



OECD Economic Surveys

Portugal

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OVERVIEW

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- ▶ The economy is progressively recovering and rebalancing
- ▶ The outlook is becoming more challenging and vulnerabilities are rising
- ▶ Managing limited fiscal space
- ▶ Safeguarding financial stability
- ▶ Strengthening investment financing
- ▶ Improving the business climate to boost investment
- ▶ Raising skills
- ▶ Making growth more sustainable

Introduction

→ Report by the OECD on the Portuguese economy in 2017.

Highlights the assessments and future recommendations for Portugal.

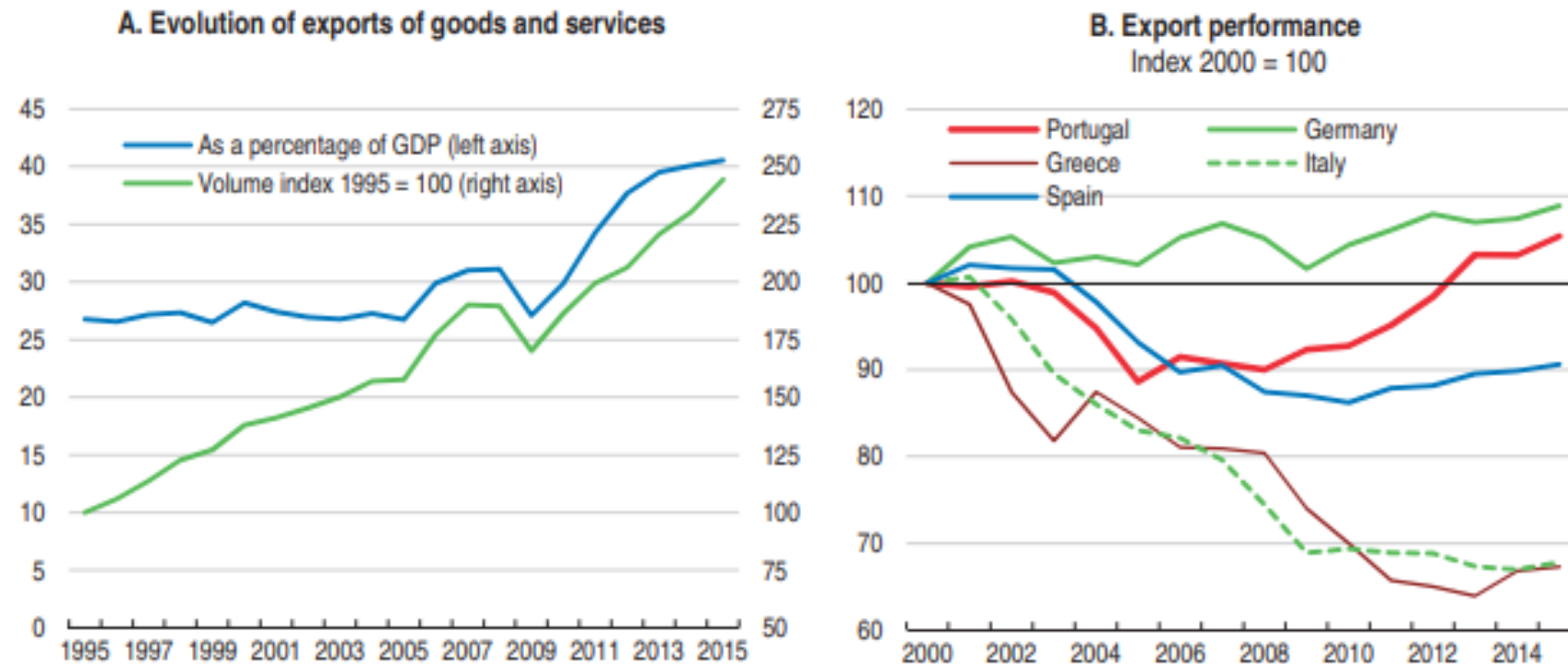
Focuses on economic, fiscal, financial, climatic and learning facts.

The text is divided in 8 parts :

- *The economy is progressively recovering and rebalancing* [L] [SEP]
- *The outlook is becoming more challenging and vulnerabilities are rising* [L] [SEP]
- *Managing limited fiscal space* [L] [SEP]
- *Safeguarding financial stability* [L] [SEP]
- *Strengthening investment financing* [L] [SEP]
- *Improving the business climate to boost investment* [L] [SEP]
- *Raising skills* [L] [SEP]
- *Making growth more sustainable* [L] [SEP]

The economy is progressively recovering and rebalancing

Figure 1. Exports have improved

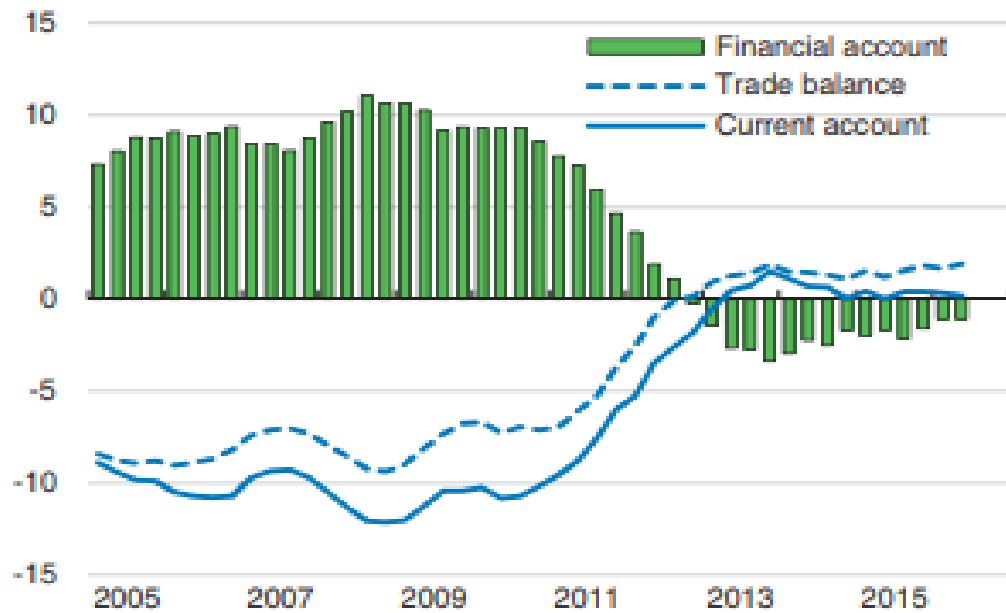


Source: OECD (2016), OECD Economic Outlook: Statistics and Projections (database).

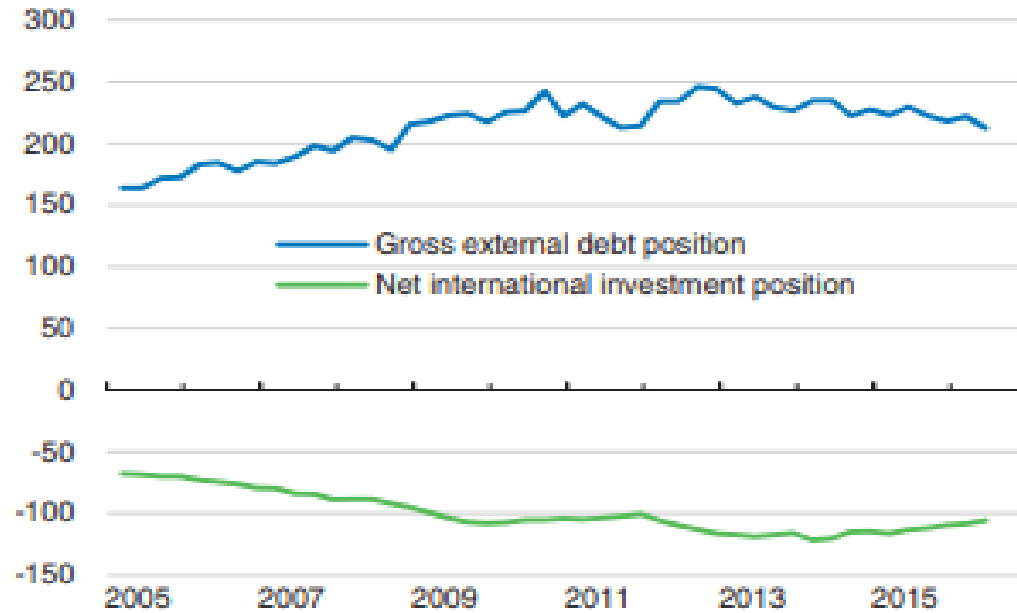
How to read this chart (Panel B): Export performance measures the expansion of a country's exports relative to the expansion of import demand from its trading partners. Improvements in export performance reflect rising market shares in the imports of trading partners.

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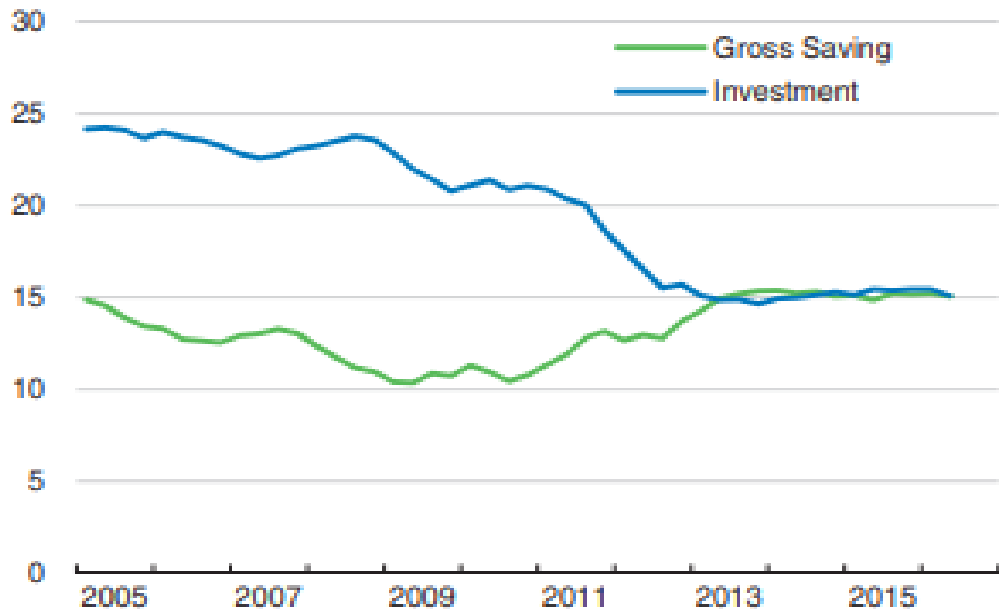
A. Balance of payments¹



B. External debt



C. Saving and investment rates¹



D. Gross saving rates by institutional sector¹

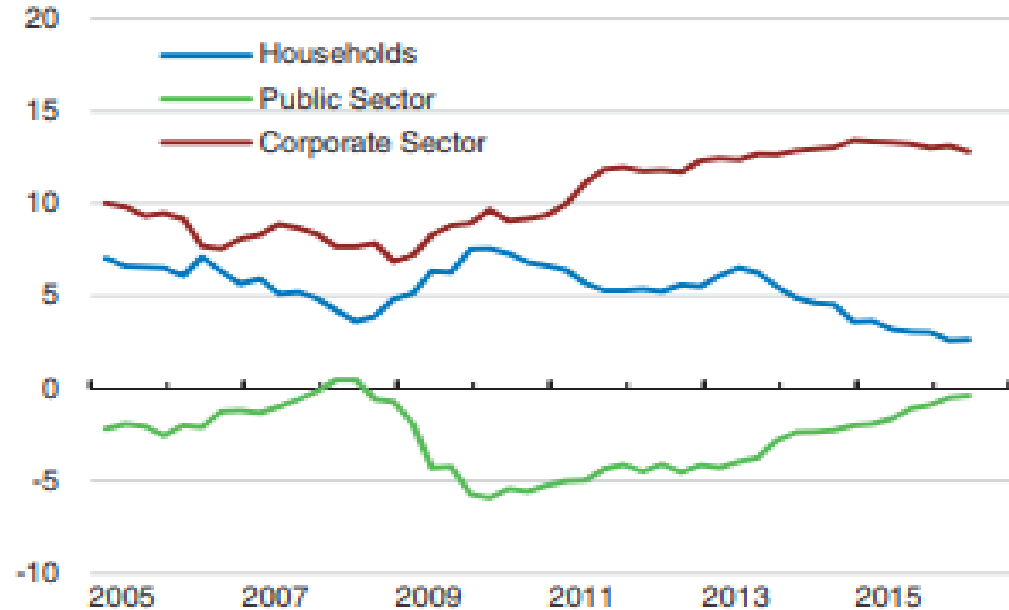
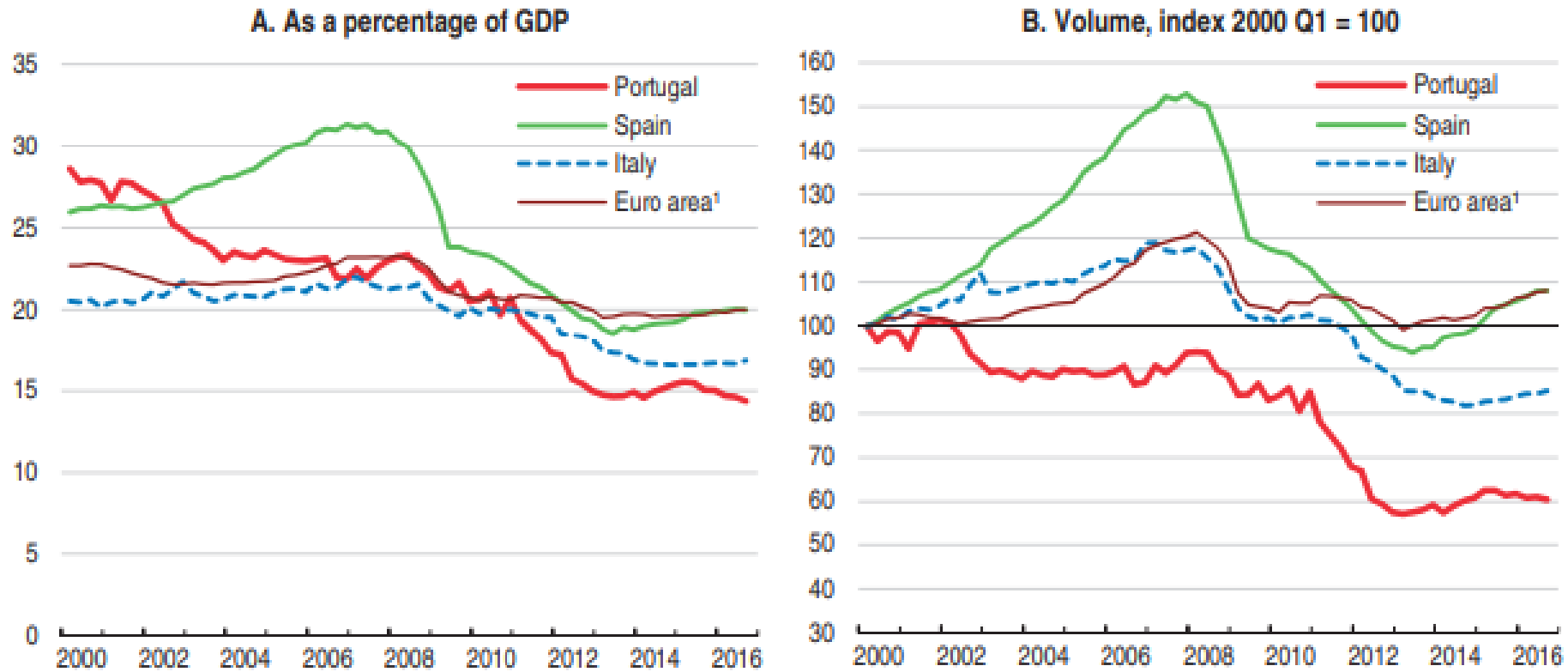


Figure 3. Investment
Total gross fixed capital formation



1. Euro area countries that are also OECD members (including Latvia).

Source: OECD (2016), OECD Economic Outlook: Statistics and Projections (database).

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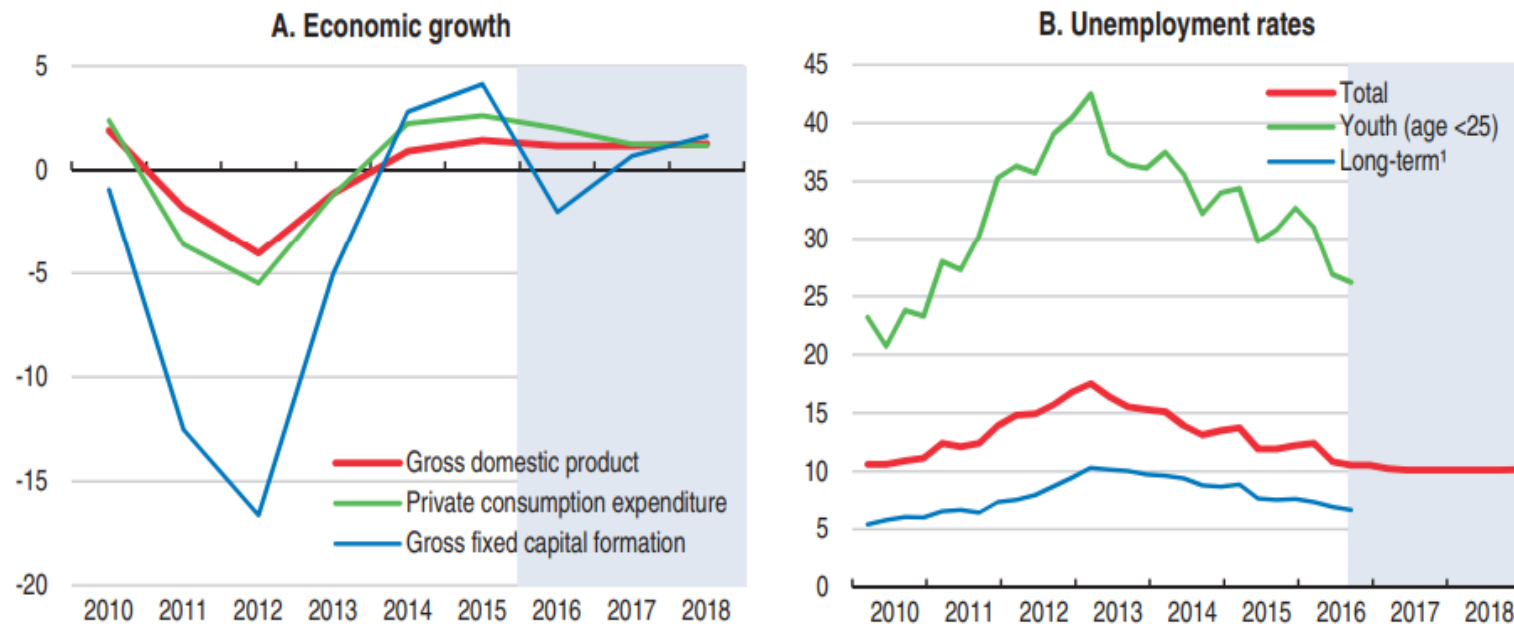
OECD recommendations on inequality and social benefits

- ▶ Choices in terms of fiscal policy
- ▶ Reduce fiscal risks and the amount of doubtful debts inscribed on the balance sheet of the banks.
- ▶ Restore investment to grow prosperity and ensure competitiveness. Banks will need to be strengthened, corporate debt reduced, more efficient insolvency procedures put in place, and the business climate improved.
- ▶ Raising well-being and reducing inequities, which are at high levels.

The outlook is becoming more challenging and vulnerabilities are rising


Figure 6. **Growth and unemployment**

Per cent



1. Unemployed persons who have been looking for jobs for 12 months or more as a share of the total labour force.

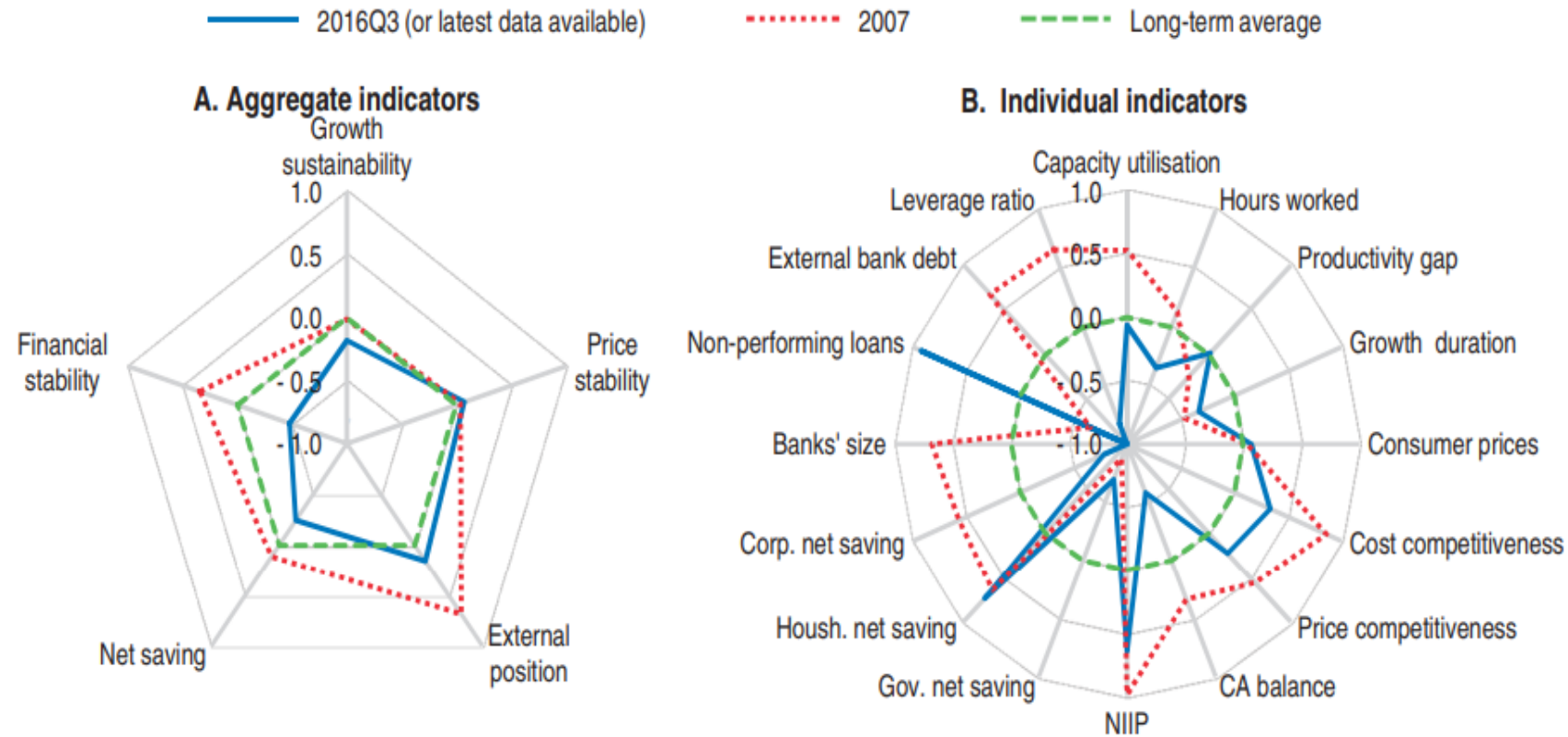
Source: OECD (2016), *OECD Economic Outlook: Statistics and Projections* (database); and Banco de Portugal (2016), "General Statistics", BPstat (database).

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The outlook is becoming more challenging and vulnerabilities are rising

Figure 7. **Macro-financial vulnerabilities**

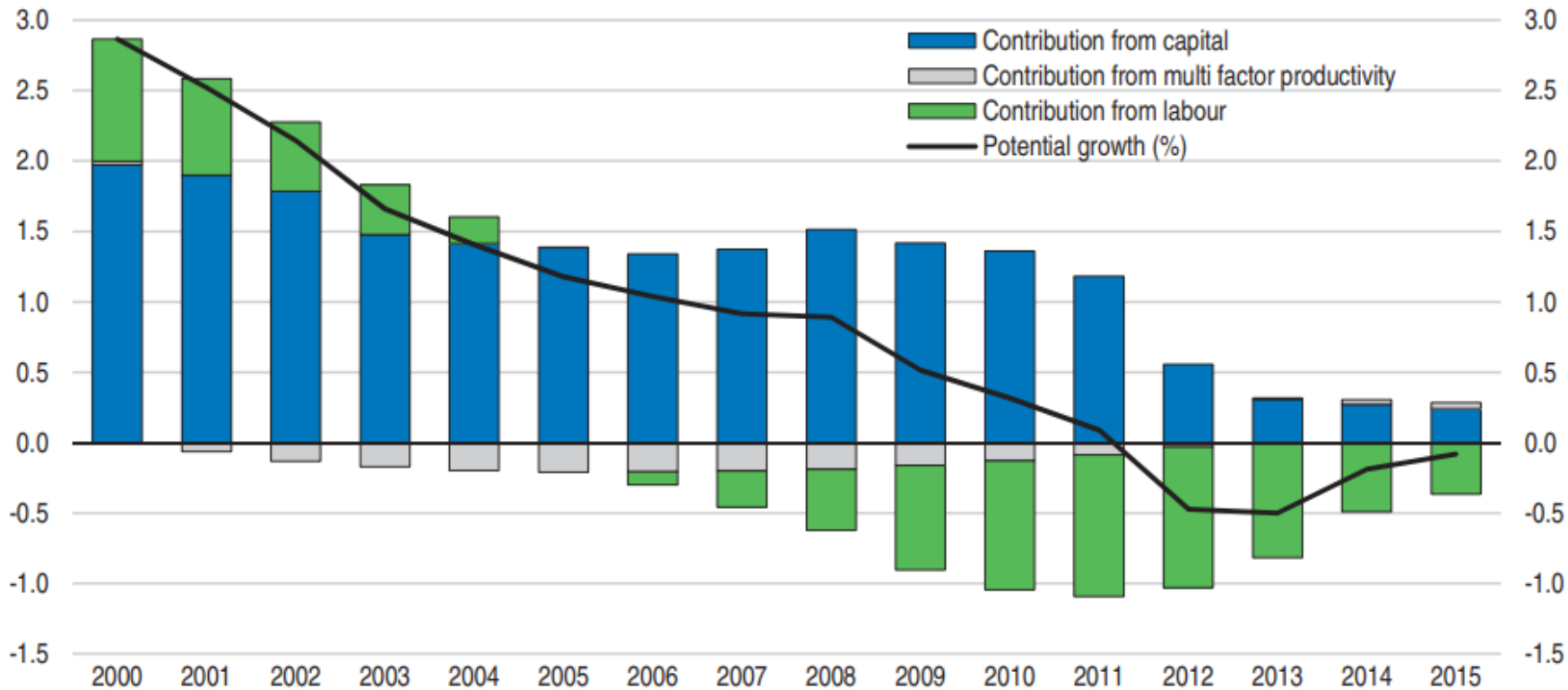
Deviations of indicators from their real time long-term averages (0), with the highest deviations representing the greatest potential vulnerability (+1), and the lowest deviations representing the smallest potential vulnerability (-1)¹



Managing limited fiscal space

Figure 8. **Low investment and a shrinking labour force have curbed the economy's growth potential**

Percentage points



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


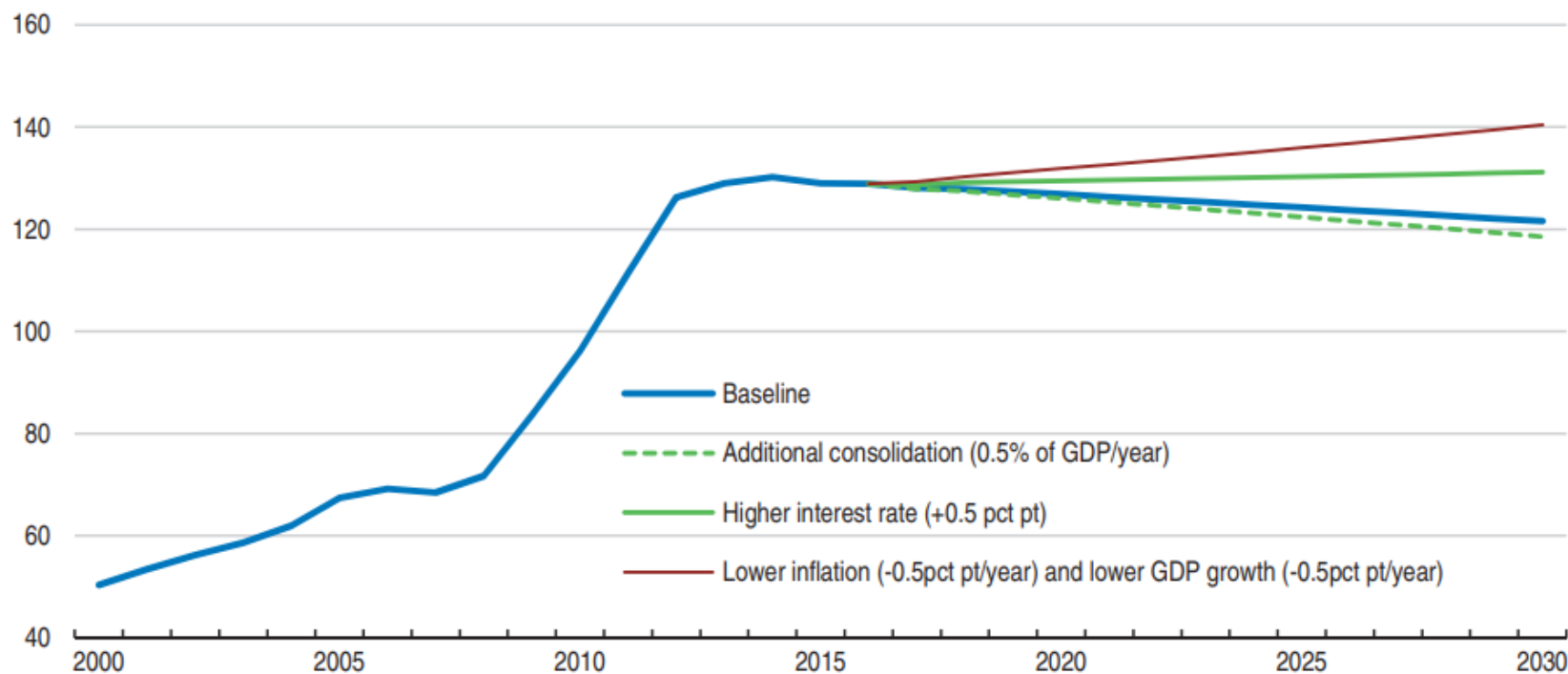
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Figure 9. **Illustrative public debt paths**
 General government debt, Maastricht definition, per cent of GDP¹



1. The baseline consists of the projections for the *OECD Economic Outlook No. 99* until 2017. From there on, baseline assumptions are real GDP growth of 1.2% per annum, a primary surplus of 1.6% in 2018 and 2019 and 1.5% thereafter, and an effective interest rate of 3.6%. These assumptions are in line with those in the Spring 2016 edition of the *IMF World Economic Outlook*.

Source: Calculations based on OECD (2016), *OECD Economic Outlook: Statistics and Projections* (database).


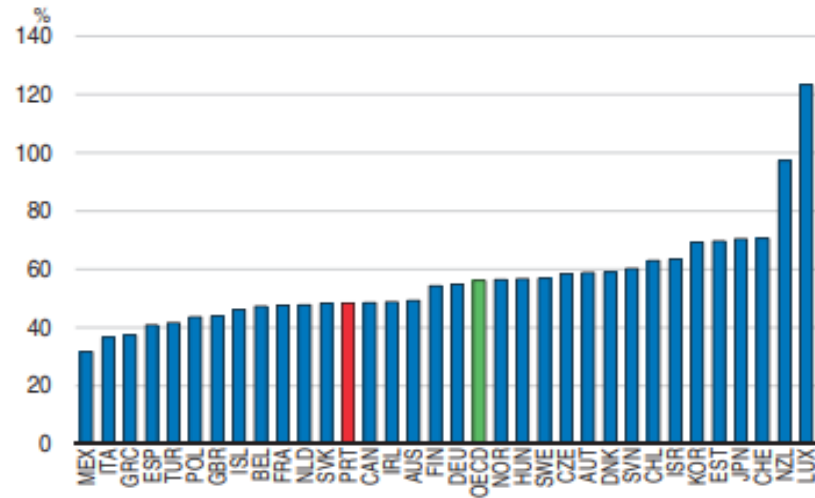
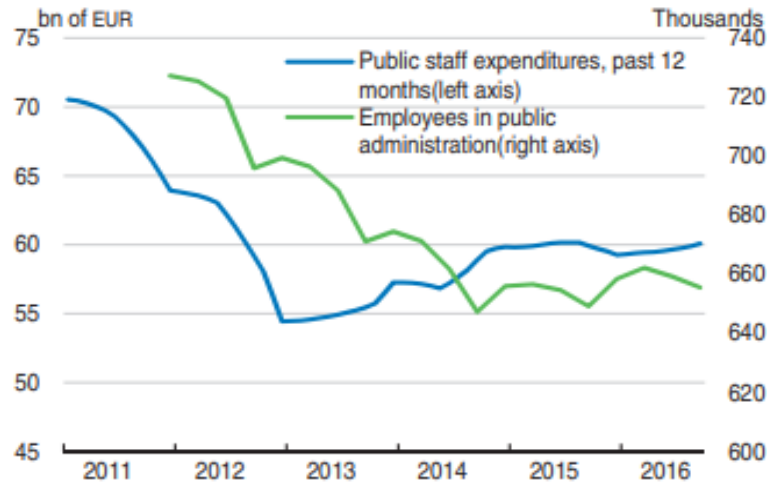
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Figure 10. Selected issues in public revenues and expenditures

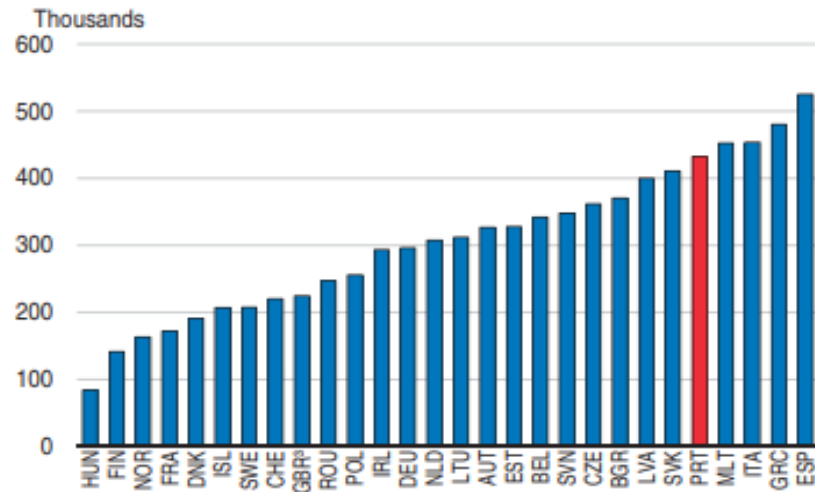
A. Value-added tax (VAT) revenue ratio, 2014¹



B. Public employment and staff expenditures



C. Total Police Personnel at the National Level, 2014²



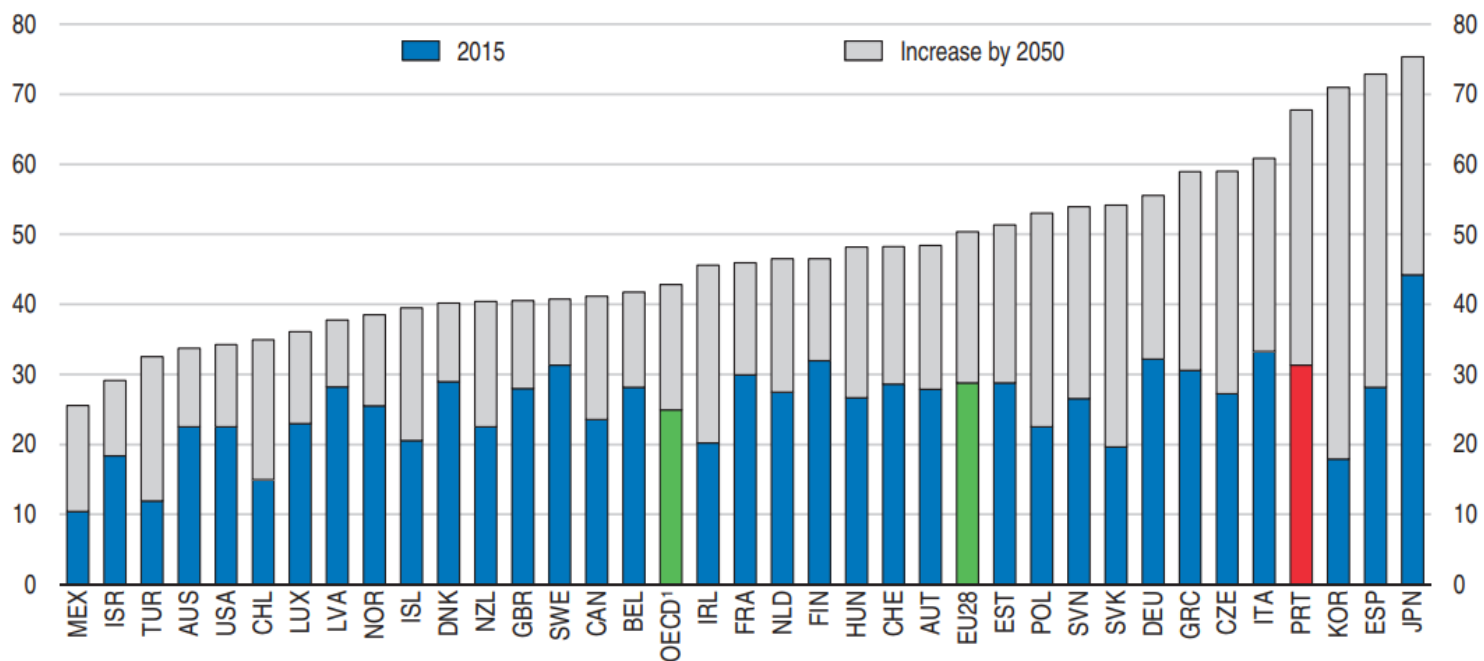
D. Debt of public enterprises



Table 3. Past OECD recommendations on fiscal policy

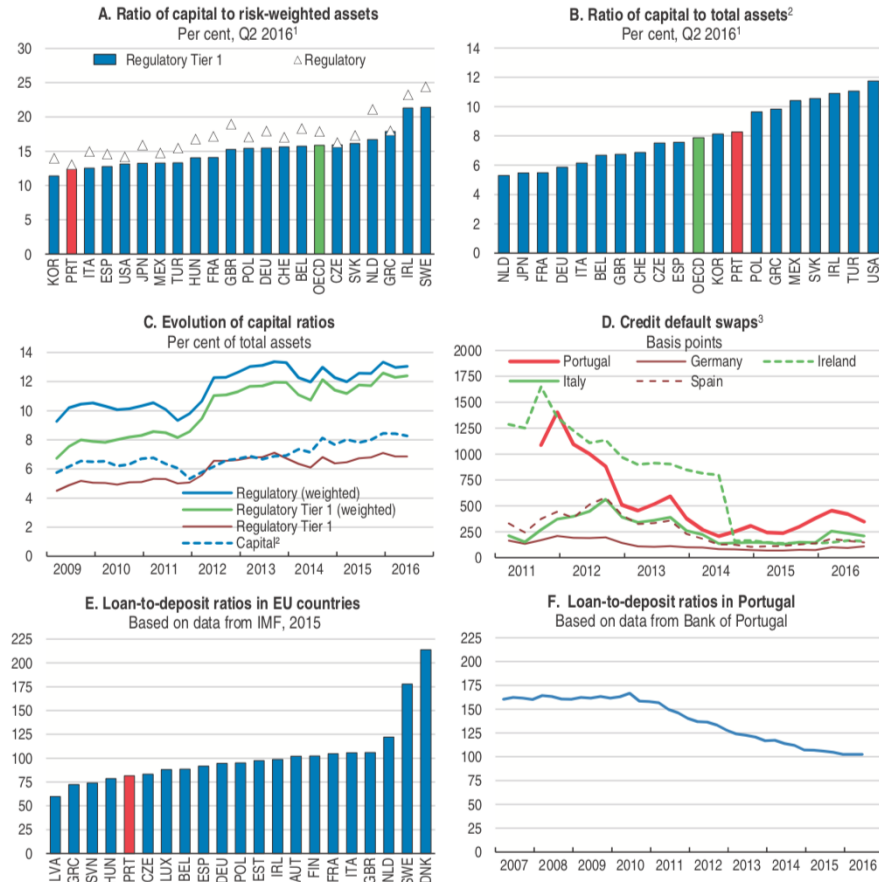
Recommendations in 2014 Economic Survey	Actions taken since 2014
Achieve planned structural fiscal consolidation targets but allow the automatic stabilisers to operate.	Despite some slippage with respect to targets, Portugal has made strong progress in reducing public deficits since 2010.
Continue to improve public sector efficiency by further reducing the number of civil servants.	The decline in public employment has been reversed.
Enhance the efficiency of the tax system including by eliminating tax exemptions and expenditures.	Consumption taxes continue to make wide use of exemptions and reduced rates, including the recently introduced reduced VAT rate applied to restaurant meals.

Figure 11. The dependency ratio will rise
Population aged 65 years-old and over as a percentage of population aged 15-64



Safeguarding financial stability

Figure 12. Banking sector indicators



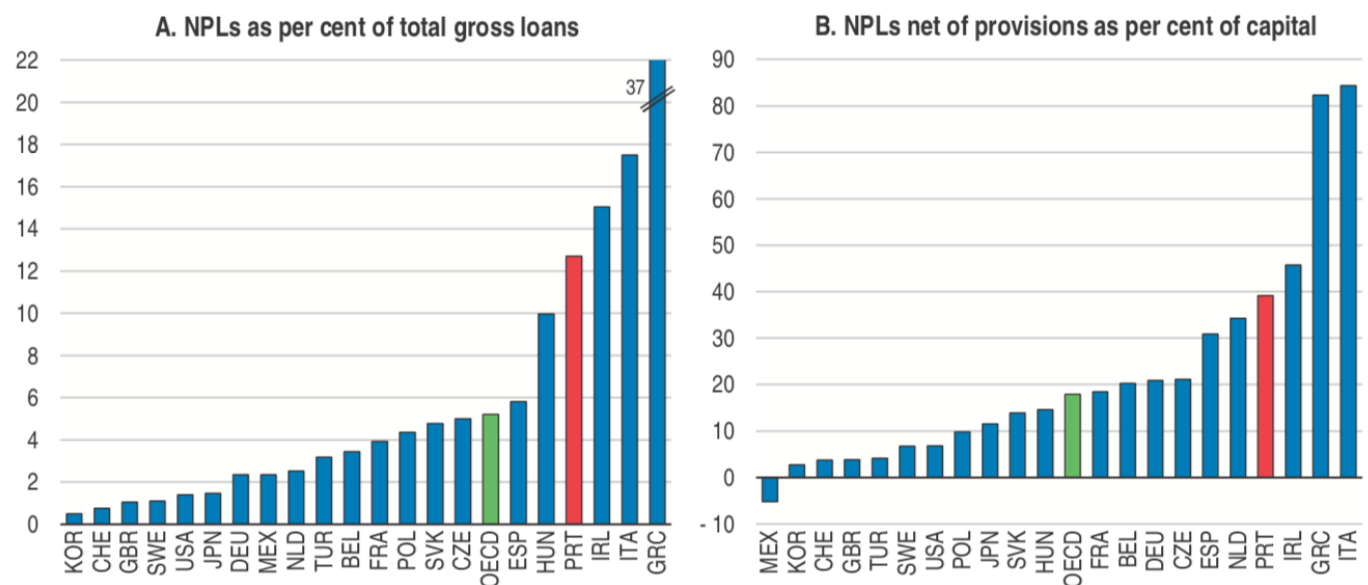
- Low profitability is a major challenge for banks
- Funding from deposits has increased

1. Or latest quarter of data available (Q4 2014 for Korea). The OECD aggregate includes Latvia and is an unweighted average of latest data for 32 countries in Panel A and 28 countries in Panel B.
 2. Ratio of total capital and reserves (as reported in the sectoral balance sheet) to total assets.
 3. Five-year senior debt, mid-rate spreads between the entity and the relevant benchmark curve; end of quarter data. For Portugal the series shown is an average of two banks – Banco Comercial Português and Banco BPI; for other countries the number of banks used in the calculation depend on data available.

- ▶ Solving NPLs rapidly is a key issue for Portugal.
- ▶ One solution to reduce NPL stock could be facilitated by a more favourable tax treatment of loan loss provisions.


Figure 13. **Non-performing loans (NPLs)**

Per cent, Q2 2016¹



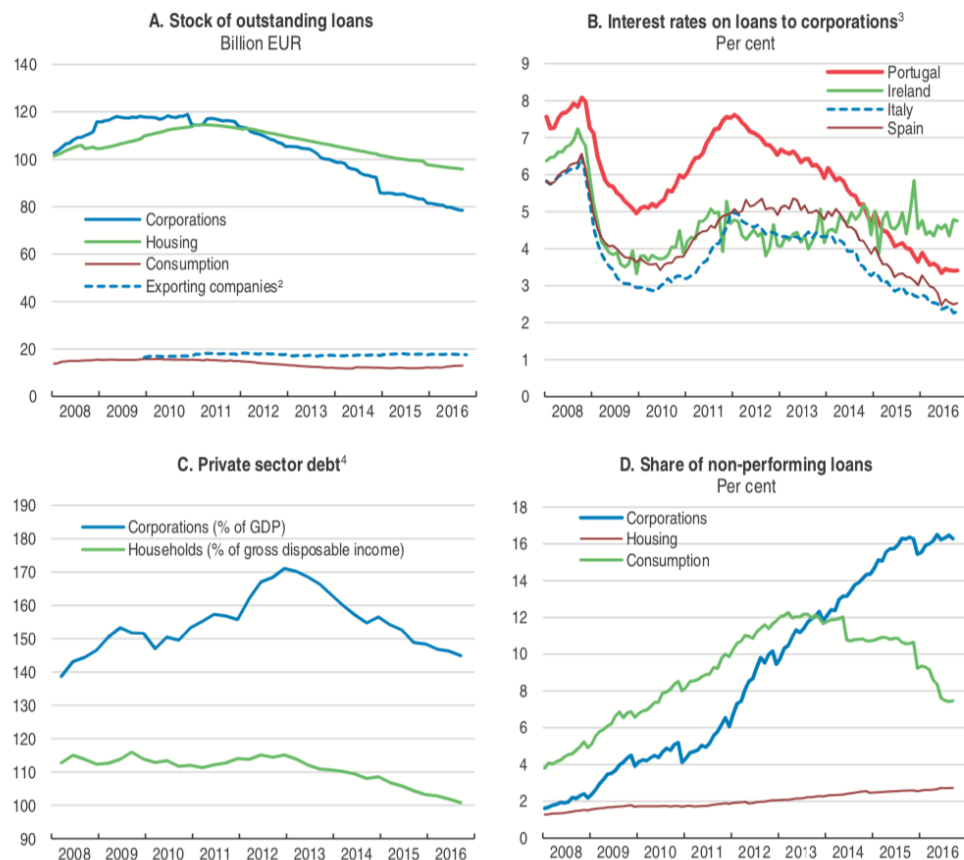
1. Latest data available at end of period: Q1 for Japan, the United Kingdom and Turkey, Q4 2015 for Switzerland; 2014 for Germany and Korea. The OECD aggregate is an unweighted average of the latest data available for OECD countries including Latvia.

Source: IMF (2016), *Financial Soundness Indicators* (FSI Database), International Monetary Fund.

StatLink  <http://dx.doi.org/10.1787/888933447728>

Strengthening investment financing

Figure 14. Financial indicators¹



1. All corporations are non-financial (NFC) and loans are from monetary and financial institutions.
2. Privately owned and either export more than 50% of the turnover or export more than 10% of the turnover and the total amount exceeds EUR 150 000.
3. Loans up to and including EUR 1 million. Operations with an initial rate fixation period of less than one year for new business.
4. The non-financial sector debt presented includes loans, debt securities and trade credits. Households include non-profit institutions serving households.

Source: Banco de Portugal (2016), BPstat Database; and ECB (2016), Statistical Data Warehouse, European Central Bank.


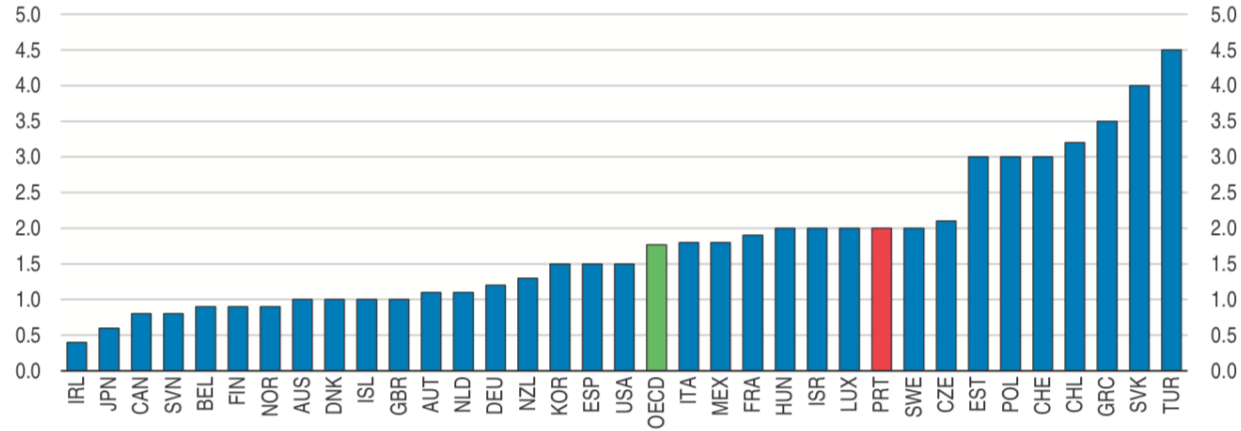
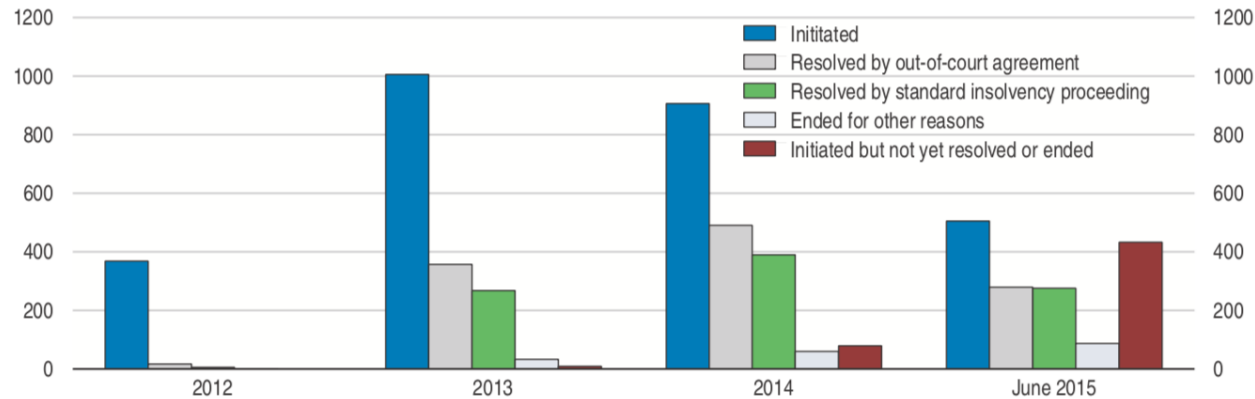
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Figure 15. **Insolvency framework**

A. Years required to resolve an insolvency case¹
2015



B. Number of out-of-court settlements



1. Time from the company's default until the payment of some or all of the money owed to the bank taking into consideration eventual delay tactics. The OECD aggregate is an unweighted average including Latvia.

Source: World Bank (2016), *Doing Business 2016: Measuring Regulatory Quality and Efficiency* (database); and APAJ (2015), "Processo Especial de Revitalização", *Turn Analysis*, No. 7, 2nd quarter, Associação Portuguesa dos Administradores Judiciais.

▶ How to strengthening investment financing?

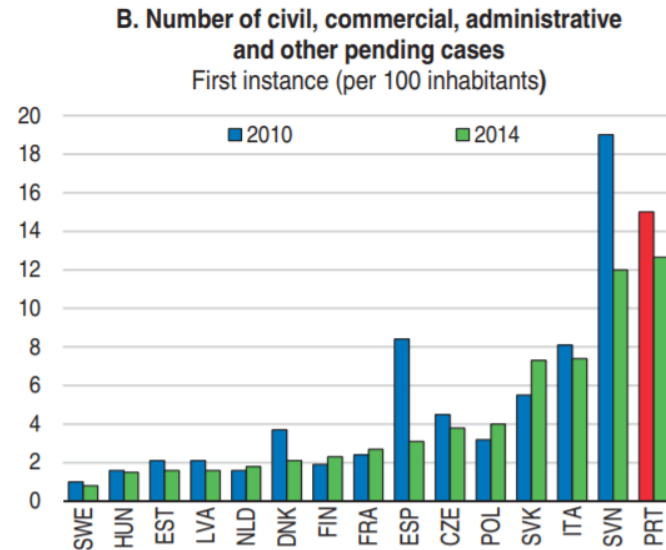
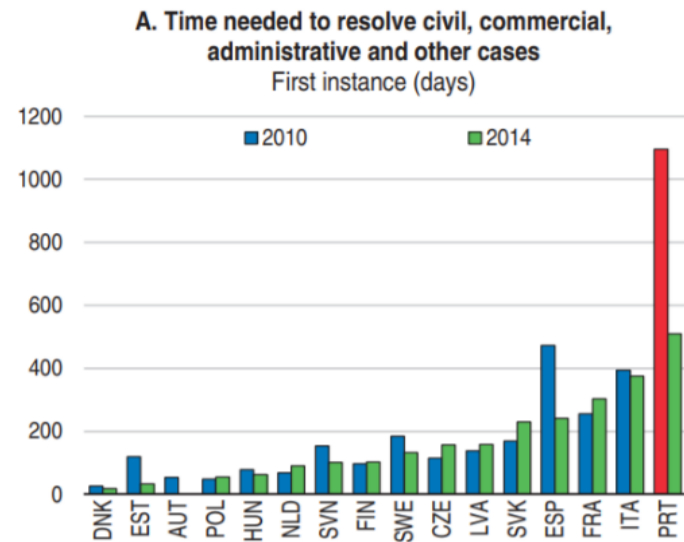
- ▶ Specialized asset management companies (AMCs)
- ▶ Well-working insolvency frameworks and investing more recourses into court capacity
- ▶ Limit the amount of deductible interest expenses
- ▶ More financing options for start-ups

Improving the business climate to boost investment

- ▶ Investment is strengthened by reforms that improve the business climate, respectively, by reducing costs and focusing on return.
- ▶ Exemplifying some reforms:
 - Judicial System
 - Red Tape and Regulation
 - Product market regulation in services and utility sectors
 - Foreign Direct Investment
 - Labour Costs

Improving the business climate to boost investment – Judicial System

- ▶ Portuguese companies identified difficulties with the judicial system as a major factor driving up costs, characterizing it as increasingly challenging over the last 3 years
- ▶ Portugal's performance:



Improving the business climate to boost investment – Red Tape and Regulation

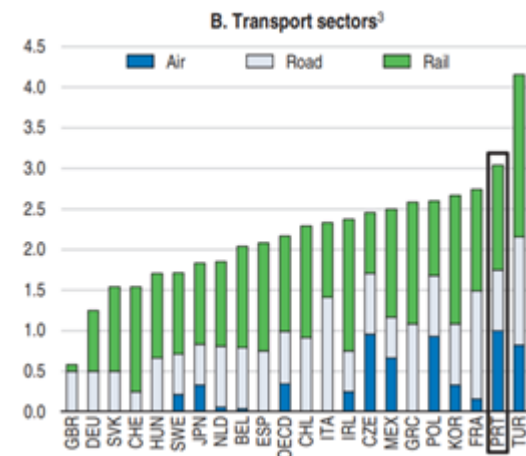
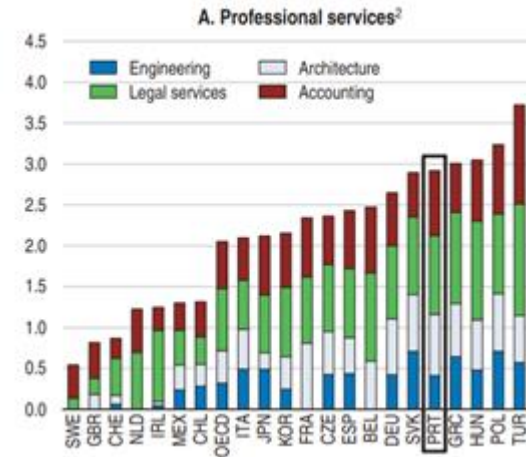
- ▶ Less “red tape” reduces costs and raises the returns on investment
- ▶ Recent measures, including new programme to simplify administrative procedures called Simplex+2016
- ▶ Firms who had to deal with licenses for starting a business considered this process a high or very high obstacle and failed to see any improvement in the process but lack of co-operation among all public entities involved is crucial for that
- ▶ The net benefit of investment projects for local development should be analysed on the basis of transparent and objective criteria, limiting the discretion of local authorities, which will also help to prevent corruption
- ▶ Authorities should limit discretionary powers of municipalities to speed up licencing procedures further.

Improving the business climate to boost investment - Product market regulation in services and utility sectors

- ▶ Services sectors have traditionally been characterised by low levels of competition and significant rents resulting from regulatory policies that stood in the way of competition
- ▶ An ongoing OECD competition assessment can help to identify concrete regulatory constraints to competition in services sectors and define further reform priorities.
- ▶ In the energy sector, a series of reforms has improved regulation and eliminated the scope for remuneration above market prices, but only for new entrants.
- ▶ Policy indicators such as the OECD Product Market Indicators reflect these substantial improvements and Portugal's network sector regulation is the second most competition friendly in the OECD.

Improving the business climate to boost investment - Product market regulation in services and utility sectors

- ▶ In professional services such as accounting, auditing, legal or architecture services, competition remains weak and regulation is more restrictive than the OECD average
- ▶ Regulation by professional associations should be monitored closely by public authorities to avoid excessive restrictions on entry and safeguard competition
- ▶ Moreover, frequent policy changes may reduce Portugal's ability to attract foreign direct investment, which is typically associated with productivity benefits

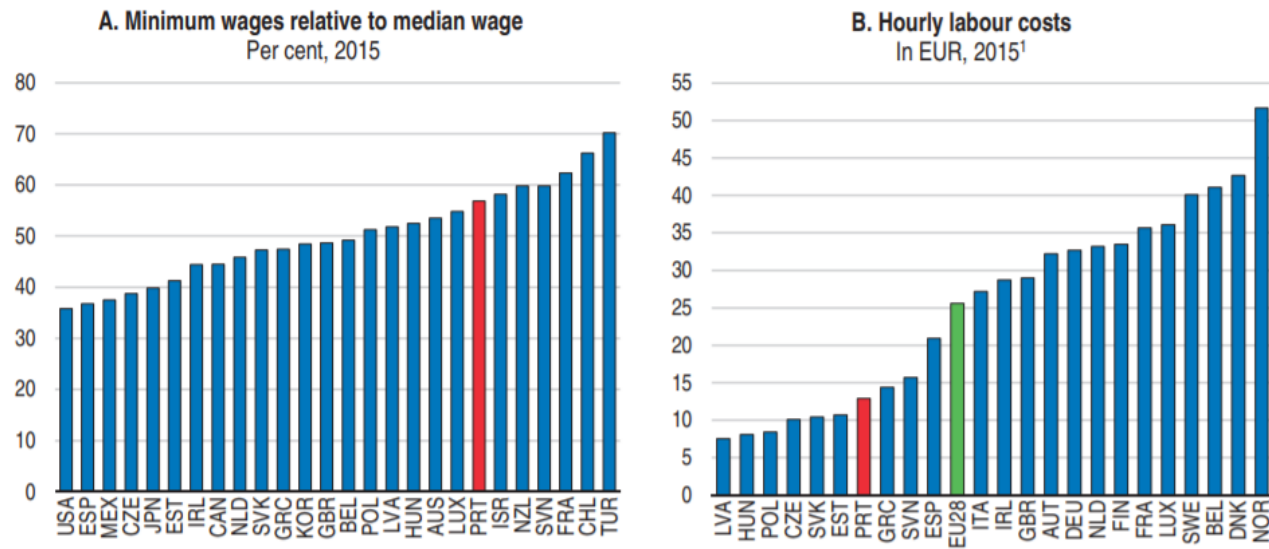


Improving the business climate to boost investment – Foreign Direct Investment

- ▶ Foreign direct investment (FDI) inflows account for significant shares of investment in some sectors. Attracting more FDI has significant potential to boost investment. Reforms enacted since the financial crisis have boosted Portugal's attractiveness as a destination for FDI.
- ▶ EU structural funds have become large relative to public investment, which declined from 5% of GDP in 2010 to 2.1% in 2015
- ▶ A new strategy for allocating these funds, called Portugal 2020, has recently been designed and aims to support the structural transformation of the economy towards export sectors

Improving the business climate to boost investment – Labour Costs

- ▶ The outlook for labour costs, which account for 19% of the costs of Portuguese companies, remains challenging
- ▶ The minimum wage has become increasingly binding



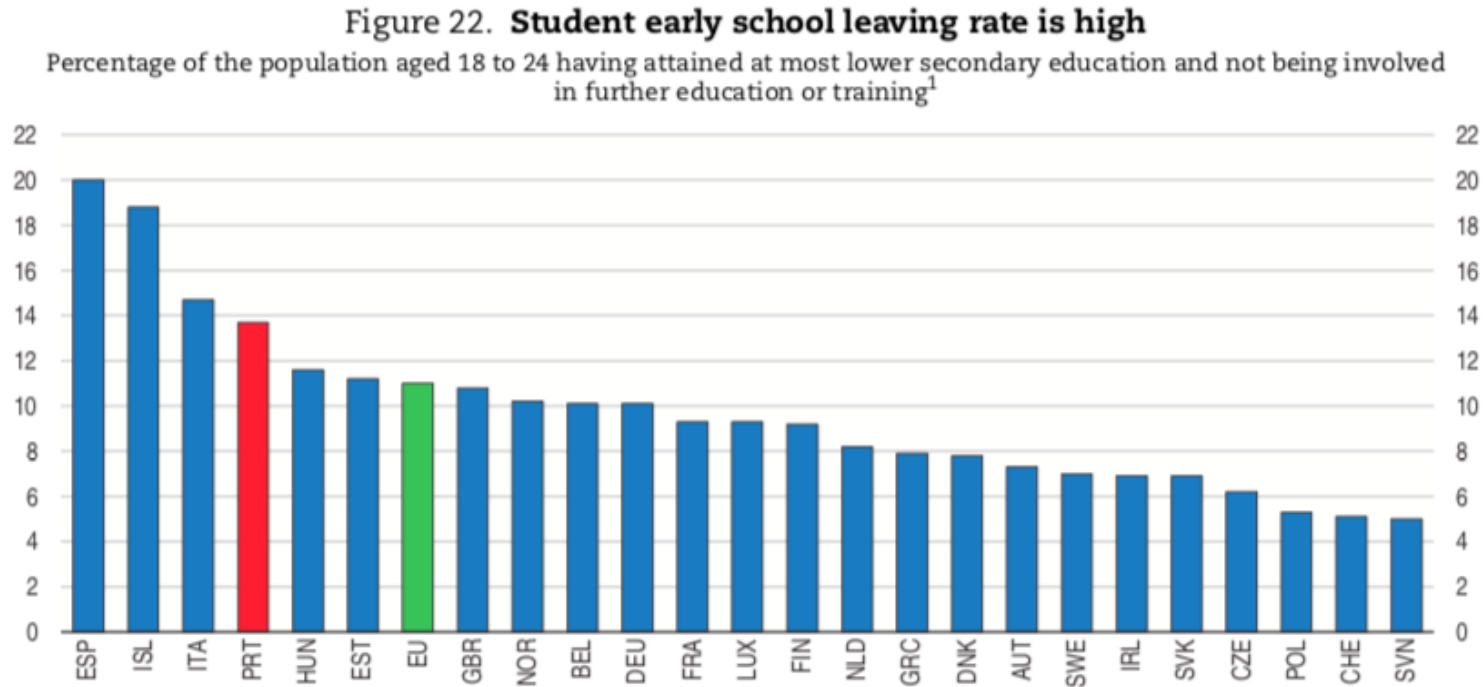
OECD recommendations on improving the business climate to boost investment

- ▶ Strengthen competition in non-tradable sectors through further regulatory reform.
- ▶ Promote wage bargaining at the firm level, including by abolishing administrative extensions of wage agreements.
- ▶ Improve the links between researchers in universities and the private sector. Consider allowing refunds of R&D tax credits for loss-making firms, or extending the carry-forward period.

Raising skills

- ▶ Reducing grade repetition and drop out
- ▶ Raising quality and equity in education
- ▶ The vocational education and training (VET) system
- ▶ Improve labour market signals and incentives to invest in skills

➤ Reducing grade repetition and drop out



1. The early school leaving rate for Spain covers "school drop outs". The United Kingdom has no national target.

Source: Eurostat (2016), "Youth education and training", Eurostat Database; and European Commission (2014), "Overview of Europe 2020 Targets", http://ec.europa.eu/europe2020/targets/national-targets/index_en.htm.

StatLink  <http://dx.doi.org/10.1787/888933447815>

→ early school leaving rate

→ one of the highest in Europe

➤ Reducing grade repetition and drop out

Negative impact of Grade Repetition

- predictor of additional repetitions along the education system
- exacerbates inequalities
- reduce the country's performance relative to its neighbors.

Recommandations

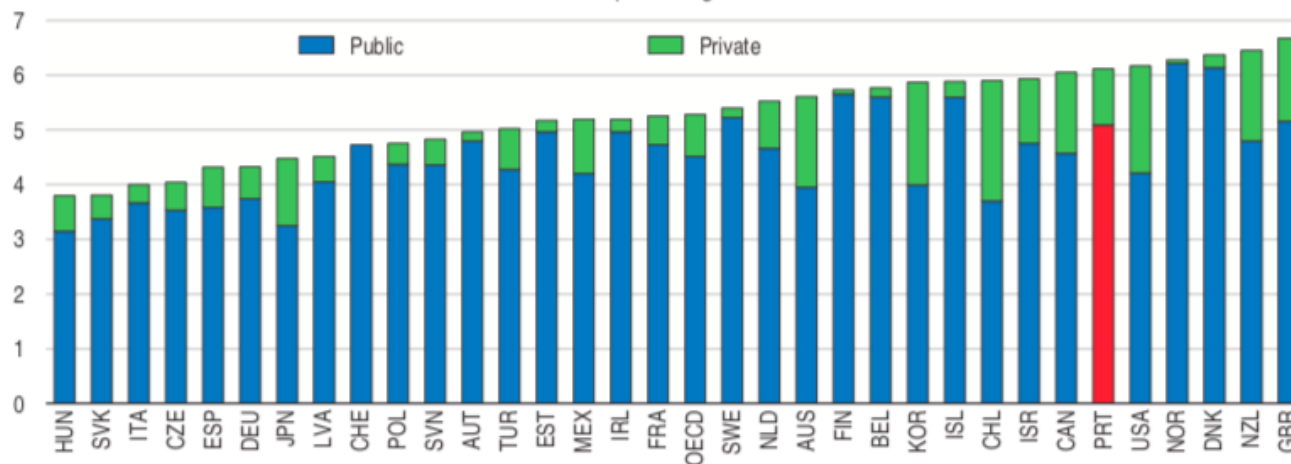
- re-focusing resources on primary and pre-primary education.
- identifying students at risk early on and providing them with individualized support
- introduce mentoring for students is more likely to succeed
- strengthening teacher training and exposure to best working practices

Figure 23. **Allocation of resources in education**

2013¹

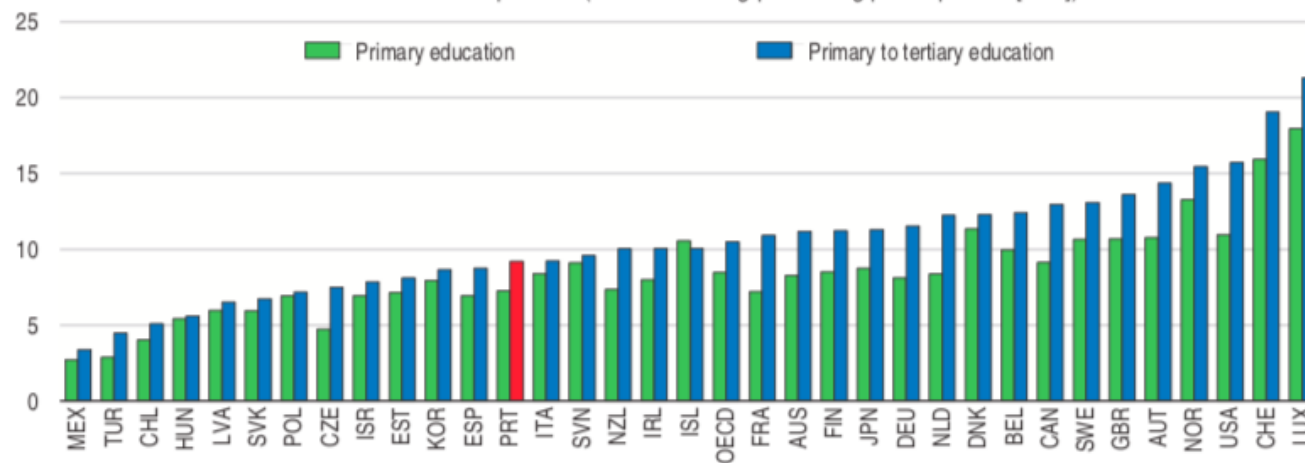
A. Expenditure on primary to tertiary educational institutions²

As a percentage of GDP



B. Annual expenditure per student³

In thousand USD equivalent (calculated using purchasing power parities [PPP])



➤ Raising quality and equity in education

Analyze

Make an effort in spending on education.

Education expenditure is above the OECD average relative to GDP annual expenditure per student is among the lowest

Recommandations

Raise spending in primary and pre-primary education

→ Because the rate of return on investment in human capital is greatest in the early years of schooling

➤ The vocational education and training (VET) system

Recommandations

- Enhance the attractiveness of the VET system
- Improve its relevance to the needs of the labor market.
- Remains highly fragmented in Portugal.
- Needs a comprehensive evaluation.

Analyze

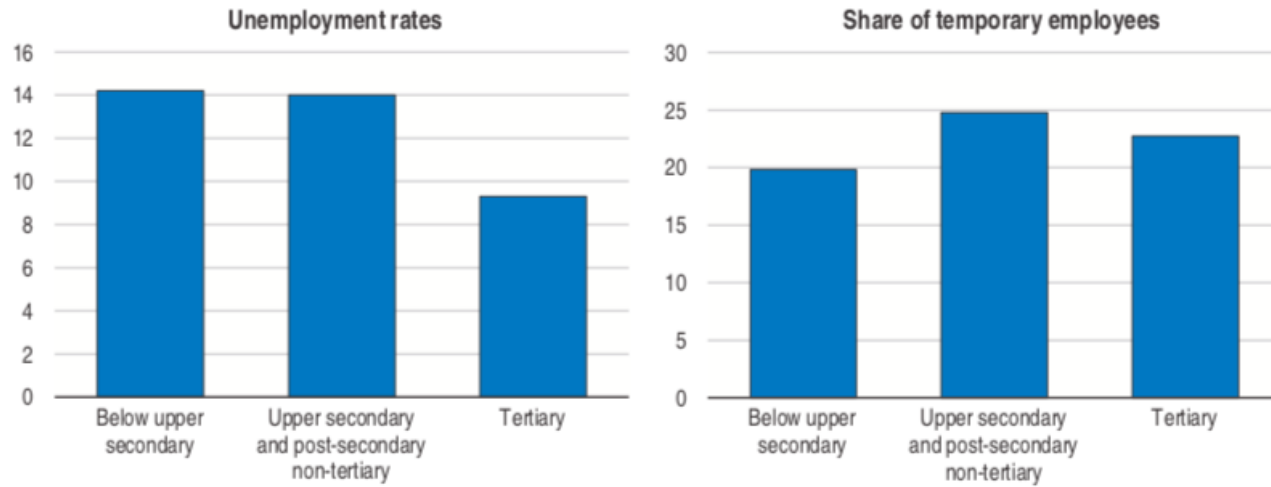
- two systems co-exist in parallel.
 - Establish a single dual VET system with strong work-based learning in companies.
- ➔ VET graduates have better job prospects in countries where these curricula integrate practical training in business (Germany).
- Portugal could learn from these practices in order to improve its training system.

➤ Improve labour market signals and incentives to invest in skills

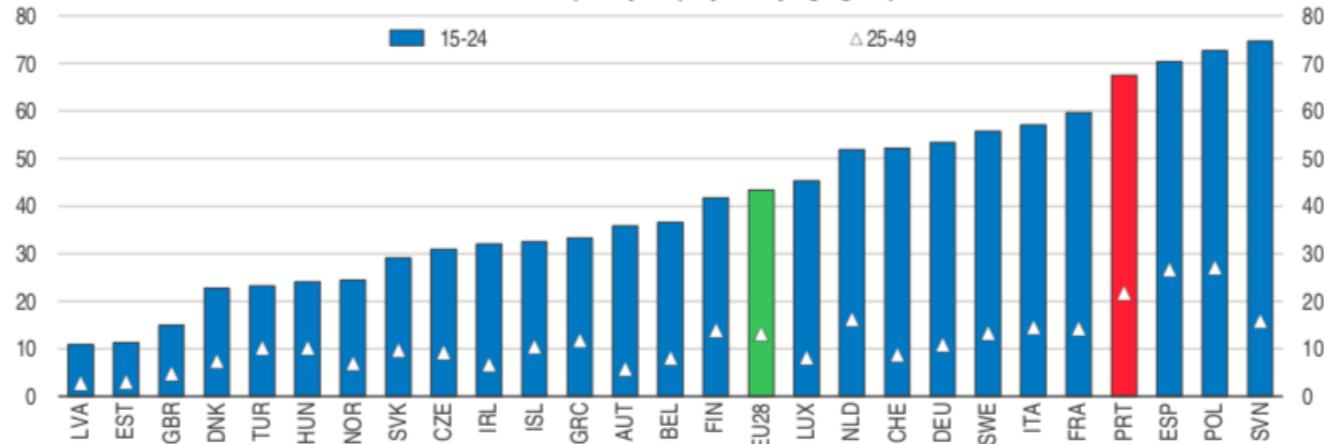
Figure 25. **The labour market remains segmented**

Per cent, 2015

A. By level of educational attainment (age 15-64)



B. Share of temporary employees by age group



➤ Improve labour market signals and incentives to invest in skills

Analyze

Portugal's unemployment rate remains one of the highest in the OECD area

significant duality in the labor market between open-ended contracts vs temporary contracts

→ reduces your chances of landing a permanent contract.

a better level of qualification does not reduce the risks of taking a temporary job

one of the highest proportions of young workers in temporary jobs,

→ impact on investment in human capital and on-the-job training

Recommandations

investing in skills is essential

reforms to mitigate labor market rigidities in some areas

crucial to narrow the gap between the two segments of the labor market in terms of job protection.

Making growth more sustainable

The challenge will be to reduce costs while contributing to environmental progress.

Some numbers about Portugal's environment :

- ▶ 60% of electricity production came from renewable sources
- ▶ 95% of the country's water could be safely consumed
- ▶ 20% of water consumers are not connected to a wastewater treatment plant.

OECD's information :

- ▶ the morbidity study found that nearly 3,300 premature deaths worldwide were attributable to outdoor air pollution in 2013.
- ▶ Fuel tax rates for agriculture and fisheries will be reviewed.
- ▶ Portugal is in a position of dependency about environment as shown by its low number of environmental patents.

Conclusion

- ▶ OECD has several recommendations regarding the previous topics which include the following:

Inequalities and social benefits

- Reduce fiscal risks and the amount of doubtful debts inscribed on the balance sheet of the banks.
- Restore investment to grow prosperity and ensure competitiveness. Banks will need to be strengthened, corporate debt reduced, more efficient insolvency procedures put in place, and the business climate improved.

Conclusion (Continuation)

The outlook is becoming more challenging and vulnerabilities are rising

- ▶ Growth prospects will increasingly depend on policies that allow the economy to compete successfully and generate new income opportunities.
- ▶ Raising the skills of the labour force will also lift potential growth
- ▶ The banking sector remains constrained by weak profitability and a high share of non-performing loans (NPLs)

Managing limited fiscal space

- ▶ The fiscal stance is broadly neutral in 2016 and 2017
- ▶ Higher losses could end up deteriorating public finances
- ▶ Aging costs are expected to rise substantially but will remain manageable
- ▶ Contingent liabilities are also a concern for the sustainability of public finances

Conclusion (Continuation)

Safeguarding financial stability & Strengthening investment financing

- ▶ Solving NPLs rapidly is a key issue for Portugal. It can be done by a more favourable tax system. An other way is with Specialized asset management companies (AMCs)
- ▶ Establish well-working insolvency frameworks and investing more resources into court capacity to shorten insolvency cases
- ▶ Limit the amount of deductible interest expenses so that entrepreneurs don't have the incentive to extend their loans and provide more financing options for start-ups

Conclusion (Continuation)

Improving the business climate to boost investment

- Strengthen competition in non-tradable sectors through further regulatory reform.
- Improve the links between researchers in universities and the private sector. Consider allowing refunds of R&D tax credits for loss-making firms, or extending the carry-forward period.

Raising skills

- The challenge for Portugal is to find strategies to engage the low skilled, which are much less likely to receive training than the highly qualified young adults. Portugal has to define clear labour market performance indicators against which to check the success of training programs.