

Efficiency of customs clearance process, 2018



Source: World Bank and Turku School of Economics, Logistics Performance Index Survey.

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Several professional services are also afforded exclusive rights to perform certain activities in Portugal. Such provisions have traditionally been designed to ensure a standard of quality for consumers, protecting them from information asymmetries related to service quality. Nevertheless, they also lower competitive pressures on incumbents and may be increasingly unnecessary with the advances in information diffusion made possible by new technologies. For instance, customs brokers are given exclusive rights over some activities, including representing firms to the relevant authorities in carrying out customs formalities and drafting requests for businesses to obtain simplified regimes. As recommended in the OECD *Competition Assessment of Self-regulated Professions in Portugal*, such activities for customs brokers should be abolished.

In July 2018, the Portuguese Competition Authority outlined an action plan to implement OECD recommendations related to professional services. Given the importance of such services to the ongoing expansion of the export sector, the full implementation of these recommendations should be a priority for policymakers across government.

Improving access to finance

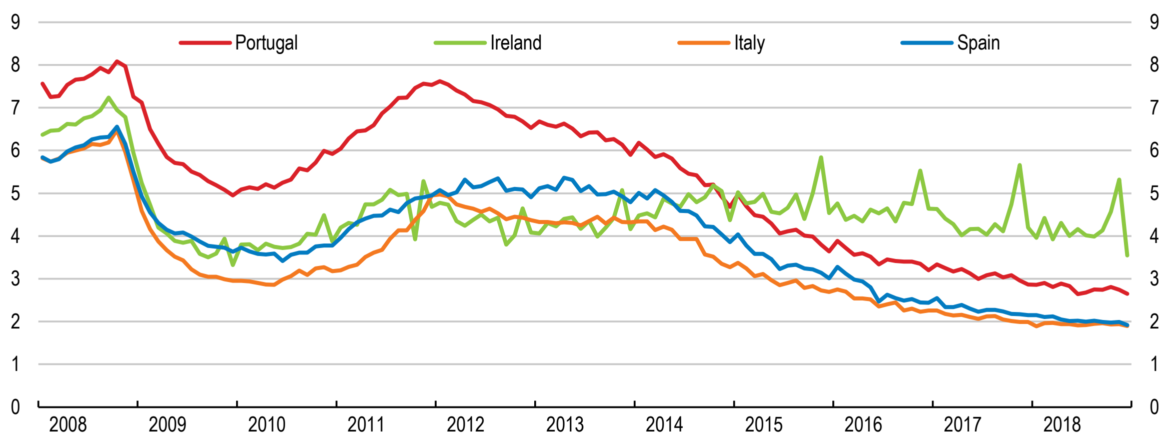
Across countries, difficulties gaining access to finance can be an obstacle for the growth of exporters, especially for young firms in a bank-based financial system (such as Portugal) that have a limited track record and minimal collateral. For such firms, the high fixed costs of establishing a distribution network, international marketing and potentially adjusting products for overseas regulatory standards, often requires external finance.

The financial crisis exacerbated financing constraints (Lee, Sameen and Cowling, 2015), particularly in countries such as Portugal with banking systems that were hard hit. In a survey by the Bank of Portugal, Portuguese firms reported increased difficulties in accessing credit as one of the most severe aspects of the economic shock in the 2010-13 period. Through that time, around 30% of firms reported a moderate or strong increase in credit constraints (Martins, 2016).

In the past few years, there has been a notable improvement in access to finance for Portuguese enterprises. Between April 2014 and March 2018, the proportion of SMEs citing access to finance as their most important problem halved to be less than 10% (European Central Bank, 2018). In accordance, borrowing costs declined (Figure 1.17) along with the spread between the interest rate charged to smaller and larger firms (OECD, 2018d). While there has been little discernible increase in the stock of credit to exporting firms, venture capital financing has been steadily rising since 2011, suggesting greater ability for young entrepreneurial exporters to gain finance.

Figure 1.17. Borrowing costs for Portuguese firms have declined rapidly

Interest rates on loans to corporations, percentage



Note: All corporations are non-financial (NFC) and loans are from monetary and financial institutions.
Source: European Central Bank.

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The improvement in borrowing conditions for businesses has reflected the cyclical recovery, the improved health of the banking sector and focused government policies. The latter have recently been under the umbrella of the *Capitalizar* programme, which was launched in 2016 with the specific aims of improving financing conditions for SMEs and the capitalisation of companies more broadly. Measures include the introduction of new credit lines focused on SMEs that amount to 15.8 billion euro (around 20% of the stock of non-financial corporation credit). Loans under these credit lines have long-term maturities (up to seven years), partially subsidised interest rates and public guarantees that cover between 50-75% of the loan. There have also been specific measures for financing entrepreneurs, including public co-investment in venture capital and business angel financing. Public support for entrepreneurs through partnering with the private sector in this way is prudent as it is more likely to succeed in fostering a sustainable early-stage capital sector as well as help avoid the common pitfalls associated with government "picking winners".

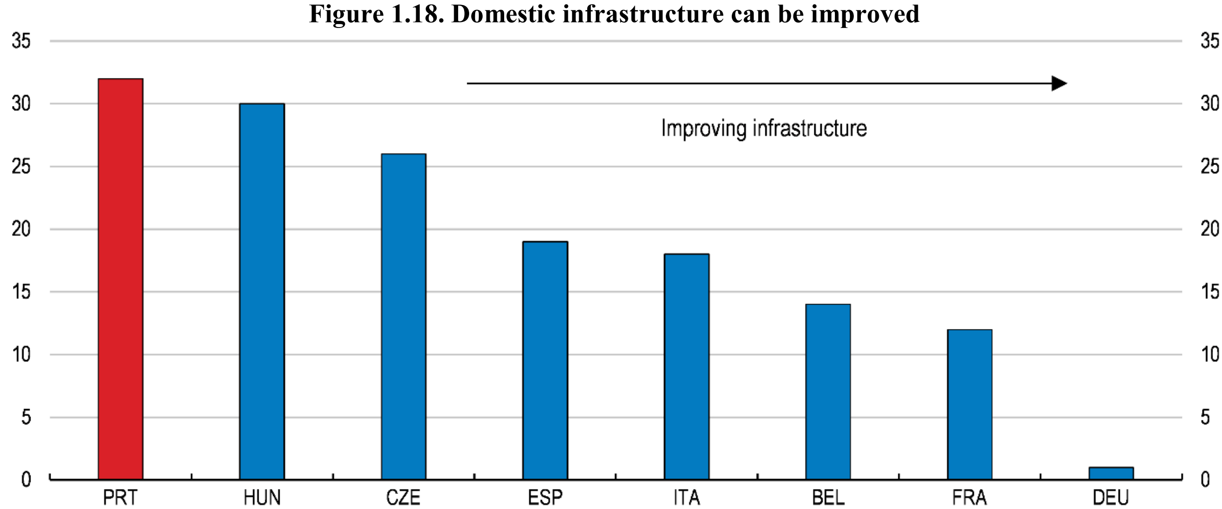
To facilitate the expansion of the export sector, measures that further improve firm's access to finance at the same time as ensuring ongoing improvements in financial stability need to be identified. For instance, medium-sized firms should be further encouraged to source finance from equity markets. Recent measures that reduced the debt bias in the corporate tax system and allowed the creation of a new type of listed company that holds shares in unlisted Portuguese firms are important in this regard. Direct stock listings of SMEs in Portugal are rare compared with other OECD countries, such as France or the Netherlands. Some public support should be allocated to improving the services that help such companies become listed and consideration should be given to introducing a lighter regulatory regime for such firms once they list.

New sources of financing, such as the emergence of providers utilising innovative financial technology ("FinTech") should also be encouraged. Such platforms may particularly benefit young entrepreneurial firms that have non-standard business models but a high degree of digital awareness. FinTech looms as an important vehicle for business-to-business trade financing. Given empirical work has highlighted the role of trade finance in substituting for bank finance in the event of financial shocks (McGuinness and Hogan, 2016), the development of a FinTech sector can help improve the resilience of Portuguese exporters. It may also reduce business costs through injecting greater competition into Portugal's financial services market. That said, new financing vehicles should be carefully regulated to ensure that they do not contribute to the build-up of systemic financial risks.

Ensuring domestic infrastructure promotes better export performance

The ability of Portuguese firms to become more export-oriented will rely on efficient domestic infrastructure that can cope with increased production volumes. Both the quality and cost of physical infrastructure such as ports, rail, roads and airports impact the ability of businesses to take advantage of the global fragmentation of production networks. Such infrastructure, along with other forms such as tourist accommodation, can also support the sustainability of Portugal's tourism boom. However, perception-based indicators suggest that the quality of ground, port and air infrastructure can be improved (Figure 1.18). While Portugal faces fiscal constraints which limit the potential for a significant increase in public capital investment, reforms to regulatory settings can have significant benefits to the functioning of domestic infrastructure with no financial cost to the state.

Figure 1.18. Domestic infrastructure can be improved



Note: The figure presents a ranking for logistics infrastructure across 160 countries in 2018, based on a survey of global freight forwarders and express carriers.
Source: World Bank *Logistics Performance Indicator*.

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Transport

Maritime transport accounts for over one-third of Portuguese freight movement (Statistics Portugal, 2017). Portugal is strategically positioned at the intersection of major shipping routes between Europe and America and Europe and Asia, an appealing location for foreign investment in the downstream activities of global value chains. Nevertheless, the ability to attract such investment depends on the adequacy of port infrastructure and ancillary services. For domestic firms, such infrastructure is similarly important for accessing foreign markets.

Portuguese ports follow the "landlord port" model whereby the port authority manages and invests in the main port infrastructure, while private operators are able to operate port activities and invest in superstructures such as equipment and terminal buildings. This is a common port model employed across OECD countries (OECD, 2018e). However, various aspects of the regulatory framework governing the Portuguese port system stifle competition and the efficiency of their operation. There appears to be substantial scope for improvements in Portuguese port efficiency. For example, cost-efficiency analysis suggests that the costs of port piloting services could be reduced by around 50% (OECD, 2018e). While the ongoing renegotiation of port concessions is being used to introduce performance-oriented objectives, with the intention of lowering user charges, progress is slow.

Some regulatory settings limit the scale of private operators that can undertake port activities, reducing competitive pressures on incumbent operators. For example, port authorities tend to directly provide ancillary services, leaving little room for participation of private operators, and affording the authority significant market power. In some port services such as piloting and cargo-handling, regulations restrict the ability for port authorities to license multiple private operators, instead favouring to grant a concession of exclusive rights to a single entity. In cases where multiple port operators could co-exist in the same port, such bias in the regulations will eliminate the potential for ongoing competition in these services markets, reducing efficiency and raising costs for exporters.

Barriers to entry also exist in the form of onerous financial requirements for an operator to provide services. These requirements are often based on fixed minimum thresholds, not proportional to the size of the operator, which discriminates against services being provided by smaller firms (OECD, 2018e). In the case of cargo-handling, licensed operators must demonstrate their financial ability to carry out services by: i) paying a financial guarantee to port authorities that is fixed across operators, ii) demonstrating a minimum amount of share capital invested in the company (the threshold varies by port, but for Lisbon it is equivalent to EUR 1 000 000) and iii) possessing subscription to an insurance policy covering a minimum capital of EUR 100 000. However, the rationale for having three separate requirements is not clear, especially when such provisions reduce the number of private providers that can operate in the market. Instead, consideration should be given to amending the regulations so that only a subscription to an insurance policy, with the minimum covered capital being determined by an assessment of the operational risks of the particular licensed operator, be required.

Regulations also exist that specify minimum levels of equipment and the forms of work contract that can be used by private operators. In the case of cargo-handling operations, national legislation requires operators to employ an exclusive group of workers and to own the equipment, machinery and vehicles. Such requirements restrict the ability of operators to organise themselves in the most efficient way, as they can exclude other contractual arrangements such as leasing equipment or the use of temporary staff. The current regulations seek to ensure that private operators have the capacity to provide the necessary services. However, a better way to ensure this, while not restricting the allocation of resources or market entry of operators, would be to establish minimum levels of public service or to enable the use of pools of equipment.

The characteristics of port concession contracts may also hamper competitive pressures and the efficiency of Portugal's freight transport. The concession of exclusive rights to a single private operator is useful in instances where ongoing private competition in the market may not be viable or substantial investment is required by the operator. In Portugal, concessions are particularly common for cargo handling services. The contracts can be structured to introduce competition into the market by being awarded based on a competitive bidding process. The framework for granting concessions is important as one which is poorly designed can grant monopoly rights to inefficient operators that may charge high tariffs to exporters for an extended period of time.

The duration of port concession contracts in Portugal are frequently excessive, reducing the potential for market entrants that can positively influence innovation and competitive tariff pricing. The length of the contracts are at the discretion of the port authority, but subject to certain maximum ceilings imposed by law. In setting contracts, the port authorities are compelled to follow the new Public Contracts Code, which came into effect in January 2018, that specifies that the term of the contract be fixed according to the period of time necessary for amortization and reasonable remuneration. It should be ensured that the new code is followed closely. Analysis contained in the *OECD Competition Assessment Review of Inland and Maritime Transports and Ports*, highlights a very weak correlation between the investment spending of private operators and the length of concession contracts previously awarded in Portuguese ports (OECD, 2018e). Furthermore, some terminal concessions have been renewed at the end of a contract for an extended period without a new competitive awarding procedure being undertaken. In granting concessions, the contract should explicitly determine a minimum level of investment to be incurred by the operator and it should not be renewed without the opening of a new public tender.

The structure of concession revenues (i.e. the charges levied by port authorities on private operators) may also negatively impact upon the efficiency of the port system. Unlike the majority of European ports, such levies comprise both a fixed charge (which is most common in other jurisdictions) and a variable component in Portugal. The latter may be justified if port authorities incur costs that vary with production, but such variable concession charges in Portugal largely exceed those costs (OECD, 2018e). The problem with having significant variable charges for private operators is that it can reduce the incentive for such firms to increase the volume of cargo or passengers handled. Instead, fixed charges should be the main mode of levying fees, with variable charges only applied in instances where the port authority has incurred variable costs.

The competitiveness of Portuguese ports is also undermined by the fact the process for awarding concessions gives insufficient consideration to the bidder who will charge the lowest price to port users. Instead, concessions are usually awarded to the bidder willing to pay the highest price to the port authority. This is consistent with the fact that many Portuguese port authorities primarily seek to maximise profits, despite being state-owned companies (OECD, 2018e). Strong financial performance of the port authorities is commendable, but not when it comes at the cost of inefficiencies in the port sector that reduce the competitiveness of the economy.

Improvements to the port system can achieve their maximum potential benefit for the export sector if combined with better connections to international rail freight services. Rail density is low in Portugal and rail links between the Portuguese and Spanish freight market have been too limited. In 2018, a tender for the 94km Évora-Elvas-Caia rail line was launched. This project will connect key Portuguese ports including Setubel and Sines with transport hubs in Spain. However, as detailed by the European Commission, a joint strategy by Portugal and Spain including the deployment of rail interoperability in the Iberian Peninsula and its connection with the French rail network is still missing (European Commission, 2018). Differences in the rail gauge, the maximum train length and signalling systems compared with other key European markets, such as France and Germany, impedes trade connections. These are challenges that are well recognised by the Portuguese authorities and overcoming them should continue to be a priority.

Road transport accounts for the majority of freight and passenger movement in Portugal. Portugal's limited rail network makes it especially dependent on the network of roads to move freight and people within the country. While the need for reforms are not as pronounced as in Portugal's port sector, the competiveness of the economy can be enhanced by policy changes that reduce barriers to new freight and passenger transportation companies entering the market.

While the road sector is mainly governed by European Union legislation, some regulations are stricter in Portugal than the EU guidance. For example, those operating "light trucks" in Portugal (those between 2.5 tonnes and 3.5 tonnes) are covered by the mandatory licensing regime for freight operators that requires the fulfilment of various licensing requirements (OECD, 2018e). However, EU regulations only require the use of an EU Community licence for vehicles above 3.5 tonnes.

Portuguese airports have seen a steep increase in demand with the boom in tourist inflows. Lisbon airport is operating close to full capacity and there are plans for a second international airport in Montijo, 20 miles from Lisbon by road. To be effective, the new airport will need to be complemented by transport links that effectively connect it with the broader city. While Portuguese airports are operated under a 50 year concession agreement with a private company, the feasibility of expanding capacity of the Lisbon airport or the ability for the government to induce efficiency improvements in that facility should also be thoroughly investigated.

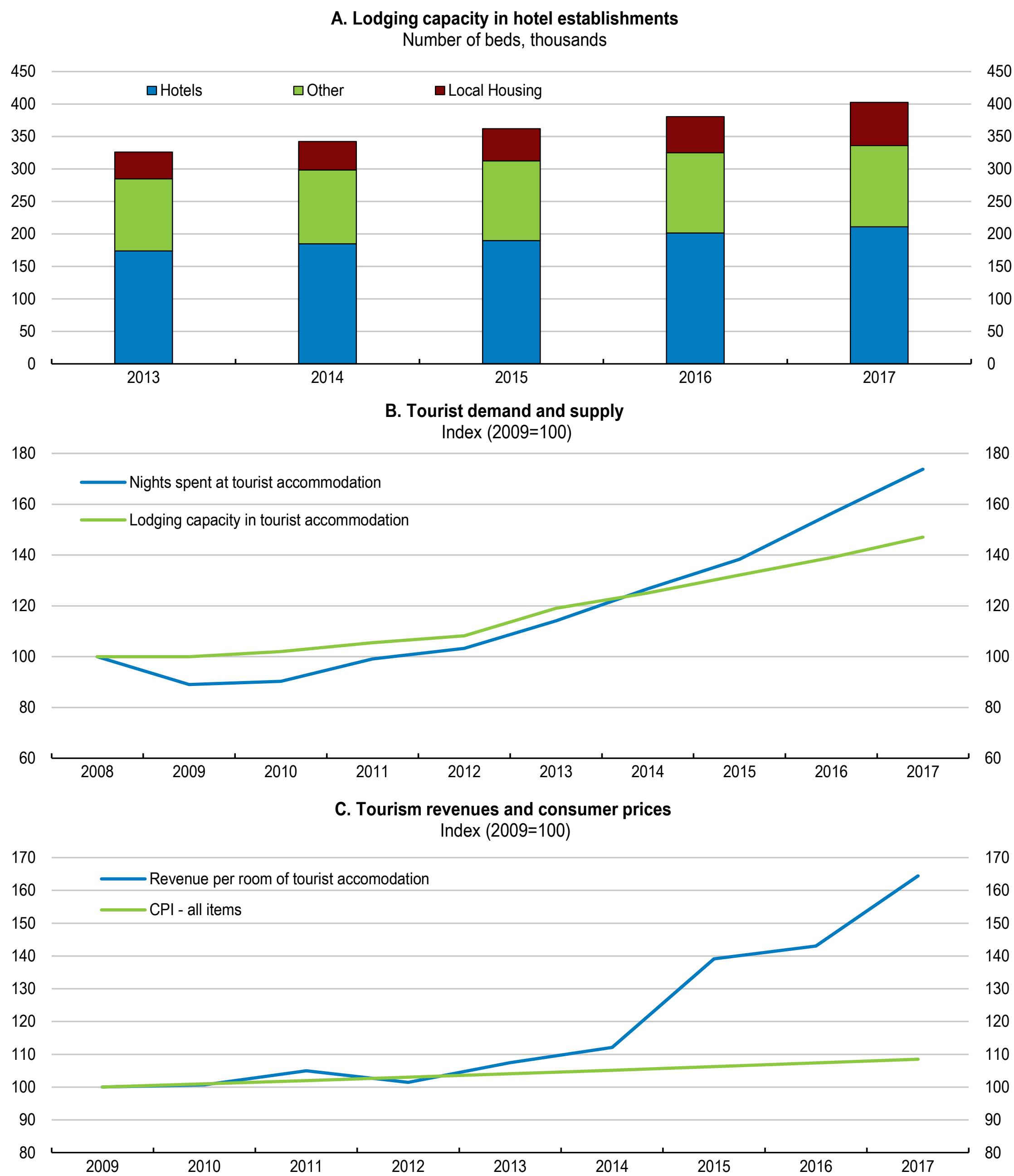
More generally, the government should ensure that the governance around public investment decisions ensures that projects with the highest long-term economic and social returns are prioritised. Public investment decisions should be made in the context of a long-term national strategic vision that addresses infrastructure service needs, how they should be met and the responsible entities (OECD, 2017b).

Tourist accommodation

The stock of housing infrastructure has come under considerable pressure in recent years. While the tourism boom and government policies tying non-resident visas to dwelling investment have boosted demand (especially in Lisbon, Porto and the Algarve), growth in the stock of housing supply has not kept pace. The latter has largely been a legacy of the slump in construction activity through the financial crisis: between 2007 and 2014, annual housing investment fell by over 50%.

In recent years, there has been a steady increase in the supply of tourist accommodation. The number of beds in tourist accommodation rose by 23% between 2013 and 2017, with one-third of the growth attributable to a rise in the use of rooms in local housing by tourists (Figure 1.19, Panel A). In Lisbon, listings on Airbnb (an online marketplace that allows people to rent-out their properties or spare rooms to guests) more than doubled between 2015 and 2017. Nevertheless, tourist demand has outpaced supply over the past few years (Figure 1.19, Panel B). This has resulted in strong growth in prices for tourist accommodation (Figure 1.19, Panel C) and contributed to the upward pressure on dwelling rents and prices more generally (Bank of Portugal, 2018b). These trends risk reducing the competitiveness of Portugal's tourism sector and prompting policy interventions that limit its expansion. Moreover, higher housing costs for professionals may dissuade foreign investment in the business sector.

Figure 1.19. Rising tourist demand has pushed-up accommodation prices



Source: Pordata, Eurostat.

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In response to the rise in local housing for tourist accommodation, the authorities have been active in updating the regulatory framework. All hosts must now register shared short-term accommodation with local authorities, comply with basic standards including fire safety and possess multi-risk insurance that covers damage in common areas of apartment buildings. These provisions protect consumers and ensure that hosts comply with their tax obligations. Nevertheless, some of the new regulations may reduce or limit the availability of local housing for tourist purposes.

As of October 2018, municipal councils have a more powerful role in influencing the supply of local housing. Along with taking on new responsibilities for fining and forcing the closure of existing units, councils are now able to create "containment areas" where the number of tourist establishments can be restricted. In addition, the new regulations stipulate that owners of apartments for tourist accommodation may be charged an additional 30% annual contribution to the association governing the building. The council will now also force the closure of an apartment used for local accommodation in cases where over half the residents in an apartment building are in opposition.

There is a tension between facilitating the expansion of well-located tourist accommodation and ensuring that culturally-rich areas are not stripped of their authenticity. In trying to navigate these dual objectives, the authorities should carefully evaluate the impact of the new regulations on the stock of tourist lodging. At the same time, complementary reforms that promote the construction of new hotels and other types of tourist accommodation should be pursued. Already, the authorities have simplified the process for the licensing of tourism facilities. Over the past decade, such licenses have been fully integrated with other construction and land use permit procedures and the volume of required documentation reduced.

The sluggish supply response to the boom in tourism demand may reflect policy settings that reduce the availability of relevant service professionals. Increasing the supply of engineering professionals has been identified as a priority for policymakers given the prospect of shortages. Nevertheless, at present, there are tight restrictions on the characteristics of professionals that can undertake engineering and other construction-related activities. Only engineers and architects registered in the respective professional associations are able to undertake engineering projects and architecture plans. In some cases, professionals must have a minimum number of years of experience to perform these tasks. Instead of retaining reserved activities for these professionals, regulations should be revised to focus more on outputs, such as quality standards for building works (OECD, 2018c). This would open up construction-related services to a broader range of providers, helping to ensure the supply of new construction keeps up with demand.

Digital networks

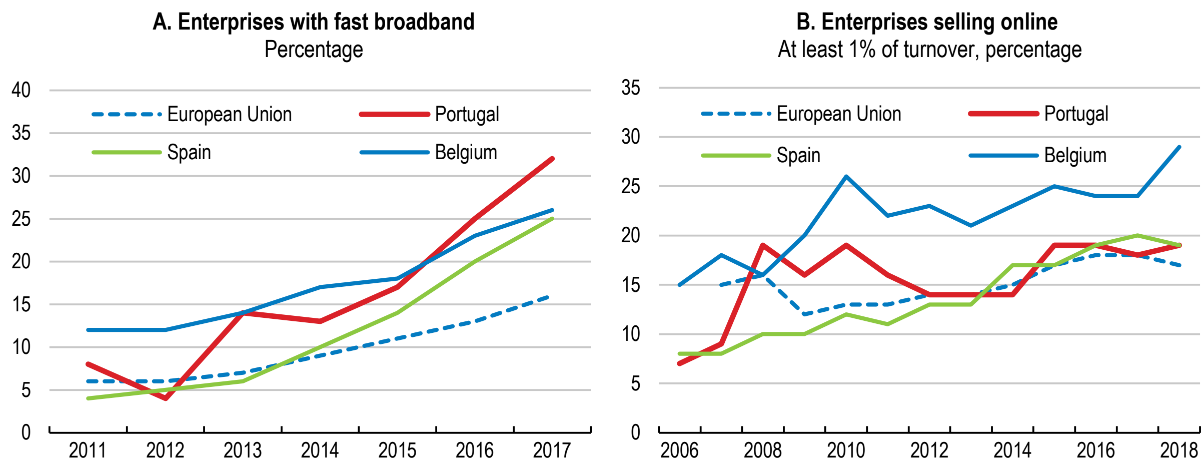
The standard of digital infrastructure is also increasingly important to firms accessing overseas markets. This is partly through its role in enabling information exchange and participation in e-commerce platforms. More generally, good digital network access allows firms to implement productivity-enhancing technologies into their production process that enhance cost competitiveness.

Portugal has good quality digital infrastructure compared with most OECD countries. Broadband is available to households throughout the country and a high proportion of enterprises have subscriptions to fast broadband (Figure 1.20, Panel A). Strong investment in the digital network over the past decade partly reflects the national regulatory authority decision to open access to the ducts and poles of Portugal Telecom to private companies.

In rural areas, government funding has played a larger role in improving access to digital infrastructure.

The proportion of enterprises selling online is low given the high proportion that have fast broadband access (Figure 1.20, Panel B). The use of productivity enhancing technologies, such as cloud computing, is also low compared with most OECD countries (Figure 1.21). Low levels of digitalisation is especially the case in small and medium enterprises, both constraining the ability of such firms to trade on world markets and the efficiency with which they can integrate into the supply chains of larger Portuguese exporters.

Figure 1.20. Broadband access is widespread but not many firms sell online



Note: In Panel A, "fast broadband" is defined as the contracted speed of an enterprises fastest internet connection being above 100 Mb/s.
Source: OECD, ICT Access and Usage by Businesses (database).

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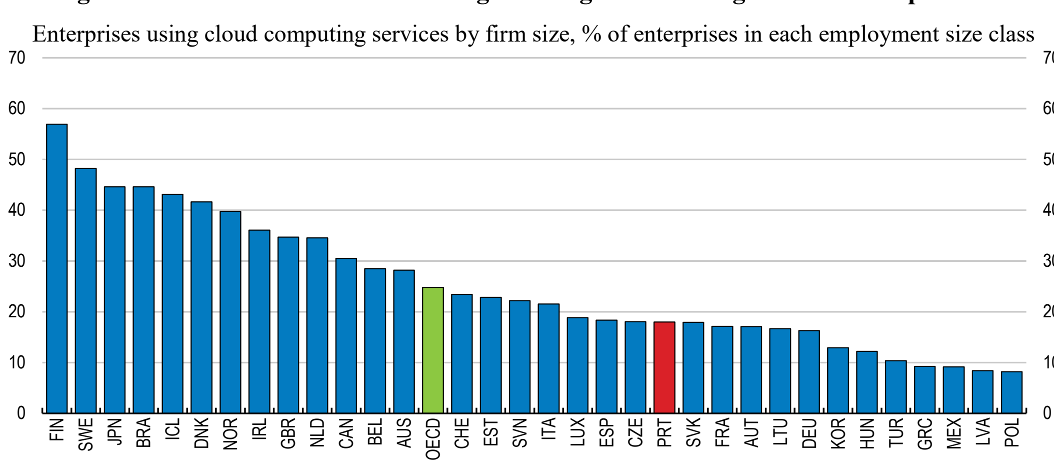
In 2017, the government launched "Indústria 4.0", a national strategy for the digitisation of the economy. Included in the goals of the strategy are to increase the number of companies using e-commerce by 55% between 2011 and 2020 and a rise in ICT exports of 25% over that time. The programme will allocate EUR 4.5 billion to associated programmes with around half the funding provided by EU Structural Funds.

Figure 1.21. Few businesses have integrated digital technologies into their operations



Source: OECD Digital Economy Outlook 2017.

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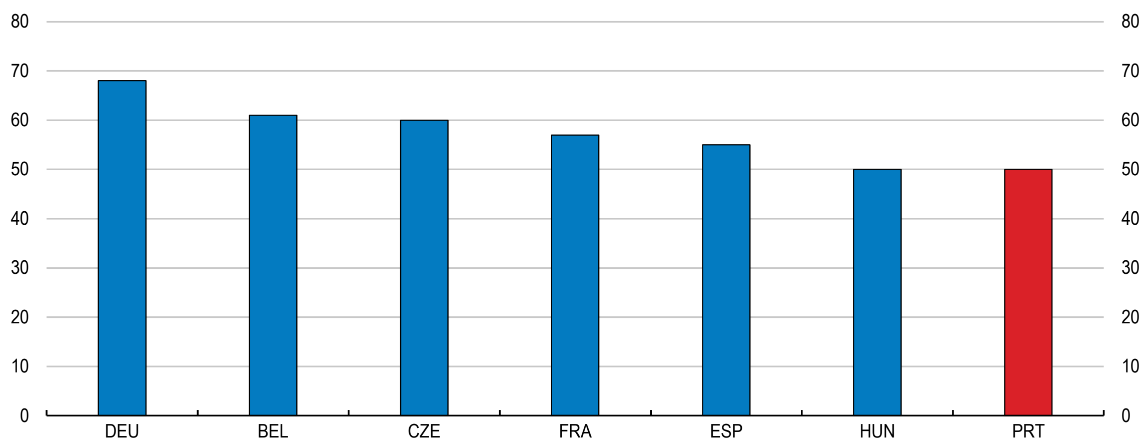
A constraint to expanding the penetration of new digital technologies is the low level of digital skills within the community. Just 50% of individuals possess basic or above basic digital skills, seven percentage points below the average across the European Union (Figure 1.22). Poor digital skills are particularly apparent in those over the age of 25 (OECD, 2018f). In response, the government has launched the National Initiative on Digital Competencies (INCoDe.2030). The programme aims to develop the digital skills of the population and to raise innovation in the digital sector (Box 1.4). Many of the activities under the programme are targeted to younger cohorts. Given the skills gap is particularly apparent for adults, the authorities should monitor the extent to which the programme is effectively targeting those with the lowest digital competencies (OECD, 2018f).

Figure 1.22. Only half the population have basic digital skills

Proportion of all individuals with basic or above basic digital skills, 2017



Source: Eurostat.

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Box 1.4. Portuguese National Initiative on Digital Competencies 2030 (INCoDe.2030)

The Portuguese National Initiative on Digital Competencies 2030 (INCoDe.2030) aims to enhance and foster digital competencies. The initiative has a broad scope, starting with the promotion of digital inclusion and literacy, educating the young generations from an early age, qualifying the active population and specialising graduates for advanced digital jobs. The programme also aims to raise Portugal's level of innovation in the digital sphere.

The content of the programme takes a broad view of digital skills and includes aspects related to digital literacy, information processing, communication, digital content production skills and the ability to handle and manipulate data. Advanced communication networks and mobile systems, network hardware and software and cyber-physical systems like robotics are also covered.

The programme enables citizens to benchmark their level of digital skills on a dynamic framework based on the European initiative DigComp2.0, helping knowledge gaps to be identified. Specific programmes have also been targeted towards disenfranchised groups, who are able to use a freely accessible online training platform and are offered other training courses that focus on building digital competencies.

Source: (OECD, 2017c)

Promoting better skills and innovation in the business sector

Further providing the right skills

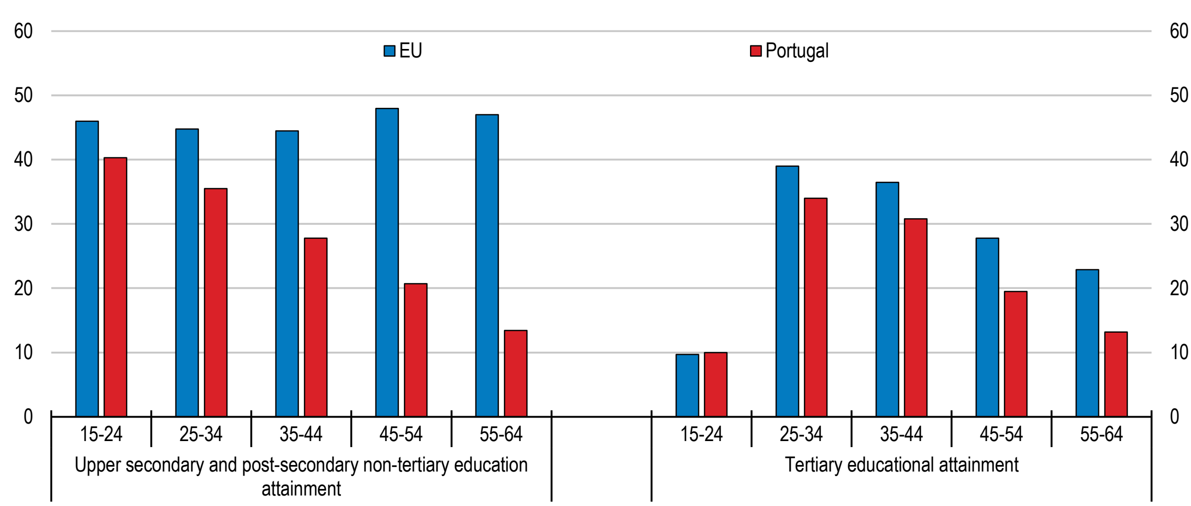
Improving the performance of the export sector will also depend on achieving continued improvements in the quality and mix of workers' skills. Empirical evidence highlights a strong relationship between workers skills and trade, partly through influencing countries' integration into global value chains (Grundke et al., 2017). Given the expected decline in the working age population over coming years, ensuring that those in the labour force have the right skills to productively contribute is critical.

As detailed extensively in the 2017 *OECD Economic Survey of Portugal*, the stock of accumulated skills in the Portuguese population is low (OECD, 2017a). At the same time, demand for high skilled workers has been growing rapidly compared with other skill classes (OECD, 2018f). While school age enrolments are around the OECD average level, high drop-out rates and frequent grade repetition compound a legacy of low skill levels. In 2017, over half of Portuguese adults aged 25 to 64 had not completed upper secondary education. The quality of education in the school system has been improving: student performance across the fields of science, mathematics and reading all rose faster than in the average OECD country between 2006 and 2015. By that time, the average score in the Programme for International Student Assessment (PISA) in each discipline was above the OECD average. This has partly owed to a sequence of reforms to education policy, including an increase in the duration of compulsory school from 9 to 12 years, the introduction of national evaluations of school quality and the expansion of vocational and educational training pathways in secondary schools.

As a result of these developments, younger cohorts of the Portuguese population are substantially more educated than those that are older (Figure 1.23). Moreover, educational attainment of older groups lags behind that in comparable countries; the attainment of both non-tertiary and tertiary education is below the average in the European Union.

Figure 1.23. The educational attainment of adults is lagging

Percentage of individuals that have completed education



Source: Eurostat.

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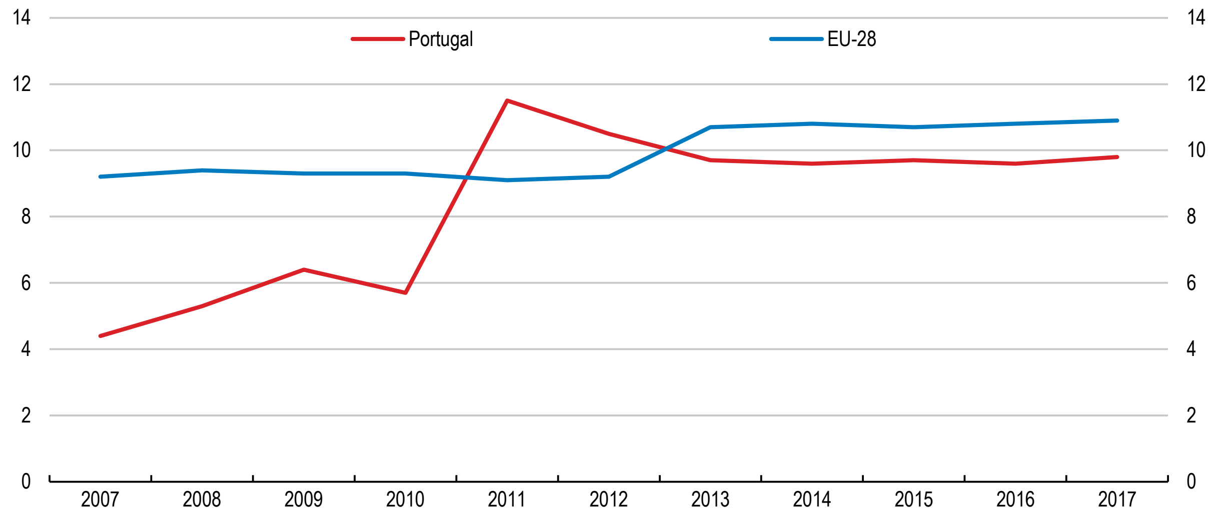
Given the educational attainment of the population aged over 24 is lagging, adult education pathways are critical. Nevertheless, participation rates of 25-64 year olds in adult learning is slightly below the EU average and has shown no sign of improvement since 2011 (Figure 1.24). Participation rates of those with initially low levels of educational attainment are particularly modest, with the gap between the participation of the high-skilled and low-skilled larger than the EU average (OECD, 2018f). As digitalisation further skews labour demand towards high-skilled activities, this situation threatens to exacerbate the already high levels of inequality that exist in Portugal.

Figure 1.24. Participation in lifelong learning opportunities is low

Participation rate, percentage



Source: Eurostat.

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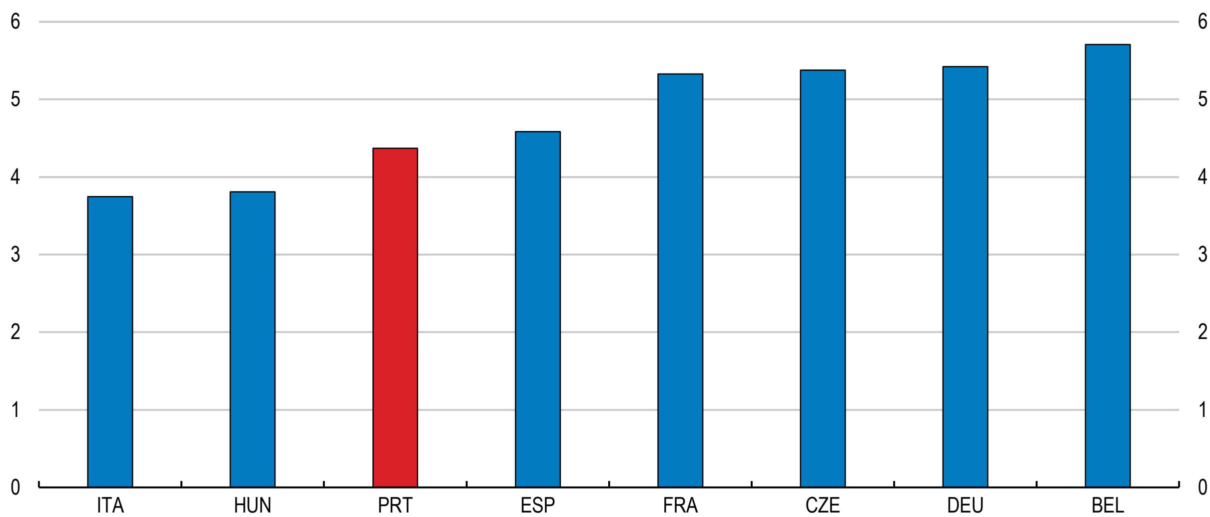
To improve both the skill profile and the inclusiveness of the economy, lifelong learning programmes should be better targeted towards the low-skilled. To be successful, this requires overcoming the motivational barriers of some low-skilled workers. In 2018, the OECD published guidance on the implementation of a skills strategy for strengthening the adult-learning system (OECD, 2018f). This emphasised useful approaches for overcoming this challenge, including the provision of better information on educational returns and tailoring information to the low-skilled population. However, to do this, better quality data about the skills of the adult population and the returns to different types of skills are needed. There may also be scope for new measures that better enable participation in learning activities, such as statutory education and training leave. This type of leave can be important for ensuring that a lack of time is not a barrier to adult learning. For this reason, it is offered in most OECD countries with many providing compensation for learners and employers alongside statutory leave (OECD, 2018f).

At the same time, there is a need for continuing to ensure that the supply of adult education programmes reflects labour market demand. It is not just a matter of increasing skills, but ensuring that the skills that will be required by the business sector in coming years are those that are being accumulated. There is significant scope in Portugal to boost the mechanisms for anticipating future skill needs and better aligning the supply of adult learning programmes to the needs of the labour market (OECD, 2018f). While such tools have been developed for planning the content of secondary-level vocational education and training courses, they should be introduced for planning vocational education offerings for adults.

One of the consequences of low participation in adult training of those in employment is weak managerial skills in Portuguese businesses. Such competencies are important for the export sector given that the ability to re-configure production processes to cater to new markets and value chains depends on the managerial skills in a firm. Compared with some other European economies, the degree of professional management in the business sector is low (Figure 1.25). Past work estimates that moving from the distribution of manager education in Portugal to that of the US would raise aggregate productivity by about 20% (Queiró, 2016). Furthermore, weak managerial capacity is found to contribute to the high share of small firms in Portugal relative to the US.

Figure 1.25. Professional management in the business sector is relatively rare

Reliance on professional management index (7=highest), 2018



Note: The metric is based on answers to the question: in your country, who holds senior management positions (1=usually relatives or friends without regard to merit; 7=mostly professional managers chosen for merit and qualifications).
Source: World Economic Forum.

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Boosting innovation in the export sector

Innovation policy settings need to support Portuguese exporters moving into new markets and continuing to develop products with a higher content of value added. There is evidence of strong gains in the quality of Portuguese manufacturing exports over the past decade compared to other European countries such as France, Germany, Italy and Spain (Box 1.5). Nevertheless, the level of export quality across most sectors remains low compared to these other countries. Furthermore, Portugal's manufacturing exports are in the mature phase of their life cycle compared to many other OECD countries (Figure 1.26), increasing the importance of innovation to sustain the future export performance of the economy.

Box 1.5. Estimates of the quality of manufacturing exports

Recent work in the Bank of Italy used a methodology outlined by (Khandelwal, Schott and Wei, 2013) to produce estimates of the quality of manufacturing exports over time for several EU countries (Bugamelli et al., 2017). Using data at the HS-6 digit product level from CEPII-BACI, they estimate an export quality parameter that is assumed to be a demand shifter in a constant elasticity of substitution demand function (for further details, see (Bugamelli et al., 2017). That is, the estimated parameter explains differences in the quantity of a product sold in a given destination country holding prices constant.

The results highlight consistent improvements in the quality of Portuguese exports over the 1999-15 period (Table 1.2). Compared to France, Germany, Italy and Spain, the quality improvements in Portugal were particularly apparent in the 2007-15 period. These estimates reflect both the changes in the quality of a single product and the reallocation of exported volumes across products with different quality levels.

Table 1.2. Estimates of export quality

% change	FRA	DEU	ITA	ESP	PRT
1999-2007	2.3	3.1	3.4	3.2	2.9
2007-10	-3.2	-0.9	-2.7	-2.5	0.8
2010-15	-1.4	0.3	0.6	0.7	0.7

Source: Bugamelli et al., 2017, unreported estimates.

The sensitivity of export quantities to the improvements in export quality are investigated through the estimation of country-specific regressions. The results suggest that the improvement in export quality was positively associated with export quantity (confirming the product-level results documented in Box 1.2). However, the estimated elasticity of exports to quality is smaller than unity, while the (negative) coefficient on the export price term is well above unity (Table 1.2). This indicates that the positive effects of quality improvements on exports could be countervailed by an equivalent percentage point increase in Portuguese export prices.

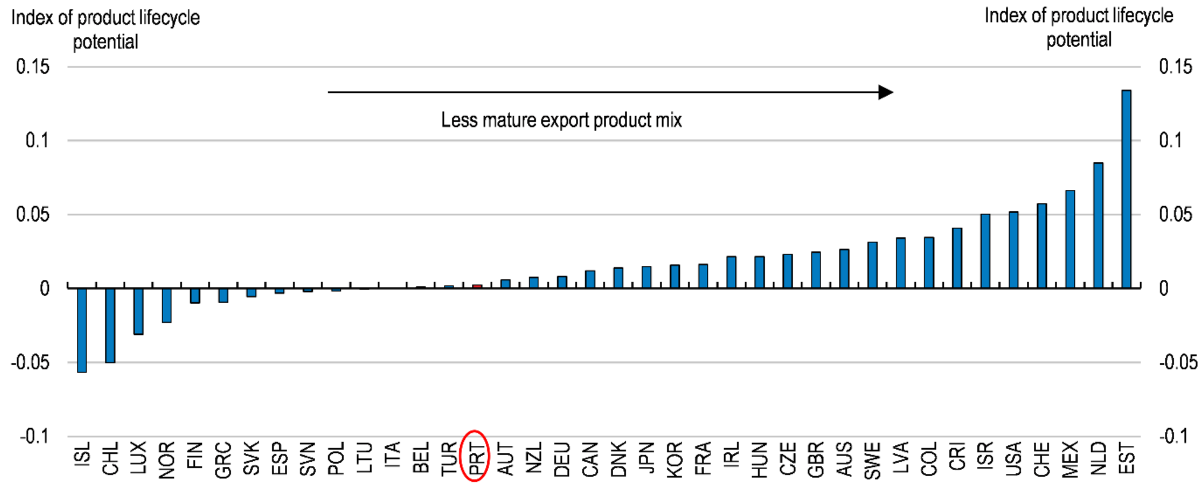
Table 1.3. Regression results (Dependent variable = export quantity)

	FRA	DEU	ITA	ESP	PRT
Export quality	0.46*** (0.01)	0.38*** (0.008)	0.45*** (0.008)	0.51*** (0.011)	0.58*** (0.02)
Export prices	-1.18*** (0.01)	-1.14*** (0.008)	-1.17*** (0.011)	-1.23*** (0.014)	-1.26*** (0.029)
Obs.	1462233	2121611	1735112	1046231	298201

Notes: Both the dependent and independent variables are in log-difference form. The regressions are estimated over the 1999-2015 period and include both product-time and destination-time fixed effects to control for changes in demand conditions that are common across products or destinations. Standard errors are in parentheses and * signifies p-value<0.05, **p<0.01, ***p<0.001.
Source: Bugamelli et al., 2017, unreported estimates.

Figure 1.26. The export product mix is relatively mature

Index of product lifecycle potential, average (2011-2015)



Note: The index is based on the analysis of dynamic comparative advantage by (Audretsch, Sanders and Zhang, 2012[37]), with the semi-elasticity of each export product with respect to time weighted according to the export shares of the product in a country's total exports. For further details, see Araujo, Chalaux and Haugh (2018).
Source: Araujo, Chalaux and Haugh (2018).

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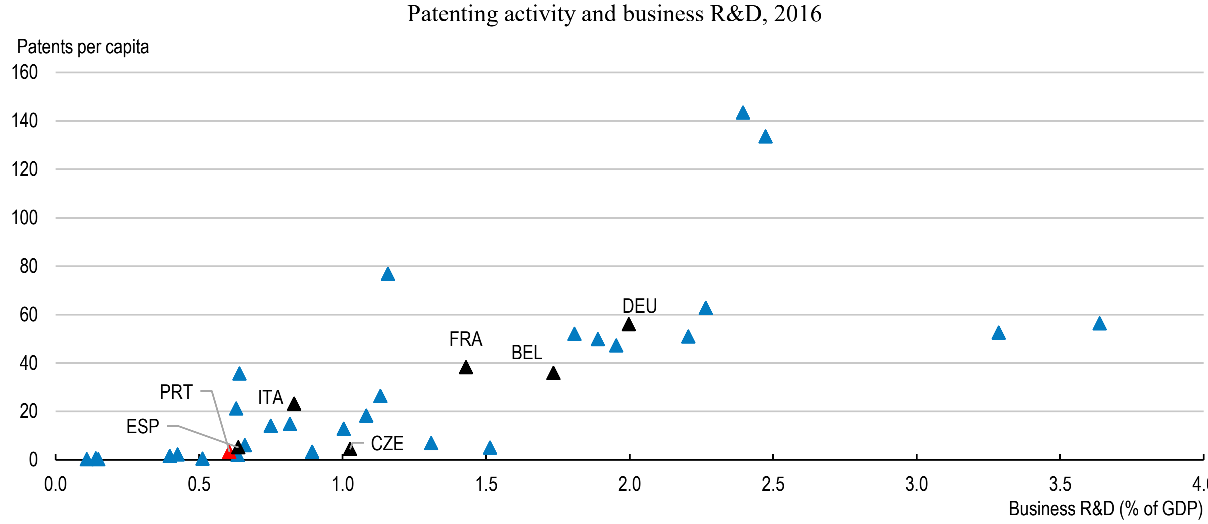
Portugal's business sector spends relatively little in the generation of knowledge-based capital. Both business research and development (as a percentage of GDP) and the number of patents (per capita) are in the lowest quadrant across OECD countries (Figure 1.27). This partly reflects the dominance of SMEs in the economy (OECD, 2018g). While many SMEs may be unlikely to develop radical innovations, performing research activity is important for their ability to demystify new technologies being developed abroad and adapt them to suit their production processes. Indeed, empirical evidence highlights the significant role of R&D capacity in the domestic business sector for technological transfer and cross-country productivity convergence more broadly (Griffith, Redding and Reenen, 2004).

Figure 1.27. Research intensity and innovation output in the business sector are low

Patenting activity and business R&D, 2016



Note: Business R&D data for Australia, New Zealand and Switzerland are for 2015.
Source: OECD, United Nations.

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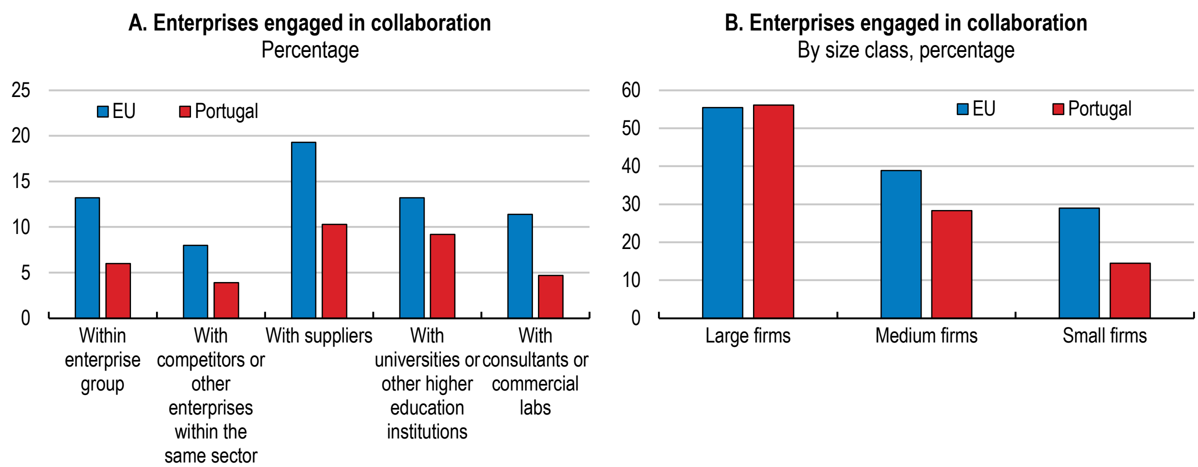
Smaller firms can build innovation capacity through collaboration with external entities possessing the advanced machinery or skilled personnel to engage with the technologies and organisational processes at the technological frontier. While collaborative projects financed by EU funds have been increasing in the last few years, Portuguese firms are less likely to collaborate in innovative activities than their EU counterparts (Figure 1.28, Panel A). This is due to particularly low collaborative activities of those smaller and medium-sized firms that could accrue substantial benefits (Figure 1.28, Panel B).

Figure 1.28. Collaborative research activities are limited, especially for small firms



Source: Eurostat.

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The government has established a variety of intermediary organisations (technology transfer offices, technology centres, science and technology parks, incubators and clusters), partly funded through EU funds. The efficacy of the various intermediary institutions should be carefully evaluated and ongoing government funding allocated to those that have been shown to be particularly effective. In 2017, the government launched the *Programa Interface*, which includes multi-annual financial support for selected intermediary organisations including technology centres, clusters and collaborative laboratories (Box 1.6). As recommended in the 2018 *OECD Review of Higher Education, Research and Innovation*, this funding should be maintained on a continuous basis for intermediary organisations that successfully fulfil the objectives announced in their development plans.

Box 1.6. Fostering innovation collaboration through *Programa Interface*

Launched in 2017, the ongoing *Programa Interface* aims to improve links between scientific knowledge and business innovation through fostering collaborative activities between universities, research and technology organisations and companies. The programme includes four main initiatives:

- **Technology and Interface Centres** - 28 such centres have been certified, with EU funds being directed to support companies' collaborations with these centres in key domains such as digitisation, circular economy or energy efficiency, as well as promoting scientific and qualified employment and R&D projects within businesses;

- **Clusters** – 20 sectoral clusters have been recognised in a variety of sectors such as mineral resources, architecture, engineering and construction, sustainability, health and footwear. The clusters aim to promote internationalisation and knowledge sharing among companies, higher education and research institutions.
- **Collaborative Laboratories** – 21 "CoLabs" have been identified that define and implement research and innovation agendas in specific topic areas that can create economic and social value. Various entities are engaged in the CoLabs including companies, higher education institutions, intermediate and interface institutions, technological centres, business associations and other relevant partners. Selected topics include food and smart farming, construction sustainability, healthcare, cyber security and poverty and social protection;
- **Clubs of Suppliers** – aims at promoting companies, especially SMEs, to participate in international value chains. For instance, this may occur by supporting a firm that already cooperates with a specific multinational to jointly expand and supply other branches.

There is also scope for a more focused approach to promoting innovation collaboration by small and medium enterprises. One of the major impediments to the participation of smaller firms may be a lack of understanding of how to engage in such collaborative activities. Research institutions, such as universities and polytechnics, should thus focus on providing simple short-term collaborative activity offerings (e.g. updating ICT capacity in a small business) that can lead to a longer term relationship and more transformational projects for the firm.

In Ireland, one approach by research centres to increase the involvement of small firms in collaborative activities has been to gather a group of them together to participate in a "grand challenge" research project in which they all have a common interest (OECD, 2018h). Such an approach reduces the investment needed in the project by any individual firm, making it more feasible and attractive for them to participate. In other countries, including the United States, the United Kingdom and several Latin American countries, specific regionally-based institutions have been set up to provide small and medium enterprises easy access to resources that help them upgrade their innovation capabilities such as relevant information, expertise and equipment (OECD, 2018g).

Policy recommendations for further promoting export performance

Improving the framework policies for high-potential businesses

Key recommendations

- Simplify the tax system by reducing the use of special provisions (e.g. tax exemptions, special rates) and ambiguity in the tax language.

Other recommendations

- Open reserved activities for certain professions to competition from other professions, such as the exclusive rights of customs brokers to represent firms to relevant authorities.

Ensure domestic infrastructure promotes better export performance

Key recommendations

- In awarding port concessions, take into account the price that bidders will charge port users in addition to other criteria.
- Ensure that port concession contracts specify a minimum level of investment by the operator and do not renew concessions without opening a new public tender.

Other recommendations

- Abolish regulations that restrict the ability of port authorities to license multiple private operators for some port services.

Promoting better skills and innovation in the business sector

Key recommendations

- Better target lifelong learning opportunities to the low-skilled, including by collecting information on the private returns to skills and making it publicly available.

Other recommendations

- Ensure that adults are targeted by programmes aiming to enhance digital skills.
- Introduce tools to ensure vocational education curricula for adult education reflect labour market needs.
- Continue to support intermediary organisations that focus on fostering innovation collaboration for small and medium enterprises.

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Chapter 2. Enhancing judicial efficiency to foster economic activity

A well-functioning justice system is indispensable to business activity and to a society as a whole. Judicial efficiency measured by trial length, one of the essential factors in the effectiveness of the justice system, ensures contract enforcement, which is the basis of market transactions. Judicial efficiency is closely associated with accessibility to judicial services and the certainty of judicial decisions, raising people's confidence. Portugal has undertaken numerous judicial reforms in the past, to the extent that it is difficult to disentangle and evaluate fully the effects of each reform. Overall, judicial efficiency remains weak, as reflected in the average trial length and bottlenecks in a number of courts. The data collection system, significantly developed as part of the reforms, can be more fully utilised for allocating court resources. The autonomy of the judicial council and court presidents can also be strengthened so that they can effectively manage resources. Individual judges can be better incentivised through performance-oriented evaluation. Competition in the legal profession sector can be enhanced while increasing the transparency of legal services. Also, alternative dispute resolution mechanisms can be developed further, meeting different needs for judicial services, in particular those on insolvency, while alleviating court congestion. Finally, building on past and ongoing reform efforts, the judicial system should continue to improve the capacity to undertake forensic investigations of economic and financial crimes.

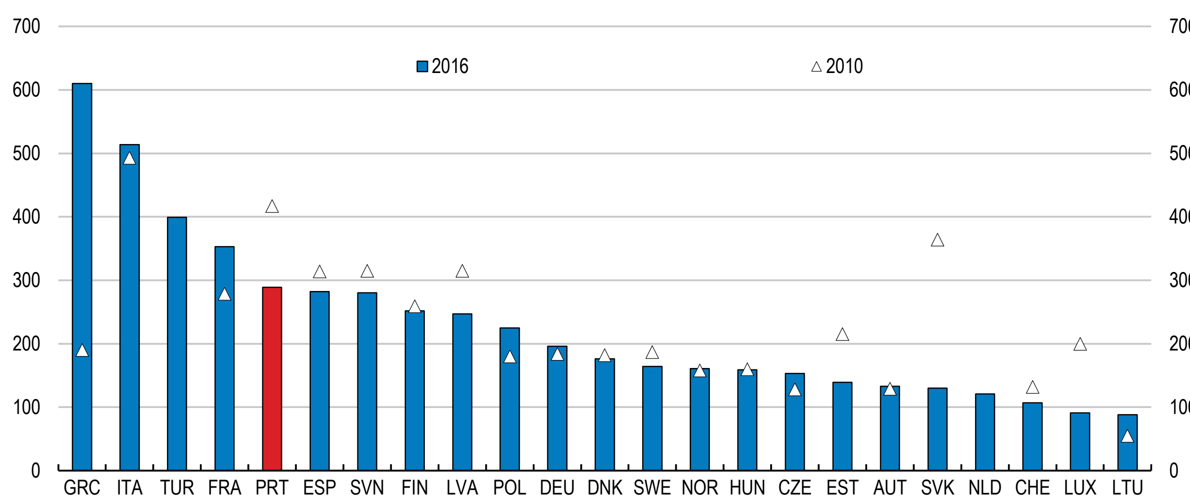
Economic development in the long run is shaped by institutions and the associated regulatory framework. Favourable regulatory settings are only effective if they are complemented by legal institutions that ensure their implementation. Portugal has made significant progress in regulatory reforms over the past decade. The beneficial effects of these reforms can be boosted further by addressing efficiency in the judicial system. A more efficient judiciary ensures contracts are enforced effectively and in a timely manner, thereby improving business dynamics and productivity and boosting investment.

The judicial system is very complex and its effectiveness comprises many facets, including efficiency, fairness, and the quality of decisions. Judicial efficiency is a key factor to ensure the proper functioning of markets. Trial length is the indicator of judicial efficiency that tends to be most closely related to economic activity (Palumbo et al., 2013). From the perspective of businesses, the certainty of judicial decisions and the accessibility of judicial services are also essential. Trial length is closely associated with these other two aspects of the judiciary, because lengthy trials constrain access to judicial services (due to the capacity constraints of the courts) and compromise the certainty of judicial decisions (as in the legal maxim: "justice delayed is justice denied"). Furthermore, judicial efficiency is positively related to individuals' confidence in the justice system (Palumbo et al., 2013).

The average time to resolve a case in courts is long in Portugal (Figure 2.1), indicating inefficiency in the court system. Trial length is affected by factors within the court settings such as resources and governance in courts (Figure 2.2), which are essential factors explaining the performance of most efficient court systems across OECD countries (Palumbo et al., 2013). Improving these aspects can reduce trial length without reducing the quality of judicial decisions. Trial length is also explained by the behaviour and incentives of different actors in a broader legal system (Figure 2.2). While ensuring fair access to the judiciary for all, ill-founded litigation that unnecessarily boosts court congestion needs to be reduced.

Figure 2.1. Court proceedings are shorter than before, but still long

Average time needed to resolve civil and commercial cases, first instance courts, in days



Source: CEPEJ.

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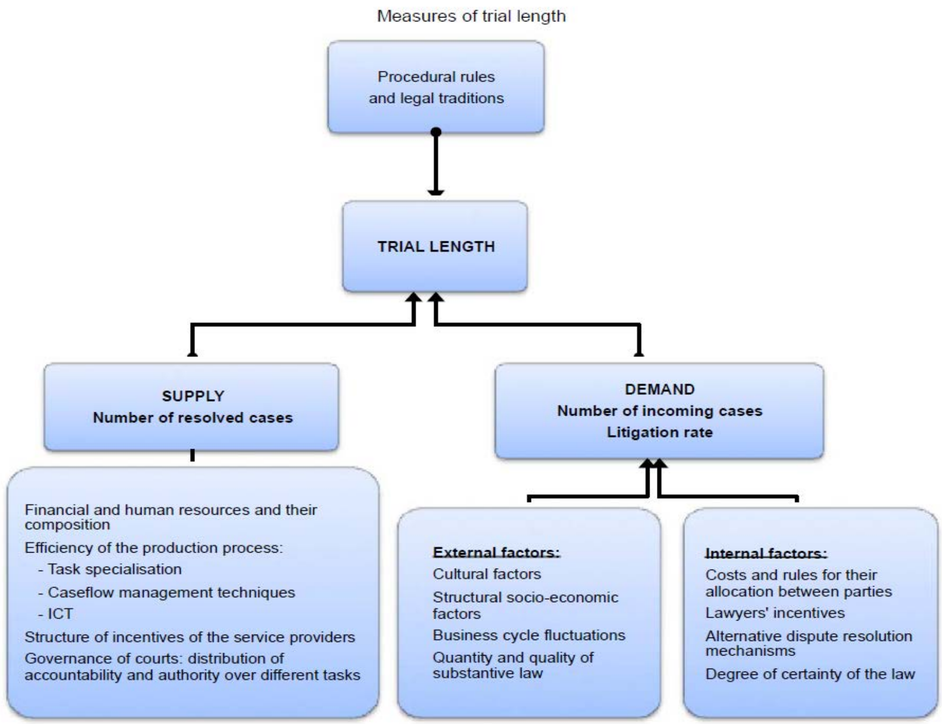
Figure 2.2. Judicial efficiency as measured by trial length



Source: Palumbo et al. (2013), "The Economics of Civil Justice".

The main findings of this chapter are:

- Judicial efficiency needs to be improved, which is indicated by the average trial length and significant bottlenecks in some courts, in order to ensure timely contract enforcement for businesses, facilitating firm expansion as well as insolvency proceedings;
- Significant reforms have been undertaken over the past years, which substantially reformed the framework of the judicial system (Box 2.1). Nonetheless, operational problems remain. Judicial resources, such as judges and budgets, can be better allocated across court districts through developing workload assessment and strengthening the governance structure;
- Court congestion remains significant, due mainly to debt enforcement proceedings, which can be alleviated by developing further alternative dispute resolution mechanisms, in particular those aiming at debt enforcement; and
- The Public Prosecution Office and the Criminal Investigation Police should be endowed with adequate resources and continue to provide specialised training for public prosecutors on economic and financial crime, including corruption.

Box 2.1. Recent reforms in the Portuguese court system

In recent decades, several reforms were implemented in the Portuguese judicial system. More recently, the Memorandum of Understanding on Financial Assistance signed in May 2011 with the IMF and the European Union demanded the implementation of judicial reforms, setting as priority the efficiency of the judicial process. A series of reforms followed:

The Backlog Reduction Program

A special task force from the judiciary and the executive reviewed all pending enforcement cases. Then, a Decree Law was enabled to close more than 500 000 enforcement cases in 2013 (45% of all pending enforcement cases as of May 2011), which had been inactive for long periods.

The new Code of Civil Procedure

The new Code of Civil Procedure (Law 41/2013, June 26) aimed to simplify some excessive procedural rules in court proceedings.

- The new Code of Civil Procedure allows judges to set time frames for their decisions and gives them the right to dismiss parties' submissions aim solely at delaying the court process.

- It increased certainty in court proceedings by, for example, limiting enforceable titles (e.g. private documents such as promissory note are no longer enforceable).

- It reduced administrative burdens, as no separate enforcement action is necessary to enforce an enforceable court decision.

- It allows an enforcement proceeding to terminate after three months, if no assets are found in the procedure.

The Law for the Judicial System Organisation

The Law for the Judicial System Organisation (Law 62/2013, August 26) reorganised the courts in Portugal and reformed the management model in the court system.

- The reorganisation of courts resulted in a reduction in the number of court to 23 district/comarca courts, from 323 first instance courts in total (142 specialised or specific competence/jurisdiction and 181 generic competence).

- The management responsibility of the High Council for the Judiciary at the central level was strengthened. The High Council for the Judiciary sets overall strategic objectives every three years, including performance targets, which are translated into annual performant targets.

- The reform introduced a new management structure in each of the new 23 district/comarca courts and these courts acquired autonomy in the management of their own courts, developing the annual work plans, the attendant budgets, and personnel requirements.

- The reform introduced performance targets for each court, set by each district/comarca court and the High Council for the Judiciary, with a quarterly assessments on performance.

Other reforms to speed up enforcement proceedings

- In 2012 the Special Proceeding for Revitalisation (PER) was introduced and reformed in 2017. The Out-of-court regime for firm restructuring (RERE) was also introduced in 2018, as well as the Company Recovery Mediator.

- "PEPEX" which is an expedited procedure allowing creditors to verify whether debtors have assets and to decide whether or not to pursue enforcement came into effects in 2015, applying to small value claim cases (up to EUR 10 000);

- "Automated" procedures for seizing amounts in bank accounts, in which the enforcement agent has access to a database in Banco de Portugal;

- Electronic platforms for auctioning of seized assets were also introduced.

Judicial efficiency is crucial for business activity

Judicial efficiency is a critical framework condition for doing business and attracting FDI (Box 2.2). As discussed further below, the Portuguese judicial system is inefficient, with firms reporting perceived inefficiency in the judicial system as one of the most severe constraints to their operations (INE, 2018).

Box 2.2. Impact of judicial efficiency on economic performance

The legal environment affecting financing and firm growth:

Secure property rights are associated with better financial and economic outcomes, such as a greater use of external finance (La Porta et al., 1997). The reliability of the legal system for dispute resolution is found to increase firms' use of external financing to fund growth, using firm-level data from 30 countries (Demirgüç-Kunt and Maksimovic (1998)). The trust in judicial efficiency is found to be particularly important to finance investment in intangible assets, which in turn increases the size of firms investing in these assets, using firm-level data from 15 European countries (Kumar, Rajan and Zingales (1999)).

Creditor rights affecting bank lending:

Creditor rights are found to affect the terms of bank loans, such as bank lending spreads (Laeven and Majnoni, 2005; Qjan and Strahan, 2007) as well as loan maturities (Qjan and Strahan, 2007), using an extensive firm-level dataset. Besides the legislation on creditor rights, the enforceability of contracts on the ground also matters. The enforceability of contracts is found to increase the amount of bank lending and loan maturities and to reduce bank lending spreads, using a larger sample of loans than the above mentioned studies (Bae and Goyal, 2009).

Insolvency regime and bank lending:

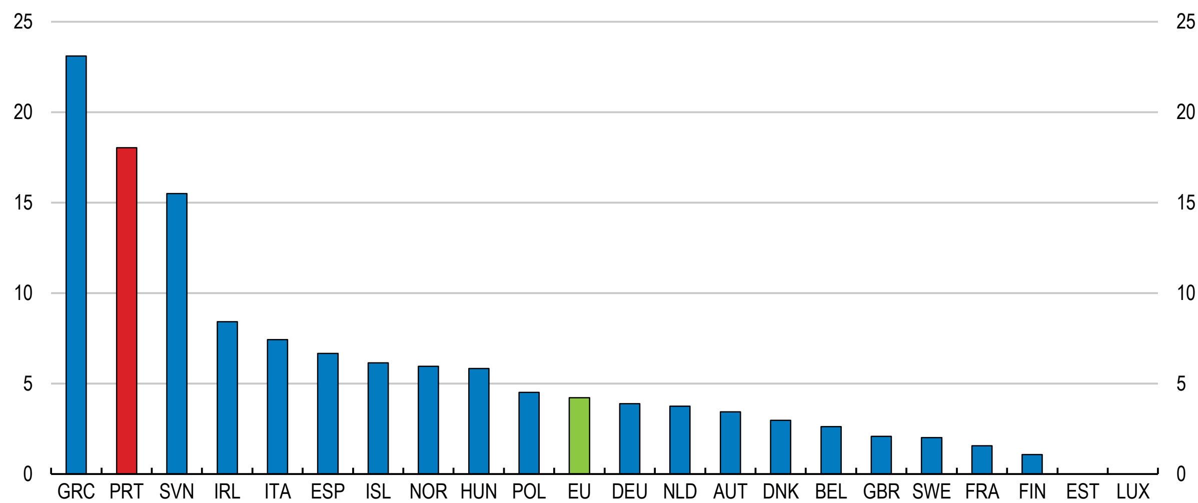
The insolvency regime affects bank lending and its conditions. The effectiveness of insolvency regimes, facilitating debt resolution, is found to be positively related to the size of debt markets (the credit-to-GDP ratio), using data from 88 countries and the World Bank Doing Business indicator on insolvency (Djankov et al., 2008). The inefficiency in debt resolution impedes the reallocation of resources from unproductive to productive firms. Such delays in debt resolution, associated with difficulties in recovering collateral quickly, are found to negatively affect bank lending, based on an analysis of SME loans in European countries (Bergthaler et al. 2015; Aiyar et al. 2015).

Judicial efficiency ensures contract enforcement

Judicial efficiency facilitates financial transactions by ensuring creditors' rights, promoting investments and innovation. In the case of default, the enforcement of collateral would limit subsequent losses. Collateral enforcement most often requires court proceedings, which are quite long, complex and surrounded by uncertainty in Portugal. The collateral value can decline markedly during the proceedings. This is reflected in a very low recovery rate; just 12% on average (Ministry of Justice, 2018). Thus instead of pursuing court proceedings, forbearance has been granted in some instances (Figure 2.3), which has the potential to crowd-out new lending to healthier firms (Anderson, Riley and Young, 2017).

Figure 2.3. Forbearance loans are frequently extended in Portugal

The forbearance loans ratio as a percentage of total outstanding loans in the corporate sector, Q2 2018



Source: EBA, "Risk Assessment Report", December 2018.

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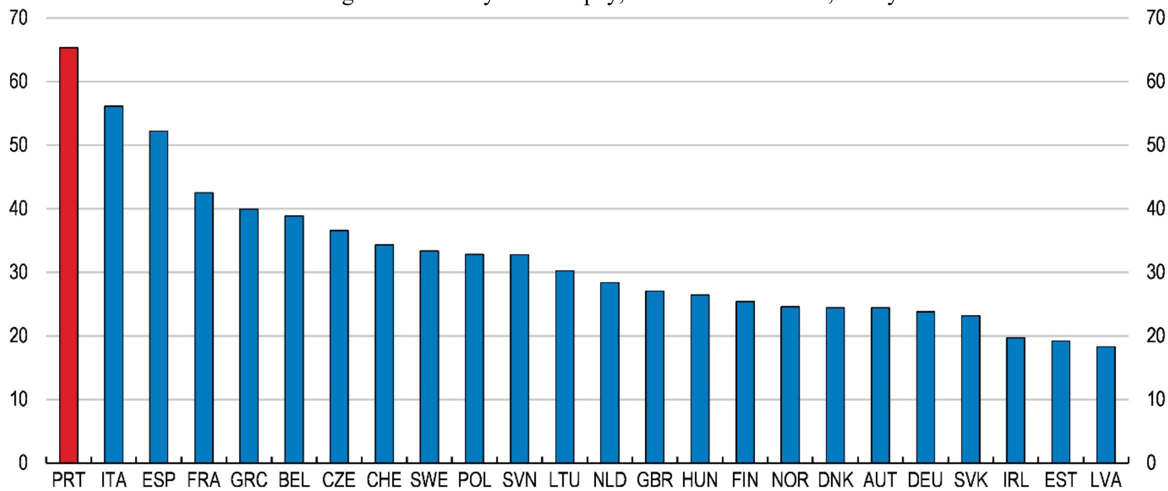
Judicial efficiency facilitates market transactions by ensuring timely contract enforcement, thus promoting competition in the business sector. Payment risk in Portugal is high, as late payments are very frequent (Figure 2.4), affecting Portuguese firms most often through liquidity constraints. These problems are also perceived to be hampering firm expansion and even to be a threat for firm survival in some cases (Intrum, 2018). Breaches of contract can be remedied by court order, but court proceedings can be long and complex in Portugal, encouraging negligent behaviour of some debtors.

Apart from economic and geographic conditions, institutional factors affect the inflow of FDI. Among different institutions, the judicial system is found to be significantly important for FDI inflows (Bénassy-Quéré, Coupet and Mayer, 2007); (Júlio, Pinheiro-Alves and Tavares, 2013), with contract enforcement among these factors (Júlio, Pinheiro-Alves and Tavares, 2013). The quality of FDI inflows can also be affected by these factors. Despite Portugal's economic openness, the stock of FDI remains below that of other comparable small European economies (Chapter 1).

Figure 2.4. The average time to pay is long in Portugal

The average time actually taken to pay, Business to business, in days.



Source: Intrum (2018), "European Payment Reports 2018".

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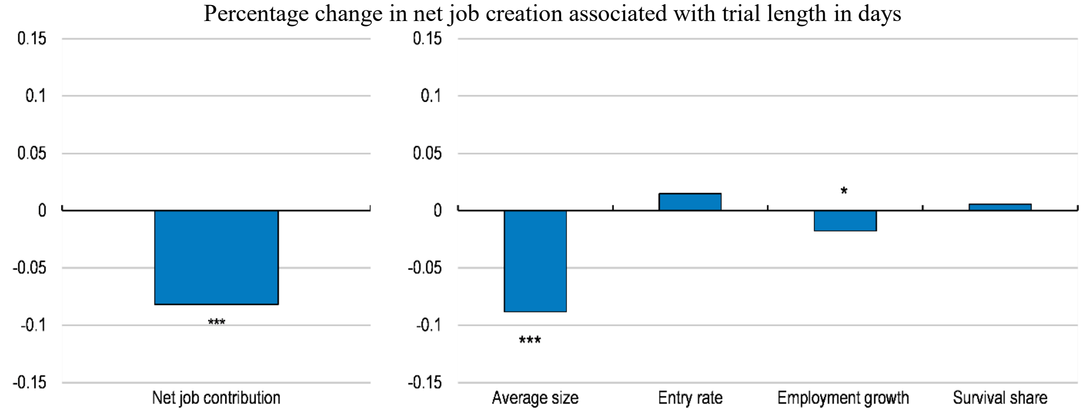
Judicial efficiency affects business dynamics

Judicial inefficiency, measured by trial length, is negatively associated with firm expansion, in particular, for start-ups. For instance, Calvino, Criscuolo and Menon (2016) show that a trial length that is 100 days longer than the average reduces net job creation by 8% (Figure 2.5). The size of firm at entry is negatively affected by judicial inefficiency because potential costs in the case of dispute rise with firm size. Furthermore, post-entry growth in employment is negatively affected by judicial inefficiency which impedes the reallocation of resources to highly-productive firms. Portuguese start-ups tend to remain small in size in both the manufacturing and services sectors, compared with other OECD countries (Criscuolo, Gal and Menon, 2014), due to problems in the reallocation of resources.

Figure 2.5. Net job creation of start-ups is reduced by judicial inefficiency

Percentage change in net job creation associated with trial length in days



Note: The DynEmp project aims at creating a harmonised cross-country micro-aggregated database on employment dynamics from confidential micro-data, where the primary sources of firm and establishment-level data are national business registers.

***, **, *: the results are statistically significant at the 1%, 5% and 10% level, respectively.

Source: Calvino et al. (2016), "No Country for Young Firms?" OECD Science, Technology and Industry Policy Papers No.29.

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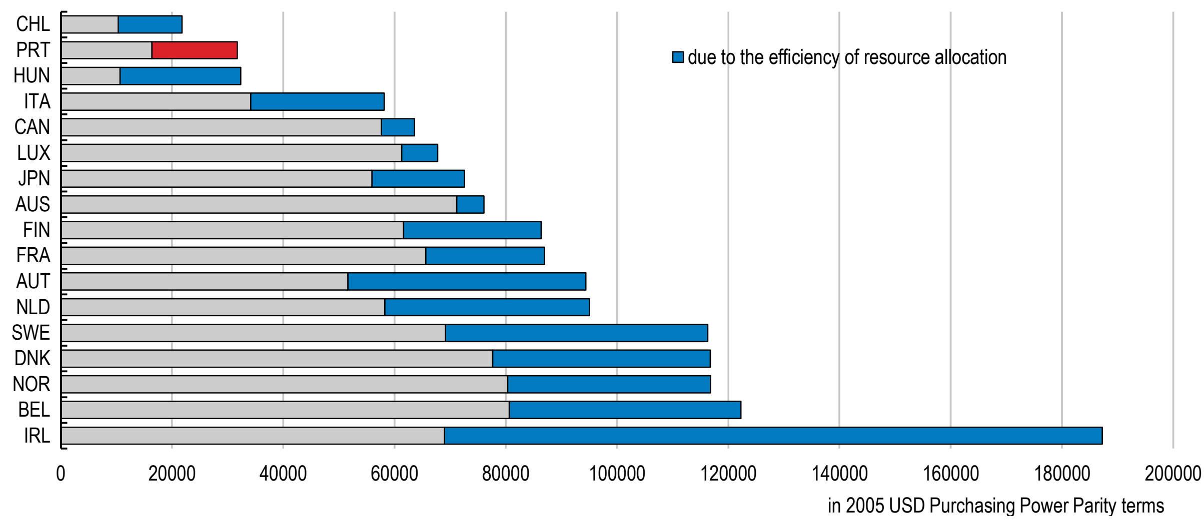
Judicial inefficiency can weaken market selection mechanisms. It is reflected in the limited expansion of highly-productive firms.. The prevalence of non-viable firms, potentially associated with judicial inefficiency, weakens the efficiency of resource allocation, as they trap resources and stifle the ability of highly-productive businesses to expand (Figure 2.6). Such non-viable firms have reduced the investment and employment growth of healthy firms in many OECD countries over the past decade (Adalet McGowan, Andrews and Millot, 2017), and in Portugal (Gouveia and Osterhold, 2018).

Figure 2.6. The allocation of resources is inefficient in Portugal

Labour productivity of firms in the manufacturing sector



How to read this chart: aggregate productivity is decomposed into the contribution of two terms, an unweighted productivity term representing average firm level productivity, and a covariance term that links productivity to firm size. The latter term is a measure of allocative efficiency, since it increases if more productive firms capture a larger share of resources in the sector, the contribution of which to aggregate productivity is shown as "due to the efficiency of resource allocation" in the chart.

Note: The MultiProd project in the OECD uses existing official firm-level data (official surveys and administrative sources) in a harmonised framework to provide micro-aggregated statistics and analysis that are comparable across countries (see Berlingieri et al., 2017 for more details).

Source: Berlingieri, G. et al. (2017), "The MultiProd Project: a Comprehensive Overview".

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Court settings are key for judicial efficiency

Courts play a crucial role in proceedings and adjudicating cases, which operate within particular institutional settings (Box 2.3). The efficiency of Portuguese courts is weak, with lengthy court proceedings (Figure 2.1), associated with slow case resolution (Figure 2.7). The most common possible explanations for slow case resolution are the structure of trial procedures and procedural formalism (e.g., Djankov et al., 2003), inefficiency in the allocation of court resources (e.g. Palumbo et al., 2013), and weak incentives for judges (e.g., Miceli and Coşgel, 1994).

Box 2.3. The Portuguese court system

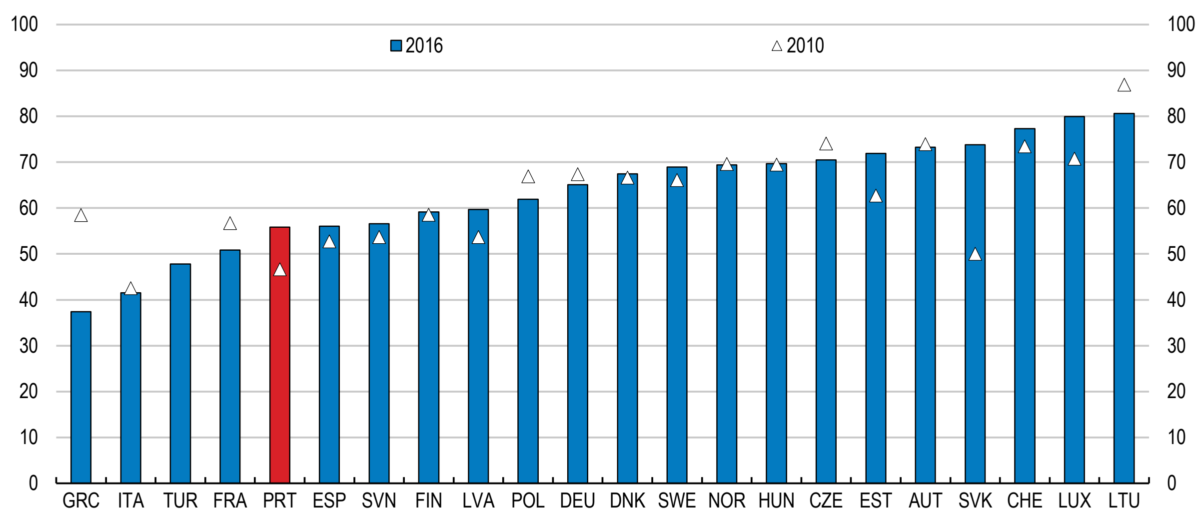
Portugal is a civil law tradition country, in common with two-thirds of the legal systems worldwide. The Portuguese court system is mainly divided into two jurisdictions, as established in the Constitution of the Portuguese Republic: administrative and civil. This separation of jurisdictions is a typical feature of this legal tradition (Merryman and Perez-Perdomo, 2007), where a strong distinction between private law and public law is made.

- Judicial courts with civil and criminal jurisdiction are organised in three levels: first instance courts (*tribunais de comarca* / district courts), courts of appeal (*tribunais da relação*) and the Supreme Court. There are currently 23 district courts and specialised courts such as the commercial courts, enforcement (execution) courts or family and minors courts. There are also enlarged jurisdiction courts (with national jurisdiction) such as the Maritime Court; Intellectual Property Court; Competition, Regulation and Supervision Court; Criminal Prosecution Central Court.

- Tax and administrative courts are also organised in three levels: first instance administrative and tax courts (*tribunais administrativos de circulo e tribunais tributários* / circuit administrative courts and the tax courts), central administrative courts (*tribunais centrais administrativos*) and the Administrative Supreme Court.

Figure 2.7. Resolution in courts is slow in Portugal

Resolution rate



Note: "Resolution rate" is defined as the number of resolved cases divided by the cases in stock (the latter is defined by the sum of the number of pending cases at the end of the previous year and the number of incoming cases).
Source: European Commission for the Efficiency of Justice (CEPEJ).

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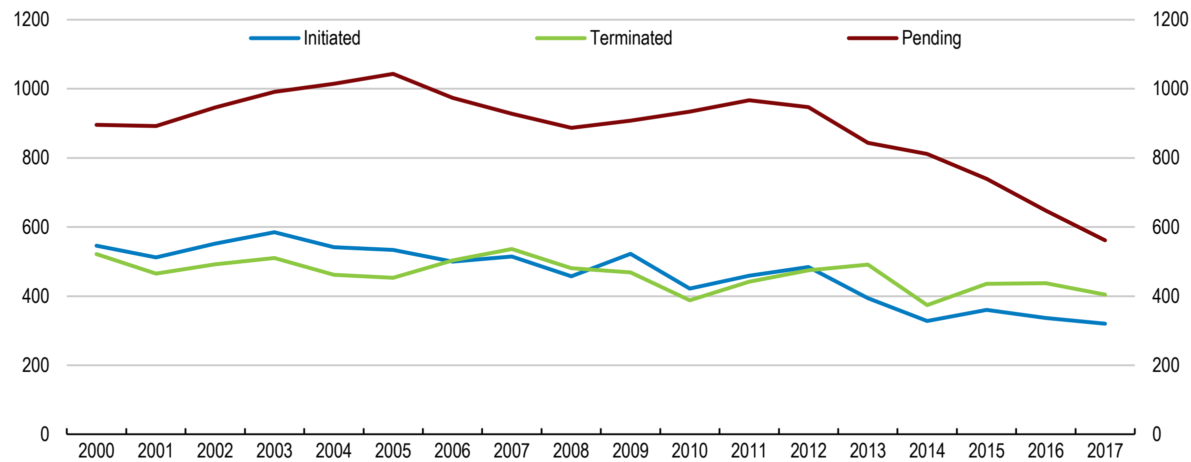
Trial length remains long with significant disparities

Court congestion has significantly declined over the past decade, but the number of pending cases remain high (Figure 2.8). The backlog in the civil justice system has declined by 45% since 2007, likely reflecting a series of reforms undertaken over the past years. The number of terminated proceedings has consistently surpassed that of initiated proceedings over the past five years, eroding the backlog of pending cases in the system (Figure 2.8). It is difficult to fully assess recent reforms due to the lack of additional data. For instance, it is not possible to control for case complexity completely, while more complex cases can take longer to be decided. There is no information regarding the quality of judicial decisions, although decisions with higher quality might require more time (Bielen et al., 2018).

Figure 2.8. Court congestion has been alleviated, but remains significant

Number of initiated, terminated and pending proceedings per judge



Source: Pordata.

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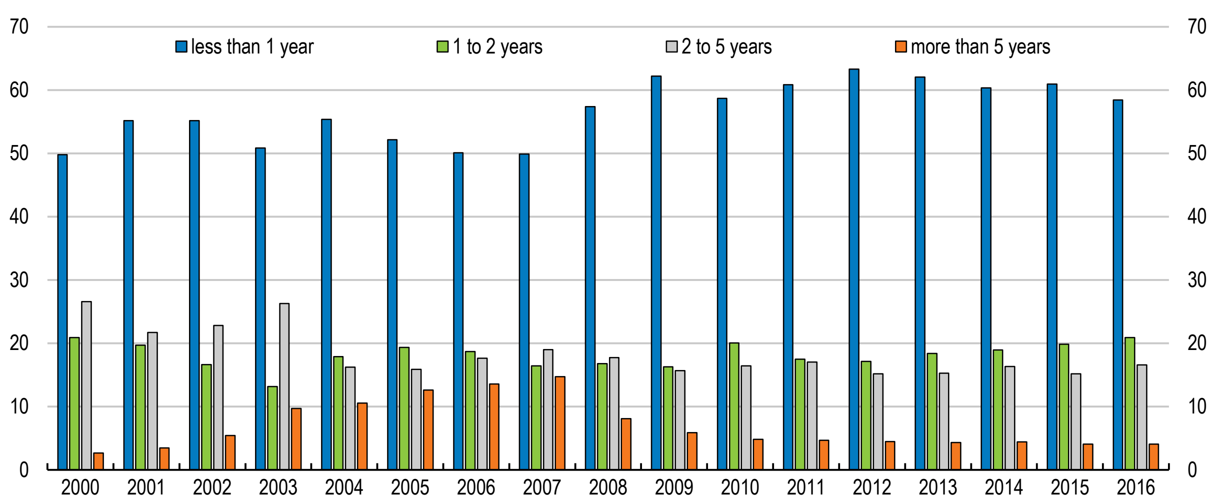
Overall, the incidence of very long proceedings has declined over time, but some cases still require a significant amount of time (Figure 2.9). At least half of cases have always been disposed in less than 1 year. The proportion of disposed cases that take more than 5 years has also decreased. Nonetheless, the proportion of cases taking more than 1 year remains high, accounting for more than 35% of all cases.

Figure 2.9. Some cases still require a significant amount of time

Share of resolved cases according to duration, civil cases, first instance courts



Source: Pordata.

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In what follows, the focus will be on civil cases, since they are essential for businesses, including contract enforcement and insolvency proceedings. It is also in this type of cases that delays are the most significant: in 2016, the average duration in first instance courts was 33 months for civil cases, 8 for criminal cases and 11 for labour cases. In 2017, civil cases accounted for 64% of initiated proceedings and 69% of terminated proceedings. These are also congested cases, as 89% of pending proceedings correspond to civil cases. If we consider the type of civil cases, those related to commercial and civil debts account for 60% of initiated proceedings and 86% of pending proceedings.

Indeed, long delays in enforcement are one of the characteristics in Portugal. The post-court enforcement process in Portugal often requires the intervention of the court even after a court decision is made, which is not common across other EU countries. Such requirements add further delays in the whole process to resolve a case. Although the series of recent reforms likely increased the chance of resolving a debt enforcement case in the early months, debt enforcement typically takes a long time despite a reduction from around 60 months in 2010 to 30 months in 2015 for the median case (Pereira and Wemans, 2018).

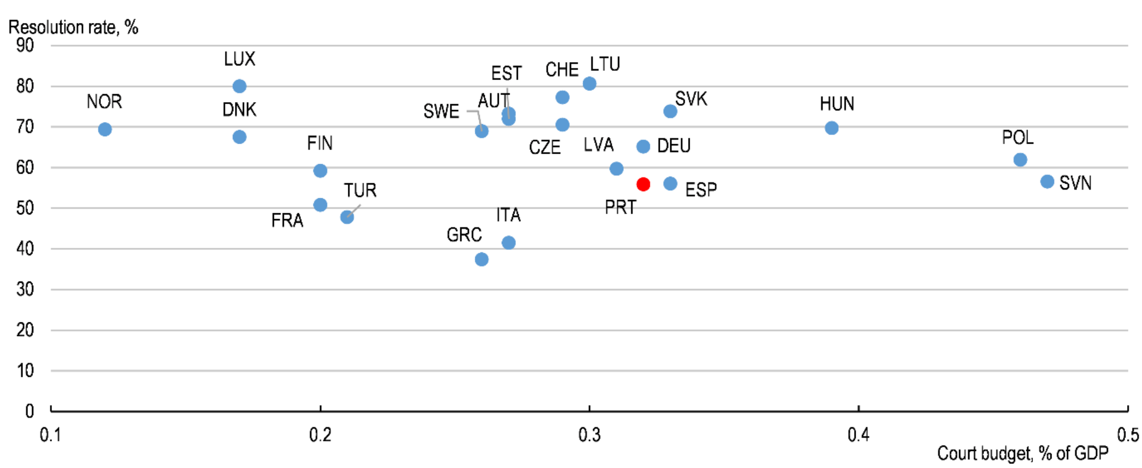
Judicial resources are not allocated efficiently

Judicial resources and allocation

Overall court performance can be affected by the total amount of resources, but the efficient allocation of judicial resources is even more important (Palumbo et al., 2013). In fact, countries with similar budget allocated to courts as a percentage of GDP have very different average trial lengths (Figure 2.10). Previous studies do not support a statistically significant relationship between the budget allocated to courts and court performance (e.g. Cross and Donelson, 2010; Voigt and El-Bialy, 2016).

Figure 2.10. Total court budget does not explain court performance

Budget allocated to courts as a percentage of GDP and the resolution rate, 2016



Note: GBR includes England and Wales only.
Source: CEPEJ.

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The composition of spending items can affect court performance. The budget allocated to the judiciary is divided into different items such as salaries, ICT, training for judges and real estate. All other things being equal, countries devoting a larger share of the budget to ICT have shorter trial length (Palumbo et al., 2013). In Portugal, the share of salaries was the largest across OECD countries for which data were available in the early 2010s. Since then, Portugal has increased the budget for digitalisation, while consolidating, strengthening and expanding computer applications, notably, the information system on court proceedings (as part of the *Justiça Mais Próxima* reforms). Portugal is now among the top countries in Europe in terms of digitalisation and ICT in the justice sector (CEPEJ, 2016).

An increase in the number of judges is unlikely to improve overall court performance in itself. The total number of judges per inhabitant in all courts has increased by 13.5% between 2004 and 2017 (Table 2.1). Several studies investigated the relationship between the total number of judges and court performance, but overall, court performance does not statistically significantly depend on the number of judges, in particular, when the causal relationship is properly controlled (e.g. Dimitrova-Grajzl et al., 2012).

Table 2.1. The number of judges has increased strongly

	Total Judges per 100,000 inhabitants and type of court:			
Year	All Courts	First Instance Courts	Tribunais da Relacao	Supreme Court
2004	16.8	11.4	2.9	0.6
2005	17.2	11.7	3.1	0.6
2006	17.5	11.9	3.2	0.6
2007	17.6	12.0	3.4	0.6
2008	18.2	12.1	3.6	0.6
2009	18.6	12.4	3.8	0.6
2010	18.6	12.6	3.7	0.5
2011	18.4	12.5	3.6	0.6
2012	19.3	12.7	3.9	0.6
2013	19.5	13.1	3.8	0.6
2014	19.3	12.9	3.7	0.6
2015	19.4	13.1	3.6	0.6
2016	19.4	12.8	3.7	0.6
2017	19.6	12.7	3.9	0.6

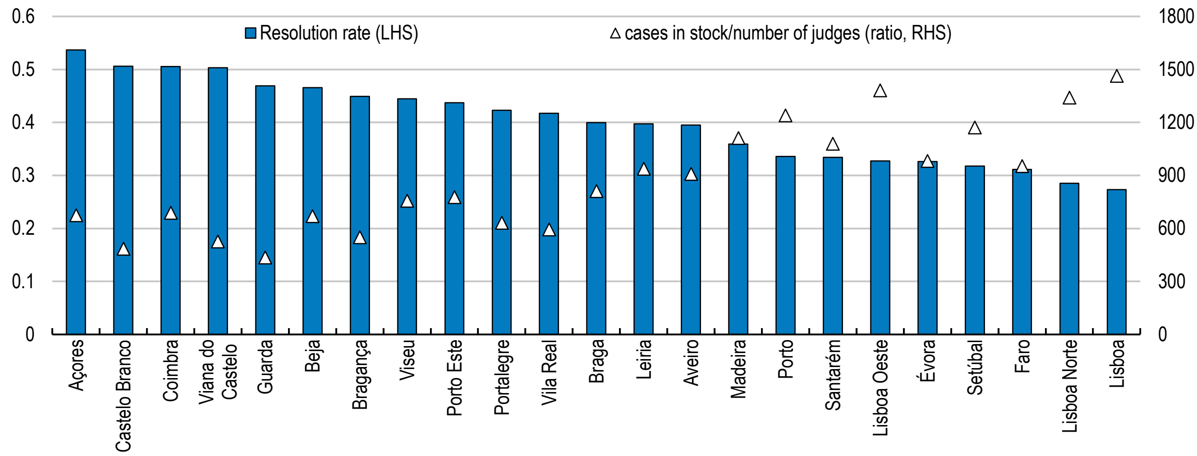
Note: "All courts", includes judges from judicial courts, from administrative and tax courts, and the Constitutional Court. Excludes Public Prosecutors.
Source: Ministry of Justice.

The allocation of judges across courts is a key factor to explain court performance (Palumbo et al., 2013). There remain significant bottlenecks in some first instance courts, in spite of the increase in the total number of judges, and these bottlenecks are clearly associated with a low resolution rate (Figure 2.11). The reallocation of judges from relatively vacant courts to congested courts would be beneficial to resolve such bottlenecks. Using district court level data in Portugal, it was found that the workload was very different across court districts and cases are resolved progressively slowly as the number of incoming cases grows, all else equal (Pereira and Wemans, 2017), supporting such a reallocation of judges. The inability to do such reallocation can result from problems in workload assessment and a lack of effective management of resources.

Currently, it is difficult to fully assess the effectiveness of the court system, including the effects of recent reforms. There is a discontinuity in data at court district level due to the introduction of a new judiciary matrix (*mapa judiciário*), which modified the boundary of court districts (Box 2.1). In general, data on some key aspects are not sufficient to evaluate the court system, such as information on quality, complexity of cases, and costs of litigation. Such disaggregated data would enable researchers to assess properly the efficiency of judges and courts (as measured by trial length), the effects of the past reforms, as well as the characteristics of complex cases associated with longer case duration. Overall, the recent reforms have improved the effectiveness of the court system (further detailed in OECD, 2019), but significant bottlenecks in some court districts imply scope for further improvements (Figure 2.11).

Figure 2.11. Significant bottlenecks remain in some court districts

Civil cases, 2017



Source: Ministry of Justice and High Council for the Judiciary.

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Courts' infrastructure for workload assessment

Case-flow management indicates the set of actions that a court can take to monitor the progress of cases and to make sure that they are managed efficiently, ensuring a smoother functioning of courts and improving the performance of courts. Among the different case-flow management techniques evaluated by Palumbo et al. (2013), the early identification of long or otherwise potentially problematic cases appears to be associated with shorter trial length.

An information system, CITIUS, was introduced in 2007 in the civil justice system. CITIUS aimed at treating electronically all information belonging to a proceeding, giving judges the possibility of making sentences, court orders and other judicial decisions in the application; signing sentences and court orders; receiving and sending proceedings electronically to the registry; and identifying which procedures were assigned to judges and corresponding stages (Contini and Lanzara, 2013). The use of CITIUS became mandatory in judicial courts and intensive training was provided to judges. The system brought significant changes, not only positive but also negative ones. There are non-negligible technical aspects that make it challenging to use, such as the need for a server and capacity to store millions of documents.

The CITIUS system was not necessarily well adapted to meet judges' needs, at least partly because judges were not involved in the process of designing the system. In 2009, a survey on the functioning of the CITIUS system was completed by 13.3% of judges using it (Associacao Sindical dos Juízes Portugueses (ASJP), 2009). 79% of respondents noted that CITIUS brought an increase in time spent with daily tasks (of up to 114%), mostly due to an inadequate word processor, difficulties in accessing and consulting the proceedings and problems connecting to the system. A significant proportion of judges reported issues related to trust in the system and other problems including: inadequate information equipment; the inability to consult the proceedings during trial; the inability to access away from the office, an increase in the number of steps to perform a given act; and the lack of immediate technical assistance, and the inability to fulfil some mandatory procedural norms. Several problems reported in 2009 have been addressed since then and there are on-going efforts to address other limitations of the CITIUS system as part of the *Justiça Mais Próxima* reforms, which should be extended.

When functioning properly, an information system can be a powerful tool in assessing judges' caseloads. A significant challenge for judges is to identify which cases should be prioritised, and a well-designed IT tool could aid them in undertaking such prioritisation. Even though CITIUS was meant to produce such a tool, it was unable to identify blockages in the court system (Contini and Lanzara, 2013). In the early years of its implementation, the system had no early warning devices for, for example, the detection of cases that had been in the system for several years (CEPEJ, 2016). Since then, the system has evolved and now includes such features, which should be fully utilised by the courts to identify problematic cases and those that should be prioritised. The system can be improved further for this purpose, if necessary. This should allow necessary measures to be taken to avoid an additional increase in congestion, such as replacement and reallocation of judges.

The distribution of cases among judges has been a concern in the Portuguese judicial system, and several studies have tried to assess bottlenecks and ways to improve the system so that delays can be reduced (Hay Group, 2002; Observatório Permanente da Justica Portuguesa (OPJP), 2005). The High Council for the Judiciary, in its functions as the managing body of judicial courts, is in charge of distributing cases among judges. The question is how cases should be distributed considering that they might entail different levels of complexity. The allocation of cases depends little on the complexity of judges' existing caseload. There are lists of criteria proposed by judges and approved by the High Council for the Judiciary that set a separate allocation for complex cases, although it is not clear what these criteria are and how they effectively translate into the distribution of caseloads.

Management of courts remains weak

Governance structure

The governance structure is a critical element for court performance, making decisions for a better functioning of the judicial system. Under many jurisdictions, judicial councils serve for the administration of courts and the entire judicial system. Such autonomy from the executive (the Ministry of Justice) can affect judicial efficiency. Allowing judges to administer at least a part of their own affairs can improve judicial efficiency taking advantage of their own knowledge in management, but judges are not necessarily experts in administrative affairs (Voigt and El-Bialy, 2016). According to Palumbo et al. (2013), rather than the presence of judicial councils, governance models within judicial councils matter to explain court performance.

In Portugal there is no single body in charge of strategic governance (CEPEJ, 2016). Different roles are assigned to the executive (the Ministry of Justice) and the judiciary (the High Council for the Judiciary at the central level). The Ministry of Justice retains the vast majority of power, but some shift of power to the judiciary took place recently. Namely, the High Council for the Judiciary is now in charge of paying wages to first instance court judges. This change in financial and administrative autonomy from the Ministry of Justice took a long time: it had been established by law in 2007 (articles 1.º and 3.º, Law 36/2007, August 14th), but it was not implemented until 2016. Importantly, judges' wages are regulated, and the High Council for the Judiciary does not have any power to change this.

Within the judiciary, the High Council for the Judiciary sets mandatory goals. These goals include a reduction in the number of pending cases, a maximum delay for scheduling of hearings (3 to 4 months) and the prioritisation of older pending cases. The High Council for the Judiciary monitors courts and judges. At the judge level, it identifies the total proportion of proceedings terminated and initiated, delays and scheduling of hearings according to the length of delays/scheduling. This information is sent every 4 months by each individual court.

A new management structure in individual courts was implemented by a recent reform (Box 2.1). The reform established a tripartite management structure in each court composed of the Court President (with functions of representation, direction, procedural, administrative and functional management), the Magistrate of the Public Ministry Coordinator (who directs and coordinates the activity of the District Attorney's Office) and the Administrator of the Court (with management functions, appointed by the Court President among candidates that are selected by the Ministry of Justice). Each court district (*comarca*) has one Court President, who assumes broader management responsibilities than those assumed by the Chief Judge before the reform, corresponding to the structure of best-practice (Palumbo et al., 2013). The Court President is appointed for three years by the High Council for the Judiciary and is accountable to it.

In spite of increased management responsibilities, the Court President has not gained sufficient autonomy in practice. The Court President manages the court, monitors the objectives set for the court's judicial services, and monitors the court' case-flow, among other functions. In terms of case-flow monitoring and management, the Court President can report to the High Council for the Judiciary the cases that have an excessive delay, suggest a reallocation of judges, and prepare reports on the current state of the courts being managed. Nonetheless, the scope of such a reallocation of judges may be limited by the total number of judges in the system and by the fact that the number of judges in each court district is determined by law (which can hamper for instance the reallocation of judges from court districts with relatively few cases since the minimum number of judges should be met in these areas), although allowing flexibility.

In this context, the courts should be given increased operational autonomy in order to achieve the objectives for which they are responsible. Reports from first instance courts mention several bottlenecks at the budget management level, with some proposing greater financial autonomy. For instance, the courts' budget is typically used for buildings, materials, utilities, and so on, and it is managed by the Administrator of the Court on the behalf of the Ministry of Justice. The Court Presidents can have a relevant role in the governance of the judicial system, but there were no significant reforms at this level.

Performance evaluation

The capacity and behaviour of judges themselves are a crucial factor for an efficient judicial system. Judges' behaviour is determined by their incentives such as career prospects, salary and the entire organisational structure of the judiciary, among others factors (Voigt, 2016).

There is scope to strengthen the performance evaluation of judges. Judges are evaluated by the High Council for the Judiciary. There is a first evaluation one year after starting their judicial career, and then judges are evaluated every 4 years. The criteria for evaluation are given by the article 34, Law 21/85 and by the article 12, Judicial Inspections Regulation approved in 2016, but the reference to quantitative criteria is limited and they are not fully defined. While performance evaluation is also taken into account, seniority is very important in judges' career progression. There is also the potential to enhance the objectivity in the evaluation of judges. The evaluation of judges is made by inspector judges, who are judges themselves. Having experience as a judge may be helpful in properly evaluating some tasks that are specific to the profession, but it may lead to a lack of objectivity in the evaluation of peer judges. If evaluations consider judgments' length, judges end up writing long opinions which is more time consuming and increases delays. Indeed, inspections tend to consider written judgments to a large extent. Compared with other countries, judges in Portugal tend to write complex and long decisions (Pompe and Bergthaler, 2015).

The authorities could consider reviewing the overall system of performance evaluation with a view to ensuring its full objectivity. As an example, the Netherlands implemented the *RechtspraaQ* system that measures judicial quality, and it was developed by the judicial council in consultation with courts. *RechtspraaQ* focuses on quality regulations and performance measures, with a strong focus at the court level (Contini, 2017). Additionally, it also included instruments such as peer review visits, audits, staff satisfaction surveys, customer satisfaction surveys. There is no obvious or straightforward way of designing incentives for judges, but a more balanced combination of qualitative and quantitative elements could lead to better outcomes in Portugal.

Apart from the evaluation of judges for their career, salaries can also directly affect judges' incentives. In Portugal, salaries are regulated, therefore there are no rewards for performing well and penalties for underperformance. The introduction of an effective incentive salary scheme can be a possibility but it presents several challenges and requires caution. If incentives are set so that judges resolve more cases, judges can simply solve easier cases and avoid more complex ones. In Spain, there was a strong focus on quantitative elements which seems to have resulted in changing judges' behaviour so that they "cherry picked" cases that would allow a higher reward (Doménech Pascual, 2008). On balance, linking salaries directly to performance may be difficult, at least for the moment, when performance measures are not well developed.

Other factors also affect judges' performance. For example, judges' educational background and experience, along with their experience of the specific court (institutional experience) can affect the length of procedures (Ramseyer, 2012 and references therein).

Specialisation of courts and judges

Task specialisation is often advocated as a major performance-enhancing factor. Specialisation can enhance court efficiency by allowing judges to acquire detailed knowledge of a given area of law and of the issues. It can also aid a more efficient organisation of the work, by preventing judges from being assigned to widely different categories of disputes, and is likely to guarantee a higher consistency and accuracy of decisions. The negative side of specialisation is the inability for judges to benefit from knowledge spillovers. These effects consider the specialisation of individual judges, not that of courts, and the empirical evidence on the effects of specialisation is mitigated (e.g. (Voigt and El-Bialy, 2016)).

The current judicial organisation implemented by the 2014 reform also aimed to enhance specialisation. The reform mentions a reinforcement of specialisation brought by an increase in family and juvenile courts, criminal instruction courts, enforcement courts and commercial courts. However, as judges may rotate between geographic locations, they might be working mostly on one type of cases in one year and on a completely different case the year after, especially in the first years of judges' career. If the authorities aim at further specialisation in the court system, they should consider introducing greater specialisation of individual judges, including appropriate training as specialised judges.

A different kind of specialisation is the presence of non-judge staff providing legal assistance to judges. Legal assistance may enhance performance by freeing judges from auxiliary tasks (legal research, drafting of memoranda, case preparation and management), enabling them to concentrate only on adjudication. Judges could speed up case resolution by up to 30% if they were supported by assistant clerks in Portugal (Hay Group, 2002). Borowczyk-Martins (2010) also finds a positive effect of clerks on the resolution rate in Portuguese civil courts.

It could be a good option to strengthen legal assistance to judges by other professionals. In respect of Law 62/2013, it should be ensured that the organisation of clerks' work should be made more flexible in responding to arising needs. Greater specialisation of clerks would also be advisable in order to promote efficiency in the assistance they provide to judges. Finally, it could also be a good option to increase other professionals, such as assistant clerks, or assistant judges, which are currently available only at the Supreme Court.

Better meeting the demand for judicial services

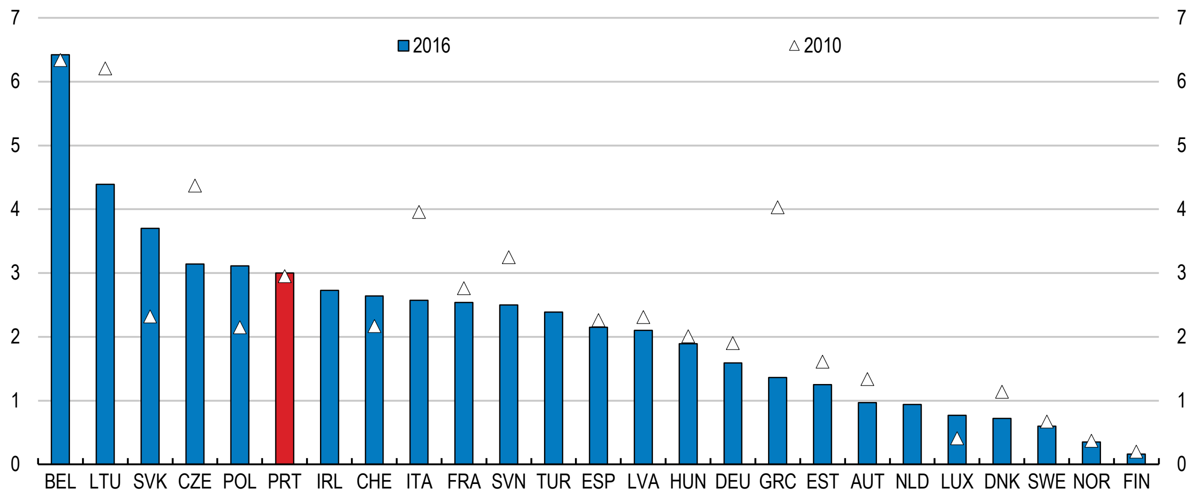
A high demand for judicial services induces court congestion, extending the average trial length in courts. Litigation is frequent in Portugal compared with other European countries for which comparable data are available (Figure 2.12). The majority of cases brought to judicial courts are civil cases (accounting for 64% of cases, followed by criminal, labour and other types of cases).

A relevant policy question is how to better meet different kinds of demand for judicial services. The high number of litigation cases could be for good reasons. Therefore, it is important to identify properly where so many litigation cases come from. As illustrated below, a number of cases are considered to be ill-founded, which weaken court case resolution and crowd out legitimate demand for judicial services from other people. It is also important to consider if some disputes can be better solved outside the court system.

The number of cases brought to courts depends on the frequency of disputes in society. This is influenced by the business cycle, structural socio-economic factors and the volume and complexity of economic transactions, among others (Palumbo et al., 2013). Over the past decades, the number of litigation cases has been on a rising trend, reflecting the structural change in the economy, such as the rise in the share of the services sector. In this context, so-called "mass-litigation" has developed significantly. This is about a small number of bulk litigants, typically large companies such as cable television operators, mobile phone companies, insurance companies, banks and consumer credit companies, claiming for a small amount of debt, in many cases less than EUR 1 000 (Gomes, 2011).

Figure 2.12. Litigation is comparatively frequent in Portugal

Number of incoming cases per 100 inhabitants



Source: European Commission for the Efficiency of Justice (CEPEJ).

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There is one particular type of demand for judicial services, which is apparently abused. In the Portuguese debt enforcement system, debtors can contest a court decision on debt payment. The problem is that they often contest the court decision with the sole objective to block enforcement procedures and thus to delay payment (Pompe and Bergthaler, 2015). Such spurious litigation was encouraged since trial costs and penalties to lose a case are low (Pompe and Bergthaler, 2015). It has increased bottlenecks in courts, preventing many citizens and companies from using the judicial system for more substantive matters. Such spurious litigation should be reduced, while their debt resolution problem should be settled through different pathways (see below).

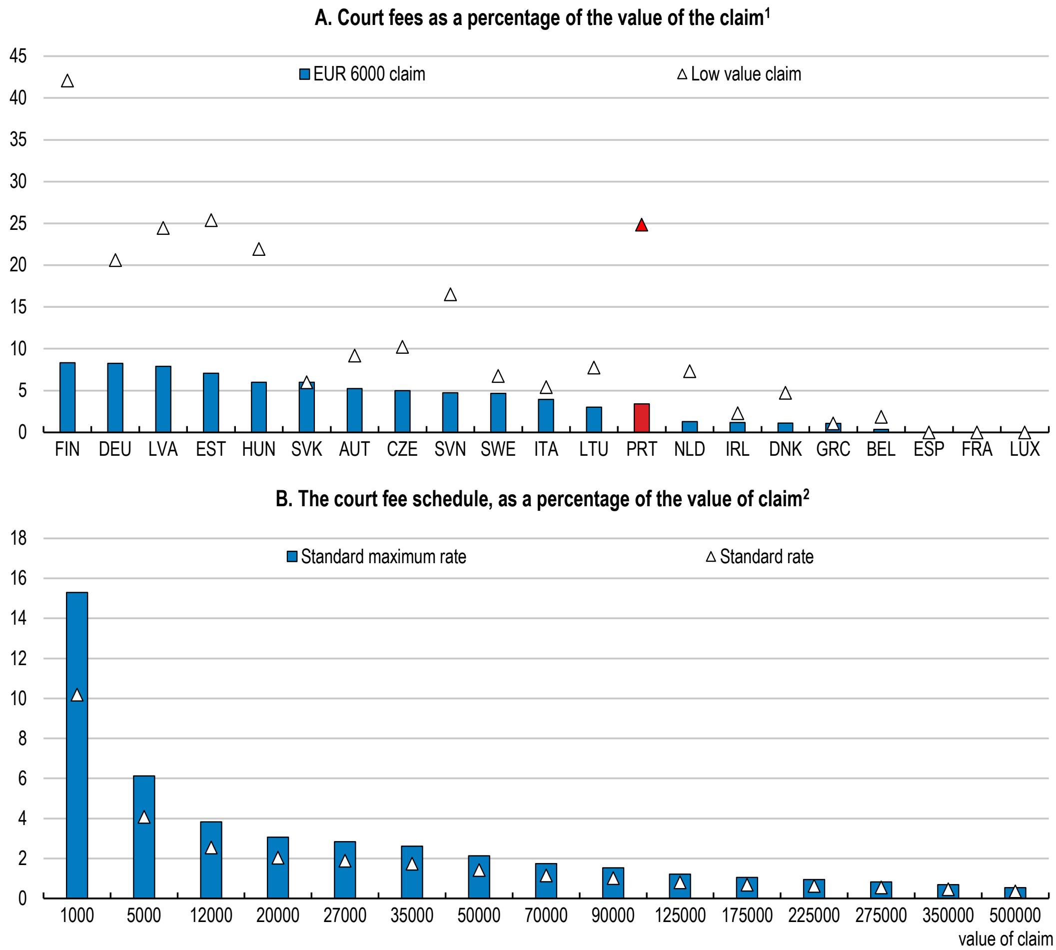
Trial costs shape the demand for judicial services

Costs of trial

The private costs of trial affect the decision to file a case to court. Overall, according to the current system, basic court fees remain very low, except for very low value cases (Figure 2.13, Panel A). This is particularly so, when the value of claims is high (Figure 2.13, Panel B). In Portugal, these costs consist of:

- Court fees;
- Charges (actual expenses such as transcriptions, court solicited documents, transport expenses, etc.); and
- Party costs paid by the losing party (cost-shifting rules).

Figure 2.13. Court fees for a high value claim are low in Portugal



Note: In Panel A, "low value claim' means a claim which corresponds to the poverty threshold for a single person in each Member State in terms of monthly income. In Panel B, the value of claims is the median value across different bands of the value of claim (for e.g. the first band ranges between EUR 0 to 2000; and the bar shows that for a case with the value of claim of EUR 1000, the parties have to pay around 10% of the value or around 15.5% of the value if the standard maximum rate is applied).
Source: EU Justice Scoreboard 2017; Procedural Costs Regulation, Portugal.

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Court fees are paid for the services of the judiciary and its staff. They are increasing with the value of claims which are specified in the Procedural Costs Regulation. The judge can apply the standard maximum rate (higher by 50%) at their discretion, depending on the complexity of cases within the limits specified in the regulation. When the procedure is particularly complex, such as those requiring preliminary injunctions, execution or reclamation of credits, and opposition to execution or embargos by third parties, the judge can apply even higher court fees, calibrated by legal criteria, specified by the regulation.

The Procedural Costs Regulation has been reformed successively over the past decade. One of the major changes was an increase in court fees for corporates that often litigate (specifically those that litigated 200 times or more in the previous year), so that they face the standard maximum rates (Figure 2.13, Panel B). This selective increase of court fees specifically targeted so-called bulk litigants (see above) who made the most use of the system and who are able to bear the costs. However, given the overall low costs, in particular, when the value of claims is high, such effects are likely to be limited. Going forward, court fees can be significantly increased for the above-mentioned "spurious litigation" (debtor contesting a court decision for the purpose of delaying debt enforcement), thus making litigation a conscious choice for these litigants.

The rules determining the allocation of trial costs between the litigants (cost-shifting rules) also affect decisions on litigation. Cost-shifting rules are claimed to induce better litigation decisions by filtering out unmeritorious cases (Palumbo et al., 2013). In Portugal, the losing party is ordered to pay to the winning party the amounts specified by the regulation (so-called "party costs"). Specifically, they pay the court fees and charges paid by the winning party as well as related costs, notably lawyer fees, which are considered to be equivalent to 50% of the court fees paid by both parties, which are low compared to average lawyer fees. Strengthening cost-shifting rules may reduce the frequency of litigation, since it makes litigation a conscious choice, but the effects of such a policy change are not found to be unambiguous. If anything, such a policy change can be introduced in a targeted way, for instance, to debtors litigating for the sole purpose of delaying enforcement processes.

Legal services profession

Lawyers have a central role in determining the pattern of demand for judicial services. Lawyers often decide whether to file a case in court or resolve the issue in alternative ways on behalf of their client. Behind such decisions lie their incentives, which are in turn shaped by regulations and the market structure.

The Bar Association both represents its members and regulates the exercise of the profession. Regulations in the legal services sector are justified to a certain degree, due to the specificities of this sector characterised by the risk of market failures. Among others, problems arising from the fact that consumers cannot judge the quality of judicial services and often rely only on prices ("the asymmetry of information" between lawyers and consumers) are important (Darby and Karni, 1973; OECD, 2007). Therefore, low-quality providers charging low prices can drive out high-quality providers charging high prices, leading to overall quality deterioration in the market ("adverse selection"). On the contrary, the asymmetry of information can incentivise lawyers to supply unnecessarily higher quality services or a larger quantity of services than consumers would require ("moral hazard"). These problems limit the extent to which free markets in legal services produce efficient outcomes (e.g. Ehlermann and Atanasiu, 2006). However, self-regulation tends to identify with the interests of the regulated profession, rather than the public interest (Canton, Ciriaci and Solera, 2014).

In certain circumstances, lawyers can be incentivised to generate more litigation than is necessary. Given the asymmetry of information, lawyers may persuade their clients to file a case to court even when it is not in the best interests of their clients, because the case deals with the claim of a low value or because the case has a low probability of winning (OECD, 2007; Carmignani and Giacomelli, 2010). The behaviour of lawyers to seek excess benefits over production costs lies behind this mechanism (Palumbo et al., 2013). Such behaviour is encouraged when competition in the market is limited, while in a competitive market lawyers are less likely to bring such cases to court.

Previous studies found that the number of lawyers is positively related to the frequency of litigation (e.g. Carmignani and Giacomelli (2010) for Italy; Mora-Sanguinetti and Garoupa (2015) for Spain). Pereira and Wemans, 2015, investigating causes for litigation in Portugal, first find the court district specific effects and related them to the number of lawyers per inhabitant, and conclude that some inducement effects by lawyers exist. These studies found this causal relationship, controlling for the possibility of the reverse causality (lawyers might increase the frequency of litigation while an increased number of litigation cases might attract more lawyers).

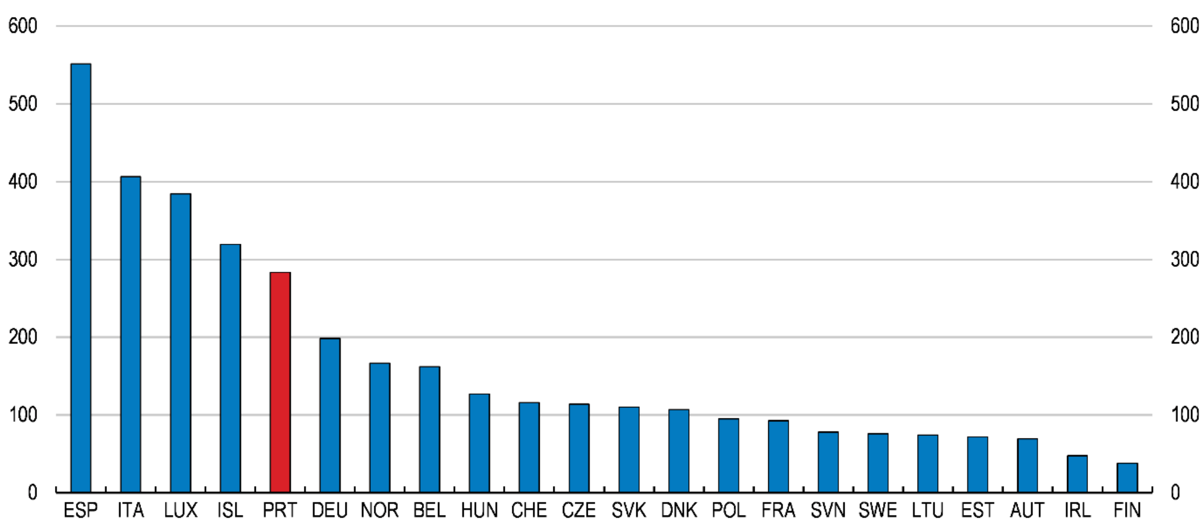
There is an excess supply in the Portuguese legal services sector. The number of lawyers per inhabitant is larger than in many other European countries (Figure 2.15) and the number of law firms per inhabitant is also large (Paterson, Fink and Ogus, 2007), in spite of very strict entry regulation in the sector. Productivity is low compared with other European countries (Paterson, Fink and Ogus, 2007; Figure 2.15), implying lawyers are more frequently involved with low productivity cases. Within the context of very strict conduct regulation (Figure 2.16), which normally is associated with rents, it is likely that excess profits are shared among a large number of lawyers, which generate more litigation than needed by their clients (OECD, 2018a).

From the policy point of view, it is necessary to increase the transparency of legal contracts for clients to better understand the services provided by lawyers (Carmignani and Giacomelli, 2010) and more generally to increase competition in the legal profession sector.

Many provisions foreseen in the recent reform have not been implemented effectively. Framework Law 2/2013, establishing the legal regime for the creation, functioning and organisation of professional associations, intended to remove unjustified restrictions. Along with this framework law, a new bylaw (legislation put forward by the professional associations and adopted by Parliament) was adopted for the legal services profession sector. This bylaw (Law 145/2015) receded from Framework Law 2/2013 in many fronts, notably, the removal of restrictions on the access to regulated professions and the recognition of professional qualifications (OECD, 2018a).

Figure 2.14. Number of lawyers per inhabitant is high in Portugal

Number of lawyers per 100 000 inhabitants, 2016



Note: 2015 for Belgium, Czech Republic, Estonia, Hungary, Iceland, Italy and Slovenia.
Source: Council of Bars and Law Societies of Europe (CCBE) and OECD.

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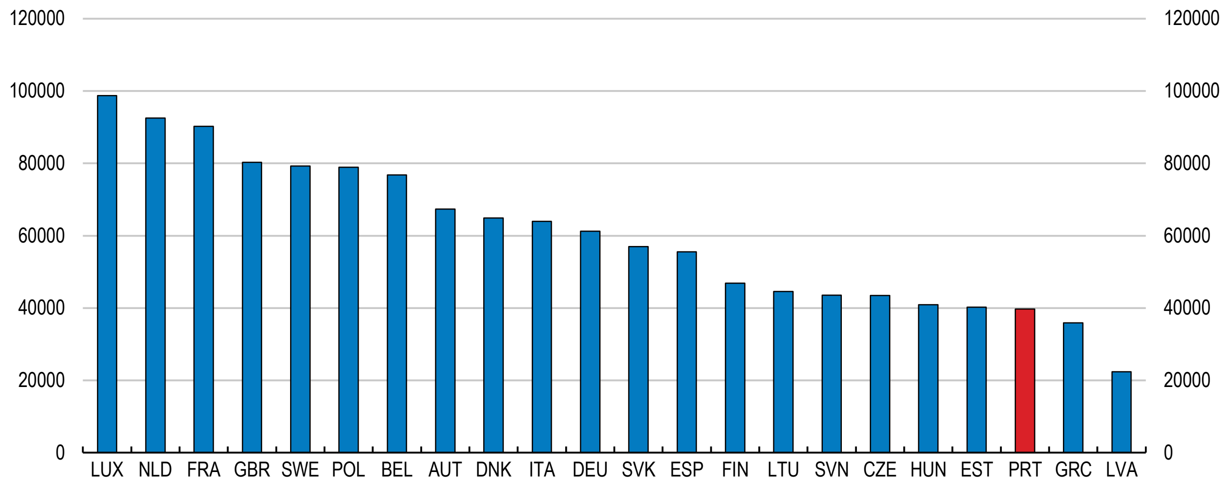
Figure 2.15. The productivity in the legal services sector is low in Portugal

Gross Value-Added per person in employment, USD PPP, in 2015



Note: The chart refers to Gross Value-Added (GVA) and the number of employment in the industry "V69_70: Legal, accounting, head offices, management consultancy activities". 2014 for Lithuania and Sweden. 2011 for Spain. GVA in the industry at 2005 constant prices are measured in terms of USD PPP using the industry level price index provided by the Groningen Growth and Productivity Centre following the methodology in Robert Inklaar and Marcel P. Timmer (2014), "The Relative Price of Services" Review of Income and Wealth 60(4): 727–746.
Source: OECD National Accounts Statistics (database) and the Groningen Growth and Productivity Centre.

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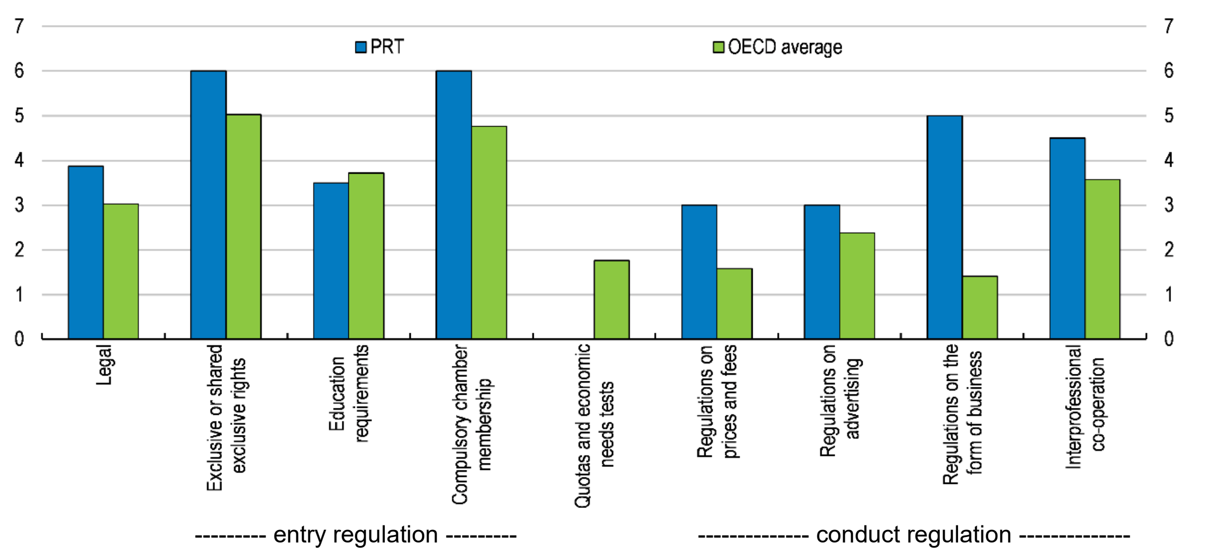
Figure 2.16. Regulation in the legal professions sector is generally strict

OECD Indicators of regulation in the legal services sector



Note: The OECD Indicators of Product Market Regulation are a comprehensive and internationally comparable set of indicators that measure the degree to which policies promote or inhibit competition. The indicator ranges from zero (least stringent) to six (most stringent).
Source: OECD Product Market Regulations Statistics (database).

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Restrictions on fees

Fee regulations exist in order to ensure the quality of services offered and to protect consumers from excessive charges. Fee restrictions can take several forms, such as mandatory fixed fees, minimum fees or maximum fees, and recommended fees. When fees are negotiated, recommended fees can also inform consumers of the average fees to be paid for certain services, which reduces transaction costs. However, these restrictions on prices prevent competition among service providers. This is clear for mandatory fixed fees and minimum fees. Maximum fees can lead to a levelling of prices towards the maximum threshold. Recommended fees have similar effects and they can facilitate coordination among service providers at the expense of consumers.

In Portugal, fees are freely negotiated between the relevant parties. The Bar Association, the self-regulatory body, does not set fees for services provided by its members. However, the law specifies the criteria on which the fee structure should be based, including the number of hours worked, the value of claims, the lawyer's qualifications, and the complexity of cases. The criteria in the fee structure also include the outcome of cases ('success fees'), although contingency fees, which tie the lawyers' remuneration entirely to the outcome of cases, are forbidden. As a matter of fact, the criteria are very detailed and exhaustive, which can be useful when the fees charged need to be arbitrated, but are not easily understood by clients, which hampers competition in the legal services market (OECD, 2018a). The complexities in the criteria in the fee structure likely solidify the bargaining power of lawyers, in particular, those in large firms, in negotiating fees with consumers.

The existing regulatory functions of professional associations can be shared with an independent body, which would take on a supervisory role vis-à-vis the Bar Association. The competence to deal with disputes over the legal contract against lawyers, which currently lies with the Bar Association, can be assumed by the independent supervisory body. The latter can ensure an independent and impartial judgment, as it is free from protecting the members which the Bar Association represents. Thus, the independent supervisory body could provide the impartial assessment of legal costs and make them more transparent, seeking to achieve a balance between the costs involved and the services rendered by lawyers.

Reserved activities for lawyers

Excessive regulation of the professions is anti-competitive. Other anti-competitive regulations in the legal services sector include reserved activities for lawyers that cannot be exercised by other professions. The rights to exercise reserved activities exist in order to guarantee the quality of legal services against the risk of market failures (adverse selection). Nevertheless, they can also contribute to excessive market power and inflated prices for regulated services at the expense of consumers. In Portugal, the following activities are reserved for lawyers:

- Exercise of the judicial mandate (representing clients in courts);
- Provision of legal advice and consultation;
- Drafting of contracts and the practice of preparatory acts related to the constitution, alteration or extinction of legal transactions;
- Negotiation aimed at collecting credits; and

- Exercise of the judicial mandate for the challenge of administrative or taxation acts.

The scope of reserved activities by lawyers in Portugal is wide, which may unduly restrict competition from other providers (OECD, 2018a). The rationale for some reserved activities is clear, such as the exercise of the judicial mandate. However, it is not necessarily so for other activities. For instance, it is not obvious why negotiations on credit collection should be reserved for lawyers. Moreover, the mandatory involvement of lawyers on such negotiations is likely to prolong debt enforcement proceedings (see above). This provision could be relaxed so that negotiations on credit collection activities can be exercised also by other professionals, possibly in the form of extended partnership between lawyers and other professionals (see below).

Restrictions on ownership and management

Law firms are subject to regulatory rules governing the form of business, which generally restrict competition. Such restrictions exclude non-regulated legal professionals from running, owning or being shareholders in law firms. Non-lawyers are not members of the Bar Association, thus they would not be bound by the same professional obligations as those for lawyers. The legal profession defends such restrictions on the grounds that they prevent the independence of lawyers being threatened by non-lawyers, undermining the lawyer-client privilege, and giving rise to conflicts of interest (Aulakh and Kirkpatrick, 2016).

In Portugal, law firms are exclusively owned by lawyers ("professional partnership" model), which is disproportionately restrictive. Only lawyers or other law firms can be partners or associates in a law firm, which must be registered with the Bar Association, thereby excluding co-ownership or co-partnership with other professionals which are not lawyers. Also, the Bar Association's self-regulation requires all members of management to be lawyers, although Law 2/2013 requires that only one of the managers or administrators of a professional firm be a member of the professional association. According to the OECD PMR indicator, the restrictions on ownership and management is where Portugal lags the furthest behind other OECD countries, with other European countries including Italy and Spain having removed barriers to the ownership by non-lawyers, albeit modestly. The UK 2007 Legal Services Act reformed ownership and partnership rules, allowing for the creation of Alternative Business Structures (ABS), where non-lawyers may own or partner with lawyers in a legal firm.

Removing barriers to the ownership and management of law firms would rationalise their activities and raise their productivity. Opening ownership to external investors could allow law firms to expand by utilising more sources of capital and to achieve further economies of scale, and to become more competitive in the market, while improving risk management (OECD, 2018a). Alleviating the restriction on management would enhance the ability of professionals to optimise the structure of their firms or groupings. Broadening the sources of funding for the profession can also promote game changing innovations that are better able to respond to the legal needs of a wider range of clients (Hadfield, 2017). Such changes would also open the way to diversifying their businesses. Moreover, evidence from the United Kingdom after the liberalisation of ownership rules, points to ABS being more innovative and having faster take-up of new technology (OECD, 2018a).

Restrictions on inter-professional cooperation

Law firms are also subject to regulatory rules on multi-disciplinary practices between lawyers and other professionals, which also hamper competition and innovation. Multi-disciplinary practices can threaten the lawyer-client privilege, since non-lawyers are not bound by the same professional obligations as those for lawyers. The legal profession defends the restrictions on multi-disciplinary practices in order to guard professional secrecy and to prevent conflicts of interest (OECD, 2007), as multi-disciplinary practices can be pressured into acting in the commercial interests of the owners, not in the best interests of the clients.

In Portugal, the Bar Association's self-regulation exclude multi-disciplinary practices in law firms. According to its self-regulation, law firms should pursue a single and exclusive objective which is the exercise of legal advocacy. In the mid-2010s, there were some proposals by the Bar Association which examined the possibility of introducing multi-disciplinary practices with other professionals or non-professionals, but none of them was adopted in the end. The *Conselho Superior do Ministerio Publico* (Public Prosecution Judicial Council) also questioned the prohibition on multi-disciplinary practices and found it disproportional to its objective. Indeed, such a prohibition is questionable since currently law firms from other EU Member States can provide multi-disciplinary services in Portugal, which are prohibited to Portuguese law firms.

The removal of the prohibition on multi-disciplinary practices would help better meet clients' demand and raise productivity among law firms. Multi-disciplinary practices can generate further economies of scale and offer 'full service' by bringing together the know-how of members of different professions within the same firm (OECD, 2018a). Such practices would spread diverse risks faced by different professionals within the same firm, thus reducing the overall internal risks (Stephen and Love, 2000). Finally, such practices can also promote innovation, as for instance the experience of Alternative Business Structures for law firms in England and Wales shown in UK Competition and Markets Authority (2016). In Portugal, such cooperation can be beneficial for the development of out-of-court mechanisms for insolvency where the accountant has an increasing role (see below). The risk related to professional secrecy could be countered by imposing similar obligations on all professionals within the same firm (Deards, 2002). The UK 2007 Legal Services Act prescribed that the regulatory safeguards are put in place to overcome this particular problem.

Alternative dispute resolution mechanisms can be developed further

There exist alternative dispute resolution (ADR) mechanisms other than the formal court proceedings. Some of them are literally out-of-court proceedings while others include the intervention of courts. The availability of such alternative dispute resolution mechanisms, also affect the demand for judicial services. Indeed, disputes can be effectively and efficiently resolved through various alternative dispute resolution mechanisms, such as online dispute resolution, mediation, and arbitration. The challenge for lawmakers is to design a justice system that supports parties in bringing their disputes to the right forum, depending on its nature and severity (OECD, 2018b).

Mediation

Mediation is underdeveloped in Portugal. Mediation is one of the alternative dispute resolution mechanisms where the parties try to reach an agreement as regards their dispute, guided by the mediator, an impartial third party. The parties are responsible for the decision they make. Countries offer different types of mediation services under different frameworks (e.g. service providers can be courts or private). In Portugal, mediation is an out-of-court process intervened by a mediator certified by the Ministry of Justice. In 2017, only 487 cases were resolved through mediation, while the narrowly defined system of mediation is limited only to the three domains – family, labour and criminal. Mediation can be extended to deal with commercial cases, if there are such needs. It can also be strengthened by the intervention of courts, which however comes at the cost of increasing the workload of the courts which is already significantly heavy, in particular, in some court districts.

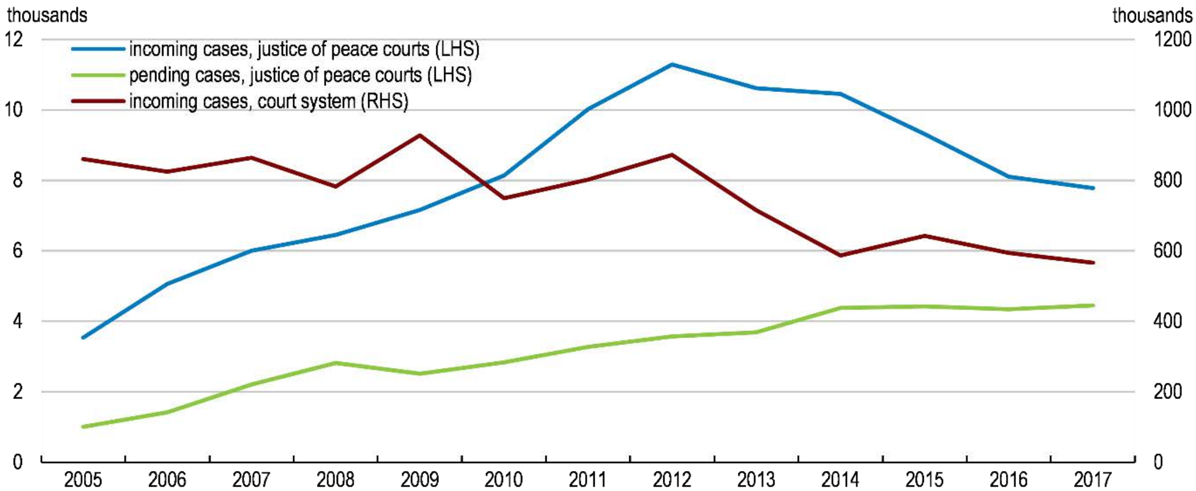
Arbitration

Arbitration is frequently used in some limited cases in Portugal. In contrast with mediation, the arbitrator makes a judgment through arbitration. There are so-called "Arbitration centres" authorised by the Ministry of Justice, which promotes voluntary arbitration. They provide information to the citizens and mediation or arbitration in the form of "Arbitration Court". There are 11 Arbitration centres which are concentrated on certain segments of the economy (such as those in the automobile sector, and the one specialised in taxation matters). Arbitration can be further developed, by establishing more Arbitration Centres. Such needs for arbitration exist, as for example, foreign-owned companies located in Portugal often resort to the Tax Arbitration Centre in order to avoid long proceedings in the tax and administrative court.

The Justice of Peace Courts

The Justice of Peace Courts ("Julgados de Paz") are the unique form of alternative dispute resolution mechanisms in Portugal. It has a particular structure and procedures, which, in practice, make them perceived as a mix of judicial courts and out-of-court proceedings. In the Justice of Peace Courts, disputes can be solved through mediation, conciliation or, if an agreement is not reached, through a court hearing. The latter has simplified proceedings and is presided by the Judge of Peace who delivers a judgment. The Justice of Peace Courts are competent to hear and decide on a number of civil actions, as long as the value of the claim does not exceed EUR 15 000 (with some exceptions, notably, those related to so-called "Contract of Adhesion", which are typically those related to consumption). There are 25 Justice of Peace Courts across 69 municipalities, based on public and/or private financing. The use of the Justice of Peace Courts remains limited and lags far behind the formal court system (Figure 2.17). In recent years, the number of pending cases has continued to increase in spite of the reduction in the number of incoming cases (Figure 2.17), suggesting inefficiency in their operation. The Justice of Peace Courts have a scope to be developed further, while strengthening their operation reducing pending cases. They can deal with relatively straightforward disputes over small value claims, the demand for which is apparently very high.

Figure 2.17. Alternative dispute resolution mechanisms falls far behind the court system



Source: INE.

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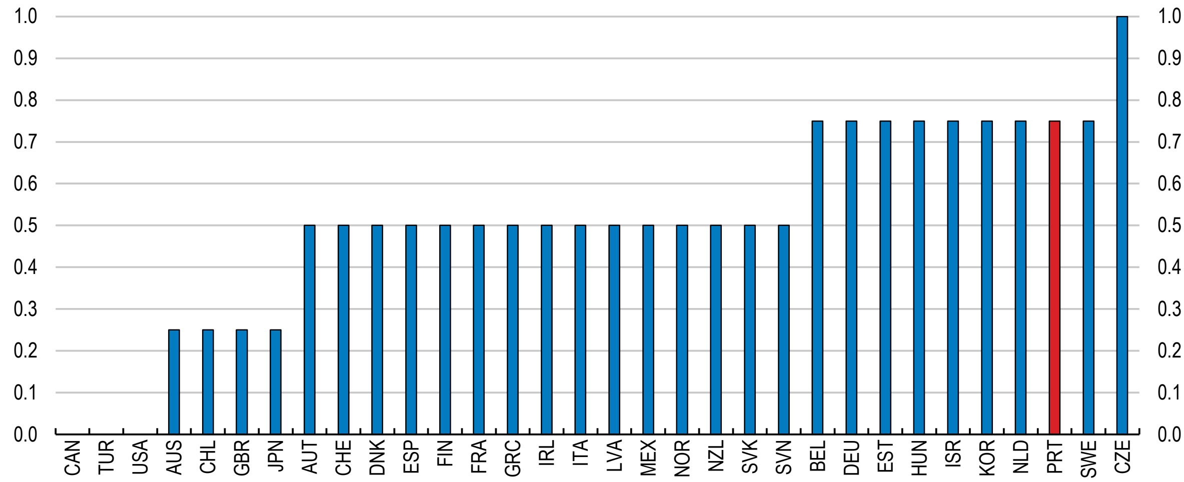
Alternative dispute resolution mechanisms for debt enforcement

As described earlier, enforcement proceedings typically take around 30 months, with some cases taking excessively long time. Over time, the nature of cases has also evolved, and complex cases with a high value claim requires a quite long time. These complex cases include the category "embargo", where the debtor contest the court order on the debt payment obligation, which is quite often spurious (debtors contest only for the purpose of delaying debt payments as mentioned earlier). Among other cases, the category "creditors' claims" (the procedure allowing other creditors with secured claims over the seized assets to intervene in the case, even if their debt is not overdue or they do not yet have an enforcement title), also takes a long time (Pereira and Wemans, 2018). The latter problem illustrates the difficulties of coordination among different creditors.

The chance for a case to end with the fulfilment of the debt payment obligation is low (only 36% out of total enforcement cases). Around 29% of cases were closed due to a lack of assets. This phenomenon can be explained by the provision that enforcement proceedings are terminated if the debtor's assets are insufficient. This provision, however, would not solve the debt payment obligation altogether There should be other ways to relieve heavily indebted persons from the debt payment obligation. These include making the bankruptcy regime more effective by reducing its stringency (Figure 2.18; see Key Policy Insight) and developing financially attractive alternative dispute resolution schemes for firm liquidation (see below).

Figure 2.18. Personal bankruptcy law is stringent in Portugal

OECD insolvency indicator: Treatment of failed entrepreneurs, 2016



Note: The indicator is constructed based on the OECD questionnaire on insolvency regimes. It ranges from zero (least stringent) to one (most stringent). "Treatment of failed entrepreneurs" takes into the following aspects: time to discharge; and bankruptcy exemptions.
Source: Adapted from Adalet McGowan et al. (2017).

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Special Proceedings for Revitalisation (PER)

Some specific alternative dispute resolution mechanisms to tackle corporate insolvency have been developed in recent years, among others, the *Processo Especial de Revitalizacao* (PER). The PER comprises two alternative proceedings. One is the "pre-pack" PER, which is applicable when the debtor and its creditors agree in advance the terms of a restructuring plan and file the PER in the court to obtain the judge's confirmation of the plan and to make it binding on all creditors including those who did not take part in the negotiations. The other one is the "negotiated-through-court" PER, where the negotiations to reach a restructuring agreement are conducted after the filing of the proceeding and are supervised by the Judicial Administrator, without any interference by the judge.

The PER has improved Portugal's firm restructuring regime, which is reflected in the World Bank's Doing Business indicators, as well as the OECD's Insolvency Indicators (Adalet McGowan, Andrews and Millot, 2017). It has contributed to around 3000 firm restructuring cases over the past three years. In 2018, in the context of *Programa Capitalizar,* the government reformed the PER to limit its access only to viable firms, in order to maximise the probability of successful restructuring. To start a PER proceeding, the debtor must present to the court an accountant's statement certifying that it is not insolvent and a proposal of the recovery plan. The commencement of a PER proceeding is now also subject to the approval of at least 10% of its creditors.

Out-of-court regime for firm restructuring (RERE)

In parallel, a new out-of-court regime for corporate recovery (*Regime Extrajudicial de Recuperacao de Empresas*, RERE) was introduced in early 2018. In this out-of-court regime a debtor company in financial distress negotiates with all or some of its creditors, to be selected by the debtor, to reach an agreement on a restructuring plan without the intervention of courts. The agreement is binding only on the participant creditors while it is confidential to others. Both the debtor and creditors can benefit from the same tax treatment that would apply should they have reached the same agreement through a PER or through insolvency proceedings.

Also in the context of *Programa Capitalizar*, the Company Recovery Mediator was created, the statute of which came into force in 2018. The Corporate Recovery Mediator is responsible for assisting a debtor company in financial distress in negotiations with its creditors. Where appropriate, the Mediator may even assist the debtor in a PER or a RERE proceeding.

An alternative dispute resolution mechanism for firm liquidation

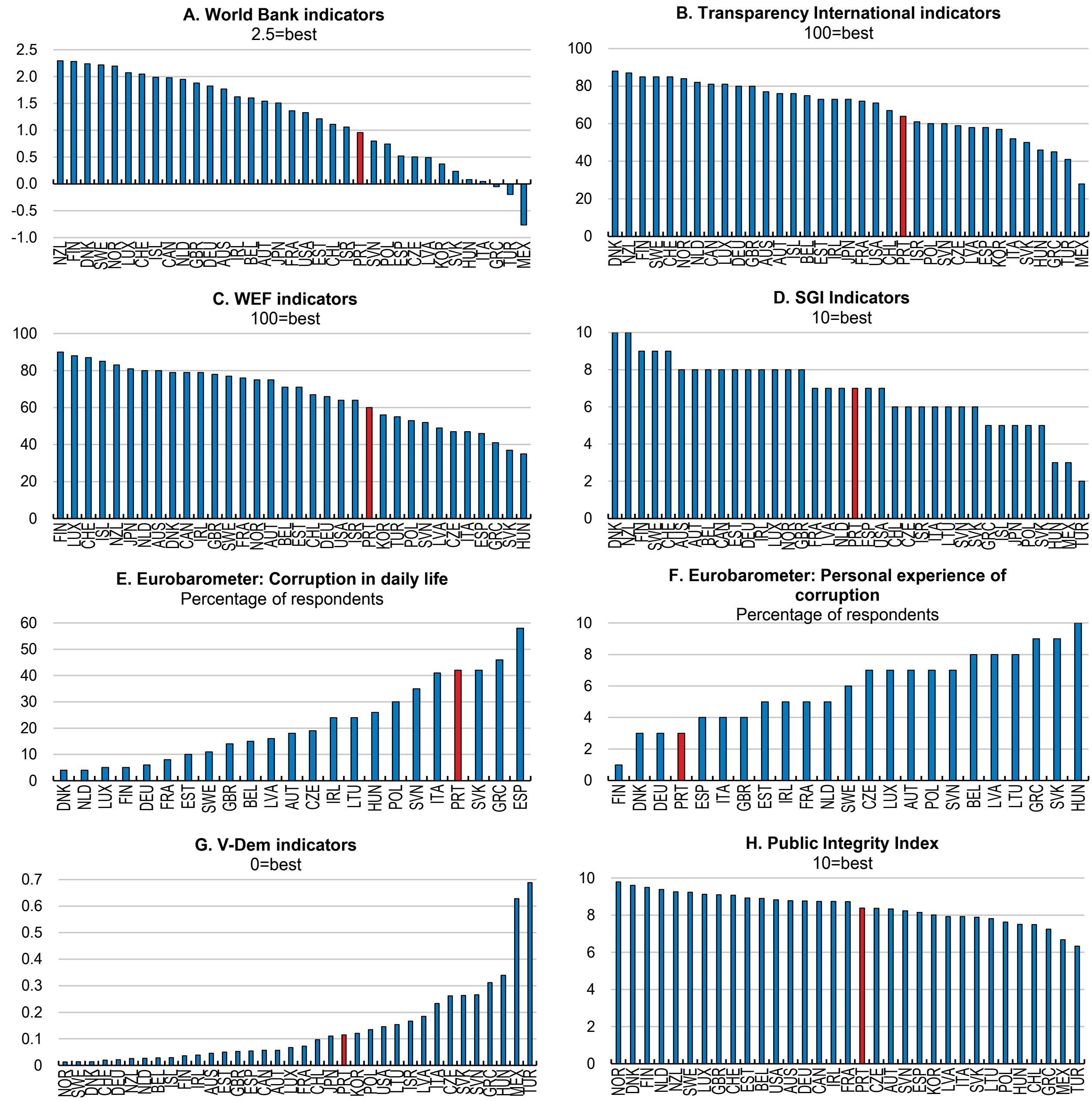
These are positive developments, but it is worth considering the introduction of an alternative dispute resolution regime for firm liquidation. There exists an out-of-court mechanism for defaulting firms, the so-called "Martian pact", through which the creditor appropriates the pleaded assets of the debtor. This is a voluntary mechanism and facilitates the appropriation of the debtor's assets without recourse to the courts. However, the scope of this regime is limited precisely to those assets pledged in the prior agreement between parties. Going further, an out-of-court regime which would primarily facilitate the liquidation of non-viable firms would help, in order to ensure their smooth exit from the market and thereby reduce the costs related to business failure.

Such an out-of-court regime should facilitate coordination among creditors and enhance cooperation among the parties concerned. In this respect, a recent example in Japan (the Guideline for Personal Guarantee Provided by Business Owners) can be insightful. It aims at starting a proceeding on debt resolution at early stages, thus preventing the deterioration of the firms' financing status, which raises the amount of assets which can be collected by the creditor. It makes the financial state of the firm transparent, allowing for an accurate valuation of the firm, which also often leads to revealing hidden assets of the debtor. Finally, the debtor is allowed to keep more assets than if they declare personal bankruptcy (the legal protected assets), within the limit of the increment in the collectable assets (OECD, 2017). Such debt resolution can also be encouraged with financial incentives, namely, the deduction of losses incurred by creditors as a consequence of debt resolution from corporate taxes, as is the case in Japan.

Improving institutional quality and preventing corruption

While extending past and on-going reform efforts, the judicial system should improve institutional arrangements to ensure transparency and strengthen the prevention of corruption. The assessment of the level of corruption is difficult since existing indicators are mainly based on perceptions. Various measures point to different levels of perceived corruption (Figure 2.19). Corruption distorts economic activity, reducing efficiency and increasing inequality by favouring the well-positioned. As a result, the cost of doing business increases, public resources are wasted and the poor are pushed aside. Perceived corruption is also found to negatively affect FDI inflows (Júlio, Pinheiro-Alves and Tavares, 2013).

Figure 2.19. Indicators of corruption



Note: "World Bank indicators" refers to "Control of Corruption" in the Worldwide Governance Indicators by World Bank; "Transparency International indicators" refers to the average of five sub-indicators available for all OECD countries in the "Corruption Perception Index"; "WEF indicators" refers to the World Economic Forum's Executive Opinion Survey; "SGI Indicators" refers to "Corruption Prevention" in the Sustainable Governance Indicators Score. "Eurobarometer: corruption in daily life" refers to the share of respondents who agreed with the statement "You are personally affected by corruption in your daily life"; "Eurobarometer: experience of corruption" refers to the share of respondents who answered positively to the question "In the last 12 months have you experienced or witnessed any case of corruption?"; "V-Dem indicators" measure six distinct types of corruption that cover both different areas and levels of the polity realm; and "Public Integrity Index" measures six policy areas that can contribute to effective control of corruption.

Source: World Bank, Transparency International, World Economic Forum; Bertelsmann Stiftung; Eurobarometer; Varieties of Democracy Institute, University of Gothenburg; and European Research Centre for Anti-Corruption and State-Building.

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Establishing safeguards and integrity frameworks can help effective prevention. The government has pledged to create a public registry of interests for members of local governments, even though this has not yet been implemented (European Commission, 2018). Such a registry should be kept in electronic form, regularly updated and monitored.

Reliable judicial systems are crucial to make sure laws and regulations are actually enforced. In this respect, court judgement should be rapid and effective, including through allocating court resources more effectively. Also, specialised courts with national jurisdiction for corruption could be considered. Such courts currently operate in some other OECD countries, such as the Slovak Republic. The appeal procedures should be reviewed with a view to minimising abuse. Finally, it is important to continue using financial investigations to seize assets obtained through the commission of criminal offences. These measures would prevent the value of assets from declining and the ownership of assets being appropriated by criminals, thus making sure that crime does not pay.

A key factor to fight against crime is an effective mechanism of prosecution (Box 2.4). There is scope to continue strengthening the prosecution mechanism in Portugal. A package of 88 measures proposed by judges, prosecutors, lawyers and other legal professionals in January 2018 contained some measures on this front. The recommended measures include setting up a technical assistance office in all court districts (*comarcas*), creating multidisciplinary teams of experts, developing international judicial cooperation, and increasing transparency in enforcement proceedings by presenting proof of bank account ownership.

Box 2.4. Public Prosecution in Portugal

As defined by the Council of Europe (2000), "Public prosecutors" are public authorities who, on behalf of society and in the public interest, ensure the application of the law where the breach of the law carries a criminal sanction, taking into account both the rights of the individual and the necessary effectiveness of the criminal justice system. Public prosecutors have a crucial role in enforcing and effectively applying the law in any judicial system (Garoupa, 2012). They exercise a critical role in criminal cases, but also in other cases. Prosecutors, together with judges and the police, are central actors when it comes to the implementation of the rule of law. Still, little attention has been devoted to the study of public prosecutors, in comparison with judges or the police (Garoupa, 2012), (Voigt and Wulf, 2017). In fact, little is known about the impact of the organisation of public prosecution (Gutmann and Voigt, 2017). The precise way in which public prosecution is organised varies across legal systems. Even though there are remarkable institutional differences among European countries, prosecutors tend to be part of the judicial branch.

In Portugal, the Public Prosecution Service represents the State, defends the interests prescribed by law, takes part in the enforcement of criminal policy, carries out the prosecution according to the principle of legality, and defends the democratic legality (Constitution of the Portuguese Republic and Statute of the Public Prosecution Service). Besides exercising tasks and powers in the criminal field, the Public Prosecution Service extends its functions to other relevant areas of the law, such as administrative, civil, constitutional, family and juvenile, taxes and labour. Similarly to judicial courts, the public prosecution service tends to have little control over the budget. The Prosecutor General's Office is the highest body of the Public Prosecution Service, and its president is the

Prosecutor General. The Prosecutor General is nominated by the political power for a six-year mandate.

Public prosecutors are trained in the same judicial school as judges (CEJ). They are subject to inspections made by the High Council of the Public Prosecution Service.

Considering the development of criminality, appropriate and additional training have been regarded as crucial to reach consistent and effective results (Council of Europe, 2000). Appropriate training should continue to be provided to public prosecutors before their appointment and on a permanent basis. Moreover, specialisation should be considered as a priority, along with the use of multi-disciplinary teams that can assist public prosecutors. In the past years, new forms of crime have emerged, namely with transnational organised criminal groups who seek to exploit legitimate activities for criminal purposes (United Nations Office on Drugs and Crime).

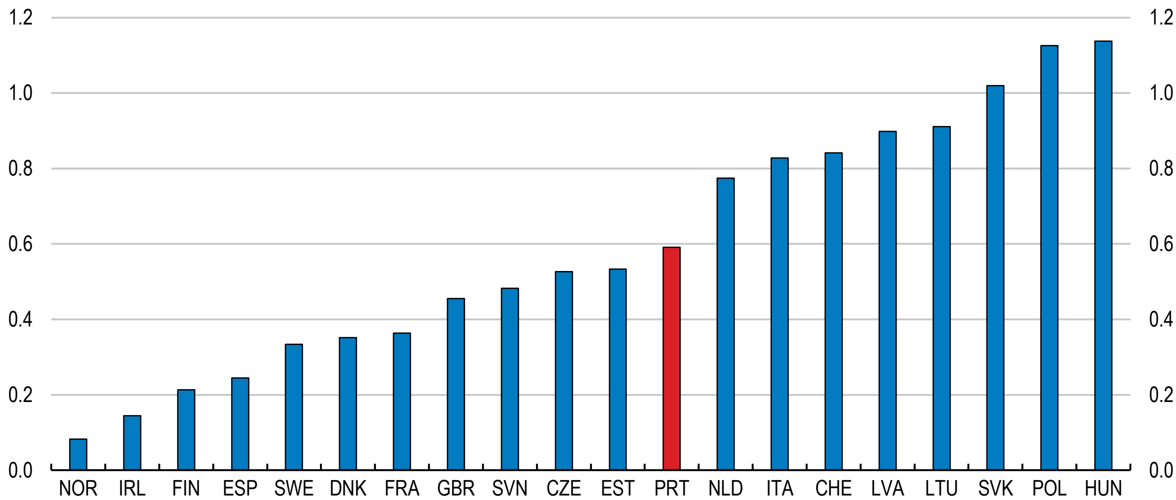
The Public Prosecution Office and Criminal Investigation Police should be endowed with adequate resources, which helps to investigate crimes but also to deter corruption from occurring in the first place. The Public Prosecution Office has strengthened the collection and analysis of evidence to improve the effectiveness of anti-corruption investigations and the cooperation with audit and control bodies to improve the detection of graft (European Commission, 2018). "Forensic-lab" is a new equipment processing a huge amount of information, recently purchased by the Central Department for Criminal Investigation and Prosecution. This lab is able to quickly locate specific information that must be reported during investigations, resulting in an improvement in terms of treatment of materials.

In tandem, specialised training for public prosecutors should be reinforced. Specialised training is important because it enables public prosecutors to be able to perform their professional activity, as complex cases such as those related to economic and financial crime often require specific knowledge and expertise. The "ETHOS project", which ended recently, provided internal specialised training to approximately 60 public prosecutors. One of the main focuses was to provide training regarding asset recovery and non-legal issues that are also relevant for corruption cases. It is important to make specialised training mandatory.

Forensic investigations of economic and financial crimes often entail long and complex judicial processes. It is important that the public prosecution services have adequate resources at their disposal to undertake such forensic investigations. The funding of the Public Prosecution Office in Portugal is comparable with most other European jurisdictions (Figure 2.20), although it is notably lower than in some countries such as Switzerland and the Netherlands in which the available indicators suggest perceived corruption is very low. It should be noted that such comparisons of budget allocation do not take into account cross-country differences in the remits of public prosecution offices. In the next few years, a significant proportion of the current stock of public prosecutors will be retiring, meaning that there needs to be a strong effort in recruitment and training.

Figure 2.20. Resources to public prosecution services differ notably across countries

Public budget allocated to public prosecution services per inhabitant as a ratio to GDP per capita, 2016



Note: The numbers are multiplied by 1000.
Source: CEPEJ.

StatLink http://dx.doi.org/10.1787/888933912656

Recommendations to enhance judicial efficiency

Institutional settings of the judicial courts

Key recommendations

- Increase the managerial autonomy of the courts so that they can effectively allocate resources such as judges, other judiciary staff and budgets.
- Fully analyse the data collected from the information system on court proceedings (CITIUS) so that it allows the courts to identify problematic cases and those that should be prioritised.

Other recommendations

- Improve the CITIUS information system by extending on-going efforts on digitalisation.
- Review the overall system of performance evaluation of judges with a view to ensuring its full objectivity.
- Provide access to detailed data on court decisions to allow the quality of court decisions, case complexity and related costs to be identified in order to assess court performance and the effects of past reforms.
- Strengthen legal assistance to judges by increasing the specialisation of clerks and ensuring the organisation of clerks is flexible.
- Consider introducing assistant judges in lower level courts.

Demand for judicial services

Key recommendations

- Introduce an out-of-court mechanism to facilitate the liquidation of non-viable firms.
- Set up an independent supervisory body to ensure that regulations in the legal profession are in the public interest.

Other recommendations

- Review the reserved activities for lawyers, which unduly restrict competition, such as those on negotiations on credit collection.
- Remove the restrictions on external professionals owning and managing law firms responding better to the needs of a wider range of clients.
- Remove the prohibition on working directly with other professionals in law firms to gain further economies of scale and offer a wider range of services.

Strengthening the prevention of corruption

Key recommendations

- Continue to enhance the capacity of the Public Prosecution Office to address economic and financial crime, including corruption. Public prosecutors should continue to undertake specialised training in this area.
- Establish an electronic registry of interests for all government members and senior civil servants that is regularly updated.

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