International
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STUDIES ON
GROWTH WITH EQUITY

TACKLING THE JOBS CRISIS IN PORTUGAL

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FOREWORD

Since Portugal's financial assistance programme was agreed in 2011, there has been a deterioration in the labour market situation that is without precedent in the modern economic history of Portugal. One in seven jobs has been lost since 2008, two-thirds of which have been over the past two years alone. While until the mid-2000s unemployment rates remained below the European average, they are today among the highest in advanced economies, coming in only after those of Greece and Spain.

At the same time, and important to recognize, recent indicators do point to some improvement on the macroeconomic front, notably with respect to export performance. On current trends, according to the latest IMF projections, economic growth could turn positive in the coming months and reach 0.8 per cent in 2014. And this is, naturally, welcome news.

However, it must be stressed that economic recovery without jobs is neither satisfactory nor sustainable, not until it has translated into an impact on employment and on living standards. In this regard, it is sometimes assumed that by reducing macroeconomic imbalances in terms of fiscal deficits and competitiveness, confidence will be restored, paving the way automatically for economic recovery and job creation. But failing to devote sufficient attention to the employment and social situation specifically will delay and could even undermine the achievement of macroeconomic goals. The improvements registered so far will just not be enough to arrest the deterioration in the labour market.

It is simply not realistic to expect a sustainable recovery unless action is taken to tackle and address the depressed levels of productive investment as well as youth unemployment, growing child poverty and other trends which are pushing so many talented and young Portuguese people to emigrate or to consider emigration.

In order to achieve a real and sustainable recovery, macroeconomic and employment goals need to be pursued at the same time. This was highlighted by 51 European Governments, Employers' and Workers' representatives in the Oslo Declaration, adopted by the ILO's 9th European Regional Conference in April 2013, which stated that "fiscal consolidation, structural reform and competitiveness, on the one hand, and stimulus packages, investment in the real economy, quality jobs, increased credit for enterprises, on the other, should not be competing paradigms. It is in our common interest to elaborate sustainable approaches in order to promote jobs, growth and social justice".

This ILO report offers reflections on just how to tackle the jobs crisis while also meeting key macroeconomic goals. It highlights the role of a strategy to unlock job creation potential in the short run, through a mix of targeted measures and action; to address the impact of tough financial conditions faced by enterprises, especially smaller enterprises, and to build a strong production base; to maintain jobs in viable firms; to support vulnerable groups through adequate social protection; to avoid a downward spiral of wages and working conditions; and to mobilize social dialogue on pro-employment measures.

Of course, it cannot be denied that some of these policies have a cost to the public exchequer. But this can be compensated by the fact that the measures will support economic recovery, and so achieve lower unemployment benefit payments and, later on, higher government revenues. So rather than focusing only on budget cuts, there does seem to be room for manoeuvre to make fiscal policy more supportive of recovery. This will still be consistent with medium-term fiscal goals.

Social dialogue will be key in the design of the strategy, as will the availability of solid government implementation institutions; and the report shows that Portugal is better placed than many other countries in this regard. An important strength and indeed one I will return to in just a moment.

In considering the elements of a shift to a more pro-employment strategy, the ILO report warns against simply imagining that one can go back to the pre-crisis situation. Indeed, already before the crisis, the economic and employment situation had exhibited worrying signs of long-term deterioration.

Between 2000 and 2008, the unemployment rate was already following a gradual upward trend. While some people still enjoyed improvements in their living standards, the average real incomes of the Portuguese population stagnated, in contrast to the majority of EU Member States. The incidence of non-standard employment was on the rise.

The period witnessed the emergence of significant macroeconomic imbalances, notably a decline in the level of investment, and the emergence of a large external and rising public debt. At least one major reason was that the economy had specialized in relatively low-productivity sectors, and over that decade, these became increasingly exposed to strong competition from low-cost locations in other countries. To put it in a nutshell, the economic and social model that had served Portugal well in earlier years was by then showing signs of fatigue.

Finally, a new policy approach is needed in Portugal. One that is consistent with the needs of a competitive economy and that is also socially inclusive and addresses the unsustainable employment and social inequalities that presently exist.

The ILO is ready to provide its assistance to Portugal in this complex task of tackling current labour market problems from a longer term perspective.

This is in line with the founding values of the International Labour Organization and with the recent decisions of our governing institutions. In different international meetings, not just in Europe but such as the G20 for example, the ILO has supported a comprehensive approach to the social and economic challenges created by the current crisis. The general objective is clear: to combine the pursuit of sound macroeconomic goals and fiscal consolidation with the creation and protection of decent jobs and addressing the needs of the most vulnerable, all of this in a balanced approach looking for a sustainable and job-rich recovery.

The European Union itself is currently debating a very much related issue, that of how to strengthen the social dimension to achieve a genuine European Economic and Monetary Union. That debate goes to the very centre of the conditions needed to achieve a sustainable European currency.

That is not – or not only – due to a concept of solidarity among participating countries of the eurozone. It is not only an issue of sharing adjustment difficulties between countries.

That aside, there is an intrinsic economic justification as well: by creating a well-designed social pillar, European countries would be creating a mechanism to achieve recovery through growth. Rather than a so-called “internal devaluation” approach of pushing weaker economies to adjust through wage cuts, job losses and increased poverty, which as we have seen reduces aggregate demand in the region and so ends up affecting stronger economies as well, European economies would achieve the sorts of stabilizers that are enjoyed within one country, and reduce the costs of adjustment to the weaker regions while encouraging continuing growth in the stronger ones.

This study was presented at a high-level conference on 4 November 2013 in Lisbon. The event provided a most helpful opportunity to discuss the findings and recommendations on the most inclusive ways for Portugal to achieve recovery with jobs. The ILO stands ready, along with the European Commission and other organizations, to assist in that job-friendly strategy that the whole of Portuguese society wants to achieve.

Guy Ryder
ILO Director-General

ACKNOWLEDGMENTS

This report has been prepared by the ILO Inter-Departmental Task Force on European Crisis Countries, launched by the Director-General in 2013. The purpose of the Task Force is to analyse the situation of European countries which have been worst hit by the global financial, economic, social and jobs crises, and to assess policy options for a job-rich and sustainable recovery. The project is led by Raymond Torres, Director of the new ILO Research Department.

The *Tackling the Jobs Crisis in Portugal* study was prepared by a research team directed by Raymond Torres and coordinated by Miguel Ángel Malo, with contributions from Rita Cruz, Stefan Kühn, Santo Milasi, Clemente Pignatti, Johanna Silvander, Vincenzo Spiezia and Raymond Torres of the ILO Research Department. Additionally, the report benefited from comments by James Howard, Special Adviser to the ILO Director-General, and Mafalda Troncho, Director of the ILO Office for Portugal.

A draft of the Portugal report was presented at a High-Level Conference in Lisbon on 4 November 2013. The feedback received from the participants was particularly rich. Special thanks go to the representatives of the Government of Portugal and the social partners, as well as the European Commission and the International Monetary Fund for their detailed comments that helped to improve the final report.

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The socio-economic situation remains critical …

Portugal is facing the most critical economic and social crisis in its recent economic history. Since the start of the global crisis in 2008, one in seven jobs has been lost – the most significant labour market deterioration among European countries after Greece and Spain. The unemployment rate has reached a historical peak of more than 17 per cent. Young workers and families with small children have been disproportionately affected by the downturn.

The labour market has not improved since the launch of the financial assistance programme with the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) in 2011. In fact, the trend of rising unemployment intensified over the past two years – showing some signs of abating only recently.

Some developments may yield long-lasting effects that will make it difficult to maintain current living standards. The volume of productive investment has declined by over one third since 2008 – with much of this decline occurring over the past two years alone, thereby eroding productivity gains and impairing future prosperity. The over 56 per cent of jobseekers who have been without work for more than one year are losing skills and motivation, and would find it difficult to participate in a future economic recovery, unless adequate support is given. Many workers, including some of the most talented and qualified youth, have been pushed into emigrating. Indeed almost 20 per cent of the population would like to move abroad permanently should the opportunity arise.

The latest IMF projections are for an economic recovery in 2014, and in fact some encouraging evidence of renewed activity has been registered recently, thanks to an increase in exports. However, on current trends, the projected recovery will prove too weak to make a significant dent in unemployment.

… reflecting the exceptionally tight macroeconomic conditions, notably since the launch of the financial assistance programme …

This critical situation reflects a combination of macroeconomic and structural factors. Fiscal policy has been geared towards a rapid reduction of deficits, which had reached alarming proportions. Restructuring measures in the public sector have directly affected unemployment. Cuts in wages and welfare programmes, combined with certain tax increases, have eroded family incomes and domestic demand. Enterprises have been affected by the exceptionally tight macroeconomic conditions that have prevailed since 2011. More than one fifth of all small and medium-sized enterprises report that access to credit is their most pressing problem – entailing lost opportunities for job creation. And, when they do obtain new credit, enterprises must pay interest rates of around 5.5 per cent, compared with 2 per cent in Germany and other core eurozone countries.

The surge in exports is a positive development that shows that the economy has the ability to compete in world markets. However, higher exports cannot compensate for the continued weakening of domestic demand.

… while structural weaknesses in labour market institutions that preceded the crisis have not been corrected.

In addition to macroeconomic factors, labour market institutions have only partially succeeded in attenuating the impact of the economic crisis on jobs. Thus, the panoply of active labour market policies and public employment services has been insufficient to cope with the significant increase in unemployment recorded in recent years. The positive effect of employment policies has been further weakened by some of the fiscal consolidation measures that curtailed key job support programmes.

Another key institution at times of crisis is the practice of job retention. In Portugal, this practice has been hampered by the relatively high incidence of temporary employment and the phenomenon of "dependent" self-employment. Both trends preceded the crisis and have intensified since then.

Likewise, the coverage of collective bargaining – an institution that has proved essential to preventing job losses in viable enterprises in countries such as Germany, Italy and the Netherlands – has declined in unprecedented proportions. The 2011 reform of collective bargaining aimed at promoting enterprise-based agreements between employers and workers. For the time being, however, the reform has resulted in an overall reduction in the coverage of collective agreements, thereby exerting downward pressure on wages and further depressing domestic demand. The proportion of workers earning the minimum wage has more than doubled since the start of the crisis.

A new strategy is needed …

A new start seems necessary to tackle these trends. Such policy changes must take into account the long-term stagnation that Portugal was already experiencing in the years before the crisis. Between 2000 and 2008, the unemployment rate followed a gentle upward trend. Average real incomes for the Portuguese population stagnated, in contrast to the majority of European Union (EU) countries. The period also witnessed the emergence of significant imbalances, notably a decline in the investment effort, the emergence of a large current account deficit and rising public debt.

… and is possible through the shift to a more job-centred approach …

The report points to the many benefits of a coherent job-centred strategy. Such an approach includes, first, measures to address the financial constraints weighing on small firms. The Government has promoted a credit guarantee system, which should no doubt help. However, the real problem lies with the financial situation of banks and their reluctance to engage in new lending, as opposed to investing in safer financial assets. This is an area where a rapid move to a banking union in the eurozone would trigger significant and rapid progress towards sustainable investment and job recovery.

Second, the production base would be boosted through measures to facilitate transitions from small to medium-sized enterprises, engage in new export markets and take advantage of emerging patterns of comparative advantage. The dynamism of other Portuguese-speaking countries, and the large Portuguese diaspora in certain countries, are major assets in this respect.

Third, well-designed labour market institutions can be instrumental in supporting jobseekers and nurturing the development of a new production base. The report offers examples of good practices in terms of facilitating transitions to stable forms of employment, reinforcing labour inspection, ensuring adequate coverage of collective bargaining hand in hand with enterprise competitiveness, and strengthening effective active labour market policies and public employment services. The competitiveness position of the country makes it possible to ensure that, in the future, wages grow closer in line with productivity. This would put a floor on the depression of demand, thus supporting the transformation process.

Fourth, devoting special attention to disadvantaged groups, notably youth, is both a social emergency and an economic necessity. Youth guarantee programmes have proved especially useful in addressing youth unemployment in countries such as Finland and Sweden. The European Commission has expressed its intention to finance similar programmes in its Member States. These resources would prove essential in Portugal, given the tight budget constraints. However, estimates presented in this report suggest that the resources needed to finance these interventions are above the proposals advanced by the Commission.

Jobless households are another key group that deserves greater policy attention. Child poverty tends to be high in this group, raising social concerns and also suggesting that policy interventions could have a significant return in the long run. The report discusses examples of programmes for jobless households.

Importantly, Portugal is relatively well placed to implement such programmes. Its institutional capacity is relatively solid, especially compared with other crisis countries. Moreover, the social protection system tends to be more redistributive than in other countries. Maintaining the purchasing power of welfare benefits would be essential to the success of such a strategy.

Fifth, certain weaknesses in the education system that existed prior to the crisis also need to be tackled. Despite significant improvements in recent years – notably in terms of the quality of secondary education and university performance – only 68 per cent of young people complete upper secondary education, compared with 75 per cent, on average, in advanced economies. In general, the school-to-work transition can be eased through an apprenticeship system, work experience and internships as part of the curriculum and a new partnership between educational institutions, enterprises, worker representatives and young people themselves.

Sixth, a job-friendly strategy requires the strong involvement of the social partners as key actors in the world of work. Social dialogue on the difficult policy choices and possible trade-offs is crucial to achieving balanced solutions. It would also boost confidence and help define a vision for a better future.

… which would curb unemployment while meeting fiscal goals, at a slightly slower pace than presently envisaged.

Some of these policies will inevitably entail a cost to the public purse. The report shows, however, that these costs would mainly arise in the short term and be compensated through kick-starting a job recovery process. According to ILO policy simulations, a stronger focus on job-friendly policies would contribute to reducing unemployment by up to 2 percentage points by 2015. The pace of reducing the fiscal deficit would be slower in 2014, but more rapid in subsequent years.

There is also a strong case for a well-designed job support system at the level of the eurozone. This is an issue being considered in EU debates on the social dimensions of the European Economic and Monetary Union. Moreover, a stronger role of the European Investment Bank would be instrumental in unlocking the investment potential of Portugal.

The ILO stands ready to work with Portugal on better jobs for a better economy.

The ILO could provide guidance in finding and analysing international best practices of interventions, based on which the Portuguese Government and social partners could choose programmes suitable to their specific needs. The ILO could also further assist in the policy-making process, by providing advice on the design of policies and encouraging the participation of social partners in the different stages of the process. Moreover, the ILO could directly support the implementation of such policies, by providing capacity-building through specialized training in areas such as labour inspection, social dialogue or public employment services. Finally, the ILO could help the Government to liaise with other international organizations to ensure that a coherent macroeconomic and employment strategy is implemented.

INTRODUCTION

Since the start of the global financial and economic crisis in 2008, Portugal has experienced a prolonged recession resulting in the most significant deterioration in the labour market and social situation in its recent history. The sluggish economic growth in the period preceding the crisis turned into a recession in 2009. Counter-cyclical policy interventions approved promptly by the Government, as well as a temporary improvement in the international economic outlook, contributed to a brief attenuation of the recession in 2010. However, the recession intensified again as the financial crisis turned into a sovereign debt crisis and the European economy itself slowed down.

Facing increasing difficulties in meeting international payment obligations in April 2011, Portugal requested financial assistance from the EU, the ECB and the IMF (Appendix 1). A financial assistance programme, amounting to €78 billion over a three-year period, was agreed in May of the same year. The programme was made conditional on the launch of fiscal consolidation measures and structural reforms, including as regards labour markets and social protection – described in detail in the so-called "Memorandum of Understanding" and its subsequent updates.

With this in mind, the purpose of this report is to assess policy avenues for improving the labour market and social situation of Portugal. It provides a comprehensive policy package to improve the short-term macroeconomic outlook, while at the same time leading the way to job-rich economic growth over the longer term. The report is based on best international practices, with an effort to adapt them to the specific situation of the country. The potential role for government, the social partners, international organizations and European institutions is considered, while particular attention is also devoted to the design and implementation of the policy proposals put forward.

After a brief presentation of the main macroeconomic, employment and social challenges (Chapter A), the report examines policy options as part of a strategy to achieve sustainable and inclusive job-rich recovery (Chapter B). Finally, the report discusses how the ILO could make a contribution to such a strategy (Chapter C). Importantly, the analysis and proposals presented in this report take into account the policy objectives established in the financial assistance programme. The aim is to show that, by adopting well-designed labour market and social measures, macroeconomic and employment objectives can be mutually supportive and it will be possible to boost job-rich recovery while meeting medium-term fiscal and financial goals.

CHAPTER 1
OVERVIEW OF KEY ECONOMIC AND SOCIAL CHALLENGES

Between 2000 and the eruption of the global crisis in 2008, average real incomes for the Portuguese population increased slightly – though much less than in the EU. The 2000–2008 period also witnessed the emergence of significant imbalances, notably a decline in investment effort, the emergence of a large current account deficit and rising public debt. Likewise, the incidence of temporary employment remained significant and the unemployment rate followed a gentle upward trend.

The main economic and social trends are presented in Table 1.1. The immediate impact of the crisis was to arrest the slow improvement of living standards since the creation of the euro. Indeed, since 2008, average per capita income has declined by over 10 per cent, compared with a stabilization in average per capita income in the EU as a whole. The deterioration in the other key indicators since then – notably unemployment, the investment effort and public debt – has been dramatic. The only exception is the current account, which has turned into a small surplus.

Table 1.1 Key economic and social trends in Portugal versus the EU, 2000–2013

	2000	2008	2010	2012	2013
Real per capita income (2000=100)	100.0	104.2	102.9	98.9	-
Real per capita income relative to the EU 27 (2000=100)	100.0	91.4	93.1	88.4	-
Investment as per cent of GDP	27.7	22.5	19.6	16.0	14.6
Government debt as per cent of GDP	50.7	71.7	94.0	123.6	-
Current account balance as per cent of GDP	-10.4	-12.6	-10.6	-1.5	1.5
Unemployment rate	4.0	7.7	11.0	15.9	17.0

Source: ILO Research Department based on Instituto Nacional de Estatística (INE), Eurostat, Organisation for Economic Co-operation and Development (OECD), EU-Statistics on Income and Living Conditions (EU-SILC). Real per capita income refers to the ratio of real GDP to total population, with the value of the ratio in 2000 taken as 100. The figures for 2013 are for the second quarter of 2013. In September 2013, the monthly unemployment rate was 16.3 per cent.

A LABOUR MARKET AND SOCIAL SITUATION

The crisis has had a profound impact on the labour market in Portugal. Around one in seven jobs has been lost since 2008, with much of the deterioration occurring since the launch of the financial assistance programme in 2011. The crisis has disproportionately hit young people: the unemployment rate of people aged 15–24 exceeded 37 per cent in July 2013, and was more than 40 per cent for young women. Average earnings have dropped and minimum wages have been frozen since 2011. The unemployment benefit system has been tightened and benefit levels effectively reduced. The risk of poverty has aggravated, in particular among families with young children. Emigration has accelerated, provoking a contraction in the size of Portugal's population. This section reviews these trends in some detail.

1 LABOUR MARKET DEVELOPMENTS AND MIGRATION

Around 12.5 per cent of all jobs have been lost since the end of 2008, two-thirds of which over the past two years alone, with some stabilization of late ...

Around 4.8 million people of working age (aged 15–64) were employed when the global financial crisis erupted in the third quarter of 2008 (Figure A1.1). That number fell to 4.5 million just before the adoption of the financial assistance programme in 2011. Since then, the fall in employment has accelerated and only 4.2 million people were employed in the second quarter of 2013. The fall in employment may have stabilized, however, in recent months.

As a result, the employment rate (proportion of working age people who have a job) has declined by around 8 percentage points since the end of 2008. This represents the largest decline in employment rates in the EU, after Greece and Spain. In comparison, employment rates in the EU-27 decreased by an average of 2 percentage points over the period 2008–2012.

Figure 1.1 **Employment trends since the start of the crisis**

Note: The figure shows the number of employed people (employment levels) and the proportion of people of working age who have a job (employment rates).
Source: ILO estimates based on Eurostat.

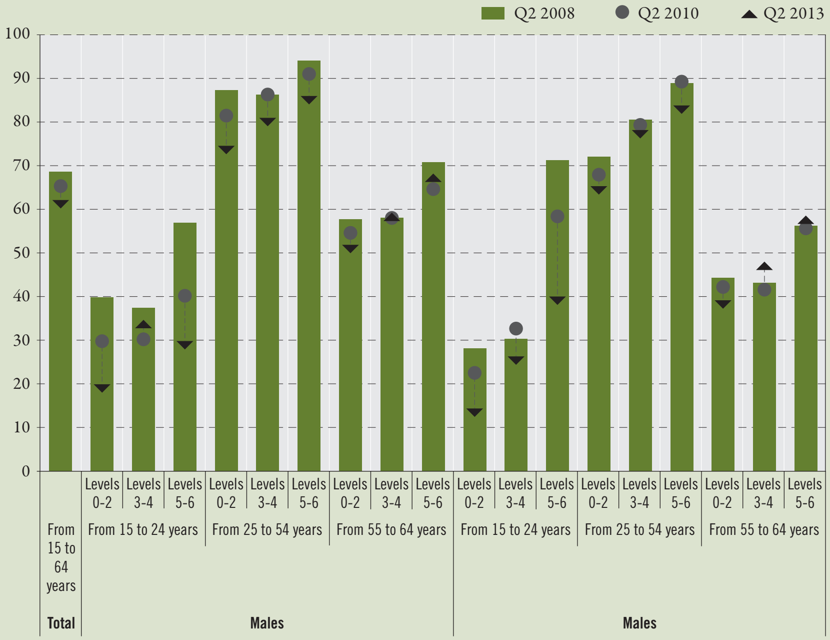
The fall in employment has disproportionately affected young people and those with low levels of education (Figure A1.2). Employment rates declined both for women and men, in broadly similar proportions. Since 2011, the number of people working in various levels of government has declined by 6 per cent.[1]

... pushing the unemployment rate to a historical high of 17.6 per cent in early 2013 ...

The fall in employment has translated into increasing unemployment. Between the third quarter of 2008 and the adoption of the financial assistance programme in 2011, the unemployment rate increased by 4 percentage points. It increased by a further 5 percentage points until the first quarter

[1] Direcção-Geral da Administração e do Emprego Público (DGAEP), Ministério das Finanças.

Figure 1.2 Employment rates by sex, age and educational level (percentages)

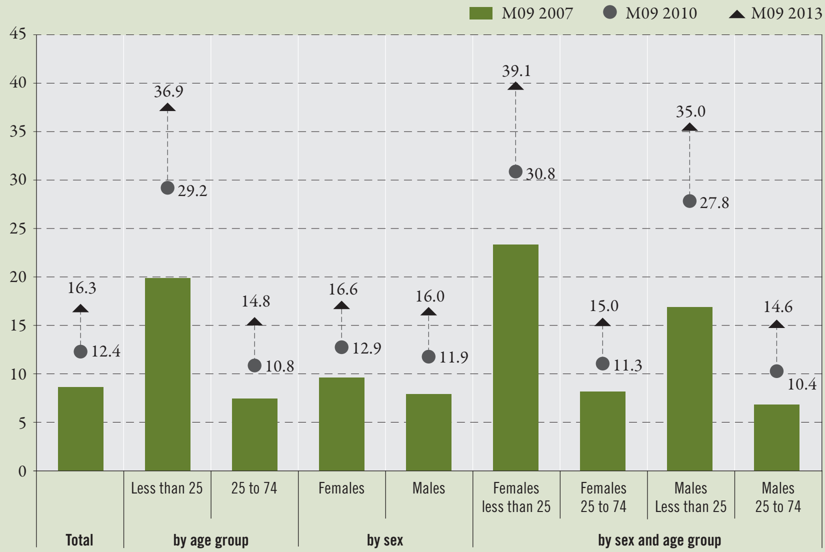


Note: The figures refer to International Standard Classification of Education (ISCED) 1997 educational categories, namely:
Levels 0 - 2: Pre-primary, primary and lower secondary education
Levels 3 - 4: Upper secondary and post-secondary non-tertiary education
Levels 5 - 6: First and second stage of tertiary education
Source: ILO estimates based on Eurostat.

of 2013 and has stabilized since then, with a slim decline of 0.7 percentage points from July to September 2013. The female unemployment rate reached 16.6 per cent in September 2013, slightly above the male rate (Figure A1.3). The youth unemployment rate (15–24), at 37.4 per cent in July 2013, has more than doubled since 2008. In February 2013, there were 13,187 couples with both members of the family unemployed, two and a half times more than at the end of 2011.[2]

[2] Registered unemployment, *Instituto do Emprego e Formação Profissiona.* Available at www.iefp.pt.

Figure 1.3 Unemployment rates by sex and age (percentages)



Note: Seasonally adjusted data.
Source: ILO based on Eurostat.

Significantly, while Portugal had been regarded as a low unemployment country in comparison to other EU members, the unemployment rate today is the highest in the EU after Greece and Spain. The increase in the unemployment rate recorded since the start of the global crisis has been the third most significant among all EU countries – also after Greece and Spain.

… resulting in record-high long-term unemployment and labour market inactivity rates, and …

The prolonged duration of the crisis has changed the characteristics of unemployment. The incidence of long-term unemployment – corresponding to the percentage of jobseekers who have been without work for over one year – has increased from 48.2 per cent in the second quarter of 2008 to 56 per cent in the second quarter of 2013 (with much of the aggravation taking place over the past year alone). This rate gives Portugal the sixth highest incidence of long-term unemployment in the EU, after Slovakia, Greece, Croatia, Ireland and Italy.

In addition to long-term unemployment, the intensification of labour market inactivity represents an even more serious long-term challenge. Indeed, evidence shows that people who move to labour market inactivity (neither employed nor looking for work) have significant difficulty obtaining new employment, even when the economy starts growing again and new jobs are created. Although the increase in the inactivity rate has not been dramatic – from 25.6 to 26.5 per cent between the second quarter of 2008 and the second quarter of 2013 – there has been a significant change in the composition of the pool of inactive workers. In particular, during the same period, the number of inactive people not willing to work declined by 18 per cent. By contrast, the number of so-called discouraged workers[3] increased by a factor of four, from 86,000 to 386,000 individuals. The incidence of discouraged work is now the fourth highest in the EU, following Latvia, Luxembourg and Italy.

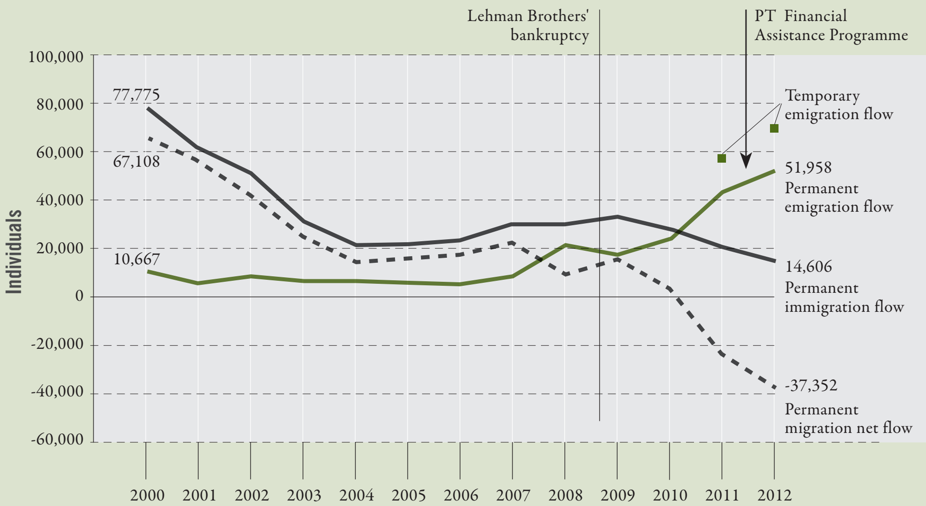
... pushing a growing number of Portuguese people to emigrate.

Since 2010, Portugal has turned into a country of emigration, i.e. the number of people leaving the country has exceeded the number of immigrants (Figure A1.4). Between 2007 and 2012, the number of permanent emigrants increased six-fold. Temporary emigrants – those that leave the country with the intention of staying abroad for less than one year – increased by 21 per cent between 2011 and 2012.[4] Young people are over-represented among emigrants. According to Instituto Nacional de Estatística (INE) statistics, those aged 20 to 39 represent almost half of total permanent emigrants. Other sources estimate more than half of emigrants are under the age of 29.[5]

In addition, it is estimated that 17 per cent of the Portuguese population would like to move abroad permanently, should the right conditions be in

[3] Discouraged workers are persons who are not seeking employment because they believe that there is no work available, but who nevertheless like to have work.
[4] These are the only available years for temporary emigration flows in the INE statistics.
[5] OECD (2012a).

Figure 1.4 **Migration flows for Portugal, 2000–2012** (number of individuals)



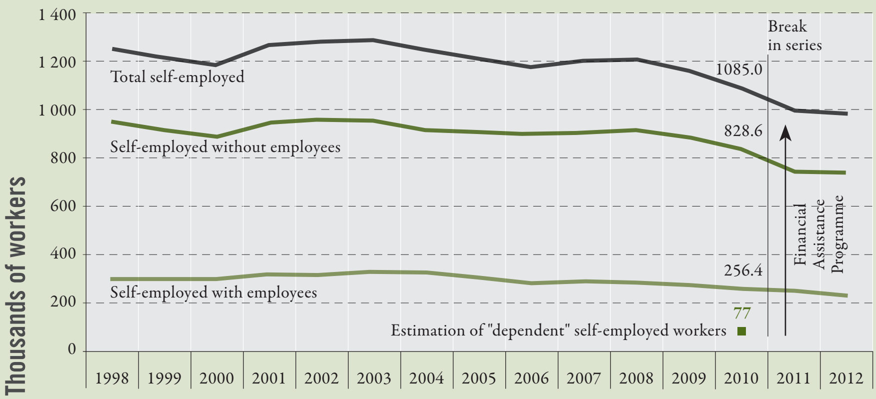
Source: INE.

place.[6] The figure is 26 per cent among the highly educated, and 31 per cent for 15–24 year olds.

Among destination countries, 60 per cent of permanent and 66 per cent of temporary emigrants from Portugal mainly moved to other EU countries in 2012.[7] This proportion has been relatively stable since 2009 (64.4 per cent), despite the consistent growth of emigration flows. Some of the traditional destinations for Portuguese emigrants are France (with nearly 16,000 new consular registrations in 2012 of Portuguese citizens born in Portugal), Switzerland (more than 5,300) or Venezuela (close to 16,500 in 2012). According to the German statistics, in 2012 there was an increase of 4,000 people arriving in Germany from Portugal, or 43 per cent more than in 2011. Similar increases for the same year were registered for migration to Germany from Spain (an increase of 45 per cent), Greece (an increase of 43 per cent) and Italy (an increase of 40 per cent).

[6] OECD (2012b).
[7] ILO Research Department's calculations using INE data.

Figure 1.5 **Trends in self-employment** (thousands)



Note: Methodological break in 2011.
Source: Eurostat and INE.

The number of self-employed people has declined significantly ...

The crisis has also resulted in a significant reduction in the number of self-employed workers with employees[8] and an even larger reduction in the number of self-employed workers without employees (Figure 1.5). The incidence of self-employment in total employment was 19 per cent in 2007 and 16.8 per cent in 2012.[9] The fall in the incidence of self-employment has been less pronounced in the EU as a whole. In some crisis-hit countries such as Greece, for example, the incidence of self-employment has actually increased during the crisis.

Importantly, according to INE, 7 per cent of total self-employed people (9.3 per cent with respect to self-employed without employees) in fact maintain a dependent relationship – or so-called "dependent" self-employment (See Box 1.1).[10]

[8] In this group, 'employers' and 'self-employed workers with employees' are included.
[9] ILO Research Department's calculations using Eurostat data (for population 15–64 years old).
[10] In Spain, a similar calculation using figures published by the Spanish Statistical Office shows a 5.2 per cent share of 'dependent' self-employment with respect to total self-employment and 8 per cent with respect to self-employed without employees (ILO Research Department's calculations using data from the Spanish Statistical Office).

Box 1.1 **The phenomenon of "dependent" self-employment** ("falsos recibos verdes")

"Dependent" self-employment is a phenomenon known as contractual arrangements where the worker is formally self-employed, but the conditions of work are de facto similar to those of employees. Workers in dependent self-employment work mainly or exclusively for one company (outsourcing firm), and are not clearly separated from, whilst also not clearly integrated in, this economic entity. In Portugal, relevant labour and social security legislation discusses this type of employment by using the following terms: *"presumption of employment contract",*[11] *"independent workers who are economically dependent of only one contracting entity"; "economically dependent self-employed workers",*[12] and *"misuse of service provider contracts in an employment relationship".*[13] In familiar terms the phenomenon is often referred to as "false" self-employment or "false green receipts" ("falsos recibos verdes").

Dependent self-employment leads to a situation of economic and personal dependence. The assumption is that the company (employer) outsources tasks to the dependent self-employed worker, but that the orders depend on the economic situation of the main (employer) firm, and thus the worker assumes a part of the entrepreneurial risk. Personal dependence means that the self-employed worker works in subordination to the company, from which most of his/her earnings are generated. The employer company determines the working methods, time, place and content of work, and the situation thus resembles that of regular employment.

For the employer company, the ability to outsource tasks to the dependent self-employed worker provides an opportunity to save costs, and – in essence – to share the entrepreneurial risk. The employer company does not need to pay social security and insurance contributions or provide holiday entitlements; the transactions related to human resource management are minimized, and procedures and payments related to the ending of the business relationship between the two parties fall out. Even though the remuneration received by the self-employed worker may resemble a salary (fixed amount paid for example each month), the transaction is carried out through a bill from the dependent self-employed worker to the company. This type of labour arrangement can in other words be interpreted as a quest for flexibility, 'segmenting' the labour market with respect to regular workers.

Dependent self-employment is assumed not to give the self-employed worker the amount of flexibility and possibility for entrepreneurial gains as regular self-employment. Truly self-employed persons usually work for a large number of contractors without placing themselves in subordination to them – they are thus free to organize their working time and other arrangements, and benefit from entrepreneurial gain. A person in dependent self-employment may in theory be able to negotiate higher fees than what could be obtained through a regular employment relationship. However, this largely depends on the worker's bargaining power, which can be assumed to be limited in this case: the worker may stand in competition with several others in the same position and would not

[11] Labour Code, Law 7/2009; Chapter II; Art. 12: *"Presunção de contrato de trabalho"* [Presumption of an employment contract], http://dre.pt/pdf1s/2009/02/03000/0092601029.pdf

[12] *"Regime dos trabalhadores independentes que sejam economicamente dependentes de uma única entidade contratante"*; Decree-Law 65/2012, 15 Mar. 2012; Art. 3. http://dre.pt/pdf1sdip/2012/03/05400/0124201244.pdf

[13] Law 63/2013, 27 Aug. 2013; *"utilização indevida do contrato de prestação de serviços em relações de trabalho subordinado"*, http://dre.pt/pdf1sdip/2013/08/16400/0516805169.pdf

Box 1.1 The phenomenon of "dependent" self-employment ("falsos recibos verdes")

have collective backing in negotiations with the employer. In terms of social security and job security, drawbacks for these workers include the absence of rights such as maternity leave, holiday and sick pay, severance pay and unemployment insurance (since they are not formally employees but 'firms'). Dependent self-employment may cause distortions in competition, and in some cases may have negative consequences for the worker in the long run in terms of social protection.

In Portugal self-employed persons[14] account for 17.1 per cent of total employment, the majority of whom are own-account workers (without employees) at 11.6 per cent. In France the total share of self-employed persons stands at 11.3 per cent of total employment, with own-account workers representing 6.5 per cent of the total, while in Italy self-employment accounts for 24 per cent of total employment and own-account workers account for 16.2 per cent. The average share of self-employment out of total employment in the EU-27 is 15.8 per cent, while own-account workers account for 10.2 per cent of total employment.[15]

In a European comparison, legal changes have been introduced in various countries with a view to addressing the situation of dependent self-employment. In Portugal, the 2009 Labour Code introduced the notion of a *"presumption of employment contract"*.[16] New laws on specific work relationships have also been introduced in Austria, France, Germany and Greece, and new legal employment statuses created in Austria and Italy.[17] In addition, Portugal adopted legislation extending social protection to dependent self-employed workers by the Decree-Law 65/2012,[18] and stipulated on the enforcement of the Labour Code's (2009) provisions through Law 63/2013.

According to the Portuguese Labour Code (2009), an employment contract is "presumed" – in other words a worker will be considered a wage earner – even when s/he is 'formally' self-employed (*'forma aparentemente autónoma'*, Art. 12.2 of the Labour Code) if some of the following characteristics are found in the working arrangements (Art. 12.1 of the Labour Code):

[14] This group consists of self-employed with employees, own account workers and helping family workers.
[15] European Parliament (2013), p. 22.
[16] Law 7/2009.
[17] European Parliament (2013).
[18] Decree-Law 65/2012, 15 Mar. 2012.

Box 1.1 **The phenomenon of "dependent" self-employment** ("falsos recibos verdes")

(a) Work is undertaken in a place belonging to or supervised by the beneficiary company (*"employer"*),*
(b) The equipment and working tools used belong to the beneficiary company (*"employer"*);
(c) The supplier[19] (*"worker"*) has to observe working times determined by the beneficiary company (*"employer"*);
(d) The supplier (*"worker"*) is paid, periodically, a certain fixed amount for the activity undertaken;
(e) The supplier (*"worker"*) carries out leadership functions in the organigram of the company.

**parenthesis added for the sake of clarification*

Carrying out work assignments in this "apparently autonomous" form, with conditions similar to employment contracts, and possibly causing damage to the worker or the State, is a serious offence attributable to the employer.

Whilst the previous piece of legislation aims at tackling the dependent self-employment situation by sanctioning the practice as carried out by the employer, the dependent self-employed workers are protected by new social security legislation enacted through the Decree-Law 65/2012. This Act extends social security coverage in case of unemployment to "economically dependent self-employed workers" which obtain 80 per cent or more of the total annual income from only one contracting entity (Art. 3), thus triggering the obligation to contribute to social security. The benefits in line with this law consist of either a benefit for *cease of activities* or for *partial cease of activities* on an involuntary basis. The criteria to access this benefit consist of 720 days of the described activity during 48 months immediately preceding the involuntary ending of the supplier (*"employment"*) contract. The entities contracting dependent self-employed workers finance the benefits in question through social security contributions.

On 1 September 2013, a new Law on misuse of service provider contracts in an employment relationship came into force.[20] It stipulates a procedure to follow in a case where a labour inspector identifies the *misuse of service provider contracts* in a company, referring to the situation described in the 2009 Labour Code. First the employer is given the possibility to regularize the situation within a period of ten days. If this fails to happen, a process will be initiated within five days by the 'Authority for working conditions' (*Autoridade para as Condições do Trabalho* (ACT)) in collaboration with the *Ministério Público* with a view to recognizing the existence of an employment contract.

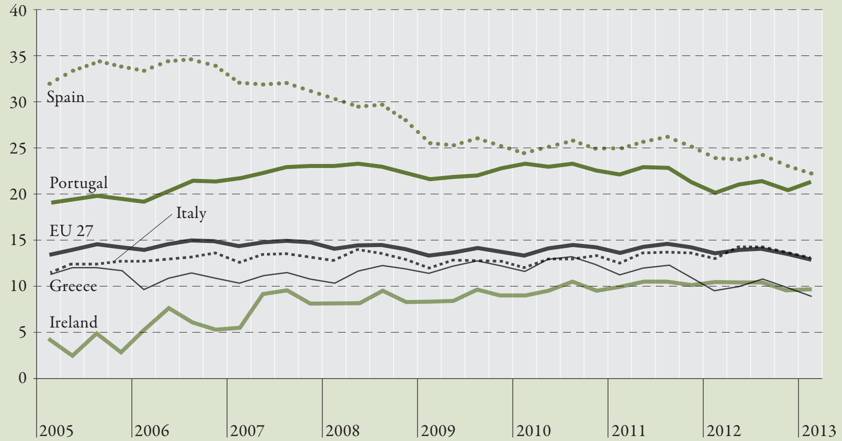
[19] *Prestador de actividade.*
[20] Law 63/2013, 27 Aug. 2013.

… and the incidence of involuntary temporary and part-time employment is on the rise.

The incidence of temporary work in Portugal is one of the largest in the EU and continues to increase. In 2012, 20 per cent of employees had temporary status in Portugal, compared with 14 per cent in the EU (Figure 1.6). Meanwhile, the share of involuntary temporary employment in Portugal is much higher than in other EU countries (Table 1.2).

Likewise, the incidence of part-time employment in Portugal has increased over the past few years – from 8 per cent of workers in 2000 to 11 per cent in 2012. Other European countries show significantly higher shares of part-time employment, with an average of 20 per cent in the EU-27 as a whole. In 2012, almost a half of part-time workers in Portugal were working reduced hours involuntarily, against 27.7 per cent in the EU-27.

Figure 1.6 Incidence of temporary employment (percentages)



Source: Eurostat – Labour Force Survey.

Table 1.2 **Involuntary temporary and part-time employment** (percentages)

	Involuntary temporary employment				Involuntary part-time employment			
	2000	2008	2010	2012	2000	2008	2010	2012
EU 27	53.7	59.7	61.7	60.8	18.0	25.3	26.7	27.7
Greece	84.0	82.5	84.9	86.4	48.4	44.1	54.7	65.0
Ireland	34.1	40.8	62.8	67.7	17.0	13.0	32.5	41.2
Italy	52.3	64.6	67.8	71.2	38.1	41.5	50.5	58.8
Portugal	44.1	81.9	84.2	87.2	31.7	40.8	43.0	47.9
Spain	93.5	87.3	91.5	91.9	23.7	35.4	49.3	60.9

Note: Data for EU-27 in 2000 refer to 2001.
Note: The ratios are presented as a percentage of total temporary employment and total part-time employment, respectively.
Source: Eurostat – Labour Force Survey.

2 EARNINGS, UNIT LABOUR COSTS AND MINIMUM WAGES

Average earnings have declined by 2 per cent since the start of the crisis ...

Average monthly earnings were €1,123 in October 2012, which is 4.3 per cent lower in real terms than a year earlier, and 1.9 per cent lower in real terms than in 2008 before the crisis. Wage cuts have been especially severe since 2011 when wages fell in nominal terms, not just in real terms (Table 1.3, Panel A).

Since 2008, managers experienced the most significant drop in real wages, followed by blue-collar workers and employees. However, during the latest period with available information, this trend has been reversed and employees and blue-collar workers have lost more in real terms than managers.

Portugal also fares badly in an international comparison. Indeed, among the EU countries with available information, Portugal is the only one where annual average gross earnings have not increased in 2009–2011 (Table 1.3, Panel B). However, other European countries, worst hit by the crisis, have also experienced wage declines over this period (such as Greece or Spain).

Table 1.3 Average monthly earnings in Portugal and the EU

Panel A. Portugal: monthly average gross earnings by occupation

	Total	Managers	Employees	Blue-collars	Aprentices
April 2008	1,063	3,136	1,121	784	587
October 2008	1,071	3,283	1,129	791	578
April 2009	1,097	2,995	1,169	799	596
October 2009	1,101	2,940	1,173	806	611
April 2010	1,109	3,123	1,181	817	624
October 2010	1,118	3,000	1,198	813	612
April 2011	1,134	2,971	1,193	822	615
October 2011	1,142	2,854	1,198	824	615
April 2012	1,114	2,883	1,171	821	600
October 2012	1,123	2,876	1,173	815	621
			Variations in real terms		
2008-2012	-1.9%	-18.1%	-2.8%	-3.6%	0.5%
2011-2012	-4.3%	-2.0%	-4.7%	-3.8%	-1.8%

Panel B. Annual average gross earnings in selected EU countries

	2009	2010	2011	2009-2011
Bulgaria	4,085	4,396	4,668	14%
Denmark	56,044	58,840	60,002	7%
Finland	40,122	39,991	43,848	9%
Germany	40,600	41,736	43,300	7%
Hungary	9,603	10,100	10,467	9%
Latvia	8,728	8,596	8,923	2%
Netherlands	44,412	45,215	46,287	4%
Portugal	16,584	16,957	16,586	0%
Romania	5,450	5,891	6,146	13%
Slovakia	10,387	10,777	11,224	8%
Sweden	34,746	40,008	43,196	24%
UK	38,047	39,626	40,045	5%

Source: ILO Research Department based on GEE/MEE (2013a), different years (Panel A) and Eurostat (Panel B).

In 2011, wages of civil servants earning more than €1,500 per month were cut, resulting in a reduction of about 5 per cent in government wages. In addition, in 2012 the payment of the 13th and 14th monthly salaries was suspended for civil servants earning more than €1,100 per month, and partially suspended for those earning between €600 and €1,100, leading to an additional reduction in average government wages of 12 per cent. The 2013 budget reversed part of these cuts, reinstating one of the two monthly wages to all public employees. On 5 April 2013, the Constitutional Court ruled that the elimination of 14th salary payment for public sector workers and pensioners in 2013 was unconstitutional.

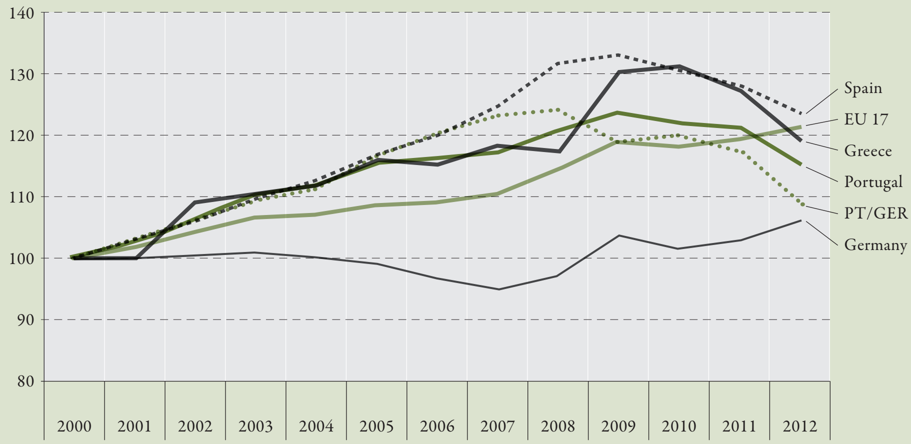
... leading to a cut in relative unit labour costs compared with EU partners.

Nominal unit labour costs in Portugal increased during the years preceding the financial crisis, a trend that has been largely reversed since 2010 (Figure 1.7).

An examination of real unit labour costs (i.e. unit labour costs corrected for price inflation) gives a somewhat different picture (Table 1.4). It turns out that real unit labour costs actually fell during the period 2000–2007. In other words, the deterioration of external competitiveness registered before the crisis mainly reflects a rise in profit margins rather than more rapidly increasing labour costs. Real unit labour costs continued to decline in recent years.

Crisis-hit countries such as Greece, Italy and Spain have also experienced a similar pattern in unit labour costs in both nominal and real terms. By contrast, German unit labour costs tended to decrease in the first half of the 2000s and have slightly increased since 2008. As a result, Portugal's cost-competitiveness with respect to Germany has markedly improved.

Figure 1.7 **Nominal unit labour costs in Portugal and other EU countries**
(in nominal terms, index 2000=100)



Source: ILO based on OECD data.

Table 1.4 **Growth in real unit labour costs in Portugal and other EU countries, 2000–2012**
(average annual growth rate over each period)

Period	EU-12	Germany	Greece	Ireland	Italy	Portugal	Spain
2000-2007	-0.66	-1.16	-0.21	0.55	0.10	-0.41	-0.90
2008-2010	1.17	1.30	0.93	2.10	1.10	0.67	0.67
2010-2012	-0.43	0.07	-3.23	-3.17	-0.10	-2.33	-2.77

Note: Real unit labour costs and nominal unit labour costs corrected for the GDP deflator.
Source: ILO Research Department calculations based on Eurostat.

The minimum wage has declined in real terms, and the proportion of workers paid at the minimum wage level has more than doubled since the start of the crisis.

In 2006, the Portuguese tripartite social commission (*Conselho Económico e Social*) agreed to raise the monthly minimum wage from €403 in 2007, to €450 in 2009 and €500 in 2011. However, in 2011 the actual minimum wage adopted was €485, and as a result of the fiscal consolidation programme it has remained frozen at that level since then. This implies that, in real terms, the level of the minimum wage was reduced by 4.7 per cent between 2011 and 2013. The proportion of employees earning the minimum wage has increased from 5.5 per cent in April 2007 to 10.9 per cent in April 2011 and 12.7 per cent in April 2012.[21]

The absolute value of minimum wages in Portugal is relatively low by EU standards. In purchasing power terms, minimum wage workers earn much less than their peers in most EU countries where there is a minimum wage, notably Greece, Ireland, Poland, Spain and the United Kingdom. The ratio of the minimum wages to the median wage, at less than 60 per cent in 2010, is higher than in several EU countries, but the ratio of minimum to mean wages, at less than 43 per cent, is relatively low (Table 1.5).

3 SOCIAL PROTECTION AND INCOME DISTRIBUTION

Around 44 per cent of jobseekers receive unemployment benefits, compared with more than 50 per cent before the crisis …

The number of jobseekers receiving unemployment benefits has increased much less than the total number of jobseekers. The proportion of jobseekers receiving benefits (coverage ratio) declined from 50.3 per cent in July 2008 to 43.7 per cent in July 2013 (Figure 1.8). The coverage ratio for women declined even more rapidly over the same period, while the coverage ratio for men remained stable.

[21] GEE/MEE (2013a).

Table 1.5 Minimum wages in Portugal and selected EU countries

(as a ratio of median and mean wages)

Panel A. Minimum wage as a proportion of median wage

	2008	2009	2010	2011	2012
Belgium	53.5	52.6	51.4		-
France	59.1	59.4	58.8	58.4	-
Greece	62.2	59.3	55.2	71.8	-
Ireland	50.4	48.5	-	-	-
Luxembourg	-	59.7	60.2	61.5	62.3
Malta	58.5	54.8	56.0	57.4	59.0
Netherlands	52.5	52.0	51.3	51.8	-
Portugal	-	57.8	59.8	-	-
Slovakia	43.5	46.8	47.5	47.7	46.3
Spain	45.2	46.4	44.7	-	-
United Kingdom	49.8	48.6	50.1	51.0	51.1

Panel B. Minimum wage as a proportion of mean wage

	2008	2009	2010	2011	2012
Belgium	47.3	45.8	44.7	-	-
France	46.5	47.0	46.5	46.1	-
Greece	48.9	46.6	43.4	56.4	-
Ireland	41.5	44.9	44.7	44.5	-
Luxembourg	-	47.8	48.6	49.3	49.6
Malta	50.2	46.5	47.2	48.3	51.3
Netherlands	44.2	43.9	44.7	43.6	-
Portugal	44.2	42.8	42.4	42.2	42.9
Slovakia	33.6	36.7	36.0	36.1	35.6
Spain	37.6	37.6	37.8	36.7	36.4
United Kingdom	38.2	38.6	38.7	39.1	39.7

Source: ILO estimates based on Eurostat.

Compared to other European countries, the coverage rate is relatively low; for example the ratio between unemployment benefit recipients and the unemployed is 63 per cent in Norway, 66 per cent in Switzerland and 59 per cent in the UK.[22]

… and, only 8.7 per cent of young jobseekers receive unemployment benefits.

The distribution of unemployment benefits is also uneven across age groups. Indeed, only one out of 10 of the unemployed below the age of 25 was entitled to unemployment benefits before the beginning of the crisis. Recently, this trend has intensified, with only 8.7 per cent of young unemployed persons receiving unemployment support as of July 2013. In this sense, Portugal also compares unfavourably to the rest of the EU where the mean coverage ratio across members is equal to 15.9 per cent for young persons unemployed for one to two months; 20.6 per cent for those who are unemployed between three and five months; and 16.1 per cent for those unemployed between six months to one year.

Social assistance benefits are available, but they are losing purchasing power.

Until 2006, the minimum wage was the main reference for the determination of welfare benefits, including social assistance and pensions. This link meant that changes in minimum wages had to be carefully considered in terms of impact on social spending and budget balances. Following the experience of other European countries such as Spain, Portugal introduced in 2007 a 'social support index' (*Indexante de Apoios Sociais* (IAS)) to serve as reference to the determination of welfare benefits, instead of the minimum wage.[23]

When launched, the IAS was set based on the level of the minimum wage. Since 2010, the IAS has been frozen at €419.22 per month, without adjustments for inflation. The result is that welfare benefits have lost purchasing power. This is particularly significant in the case of 'social integration income' (*Rendimento Social de Inserção* (RSI)), the main non-contributory social benefit programme targeted at households under severe risk of social exclusion and poverty.

[22] OECD (2013a).
[23] Law 53-B/2006, http://www.dgap.gov.pt/upload/Legis/2006_lei_53_b_29_12.pdf

In March 2013, over 110,500 households were beneficiaries of the RSI; for more than one third of these households, these transfers constituted the only source of income. The average benefit per individual was €81.3 per month, or less than €3 a day.[24] In March 2011, 118,745 households were covered by this programme, thus reflecting a decline in the number of beneficiaries in the past two years.[25]

Pension benefits have been significantly reformed.

Portugal's pension system combines earnings-related benefits with a means-tested safety net. The system was unified – under the General Contributory Regime – for all labour market entrants from 2006 onwards, but it remains rather fragmented.

Public expenditure on old-age pensions in Portugal consistently increased in the last decade, from 7 per cent of the GDP in 2000 to around 10 per cent in 2010. However, a large part of the increase occurred well before the 2008 crisis. According to the latest comparable data available for 2010, other countries, such as Greece, Ireland and Spain, show lower shares of expenditure devoted to old-age pension – 8; 5; and 6.5 per cent respectively. Nonetheless, all of these countries have experienced an increase in expenditure for old-age pensions similar to Portugal, suggesting that increasing incidence of expenditure on pensions is a global dynamic rather than a peculiarity of the Portuguese economy.

Although the spending on pensions as a share of the GDP is around 2 percentage points above the average of the EU-27,[26] in 2011 an estimated 19.2 per cent of retired persons (65 years and over) were at risk of living in poverty in Portugal, compared with the EU-27 average of 14.7 per cent. However, in some European countries, the risk of poverty for retired persons is close to or even higher than in Portugal (e.g. 16.9 per cent in Spain or 22.4 per cent in Greece).

[24] GEE/MEE (2013b).
[25] This declining trend began in 2010 after the implementation of a legal change (Decree-Law 70/2010) with stricter requirements for accessing and maintaining this benefit. This legal change was part of the Stability and Growth Programme 2010–2013.
[26] IMF (2013a).

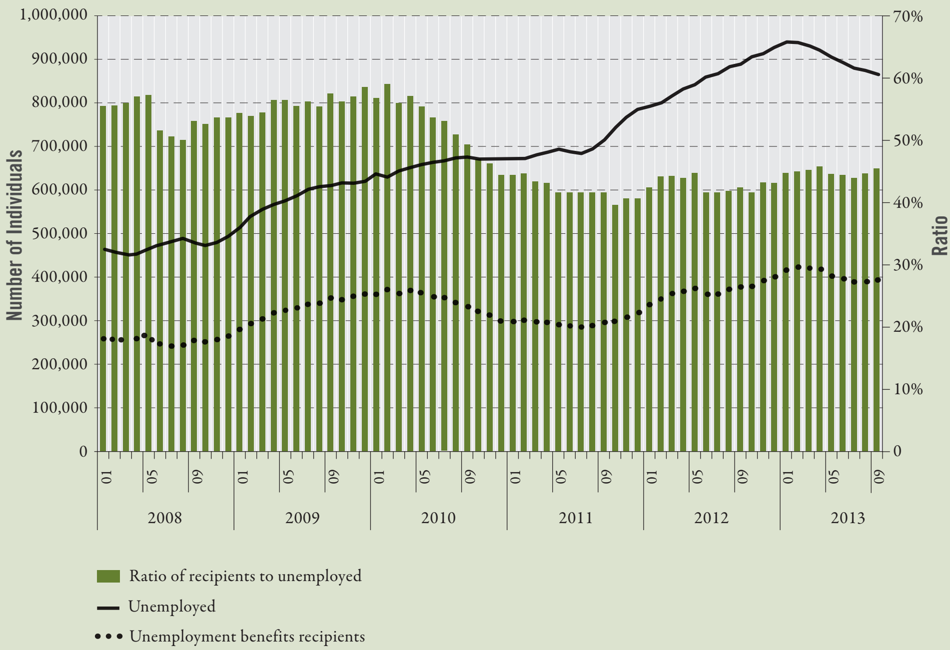
Paradoxically, the wealthiest 5 per cent of the population receive around 40 per cent of old age pension spending. Also, pensions of government employees tend to be higher than those of their private-sector counterparts.

As a part of the financial assistance programme, the pension system has been significantly reformed to achieve savings through benefit adjustments. The reform set the target of reducing pensions above a monthly limit of €1,500, according to the progressive rates applied to public sector wages as of January 2011. Other measures included the suspension of the application of pension indexation rules resulting in a freeze in all but the lowest pensions. In 2012, the objective was to (i) suspend the 13th and 14th monthly payments for those pensioners with monthly pension benefits of over €1,100; and (ii) suspend on average and in a progressive way the equivalent of one of those monthly benefits for pensioners with monthly pension benefits between €600 and €1,100. The pensions for those receiving benefits below €600 were to be frozen whilst the lowest pensions were to be marginally increased.

Austerity measures concerning pension cuts were among those ruled unconstitutional by the Constitutional Court on 5 April 2013. The Court ruled that the measures breached the principle of equality in Article 13 of Portugal's Constitution, as the measures suspending holiday allowances (14th monthly payment) to public sector workers, with an extension to pensioners, were deemed discriminatory in relation to private sector workers.

Faced with the need to maintain the planned level of savings, the Government introduced new austerity measures in May 2013, encompassing various measures including reforms on civil servants' jobs, salaries and working time, as well as pensioners' incomes. In relation to pensioners, a new tax was proposed for pensioners with earnings surpassing a certain level, and retirement age (without financial penalties) was to be raised to 66. Some of the measures, notably concerning cuts in the number of civil servants, were declared unconstitutional by the Constitutional Court on 29 August 2013.

Figure 1.8 **Proportion of jobseekers who receive unemployment benefits**



Source: ILO Research Department based on Eurostat and Estatísticas da Segurança Social.

A legislative proposal to reform the pension system was presented by the Portuguese Government in August 2013. Measures recently discussed by the Government with social partners include: (i) applying an average 10 per cent cut on retiring civil servants' pensions of more than €600 a month starting from 2014; (ii) increasing the legal retirement age for public and private sector workers from 65 to 66 years; and, (iii) establishing a criterion according to which protected minimum pensions would be rising with age, starting with €600 for pensioners below 75 years up to €1,200 for those above 90 years old.

Poverty rates have increased, notably for families with children, and despite a relatively strong redistribution effect of social protection.

Box 1.2 **The 2012 reform of unemployment benefits**

One of the conditions for Portugal to receive financial assistance under the programme with the IMF, EC and ECB was the reform of unemployment benefits. This reform was launched in 2012 through Decree-Laws 64/2012[27] and 65/2012[28]. The new legislation aimed at facilitating access to unemployment benefits and taking into account jobless households, as well as to reducing the monetary amounts of benefits and the maximum length of support.

With the objective of improving access, the necessary contributory period to access unemployment benefits was reduced from 450 to 360 days (or from 15 to 12 months). In addition, social security was extended to cover a new group of workers, namely "dependent" self-employed workers, working mainly with only one contracting entity. Jobless households with children were identified as a specific target group – a temporary increase of 10 per cent in the unemployment benefit was introduced in these cases for both members of the couple, and correspondingly to single-parent households where the single parent is unemployed and does not benefit from a subsistence pension.

The other objective encompassed dis-incentivizing the permanence of workers in unemployment as well as encouraging their more rapid re-entry to the labour market. To this end, the maximum limit of unemployment benefit was reduced from €1,257.66 to €1,048.05,[29] with a reduction of 10 per cent after six months of unemployment. In addition, the maximum length of time the benefit can be paid was reduced from 900 to 540 days (or from 30 to 18 months).

Portugal has the third highest level of income inequality in the European Union. The richest 10 per cent of the population earned around 38 per cent of the national income in 2005. And, in the case of the richest 1 per cent of the population, the national income share was around 10 per cent.[30]

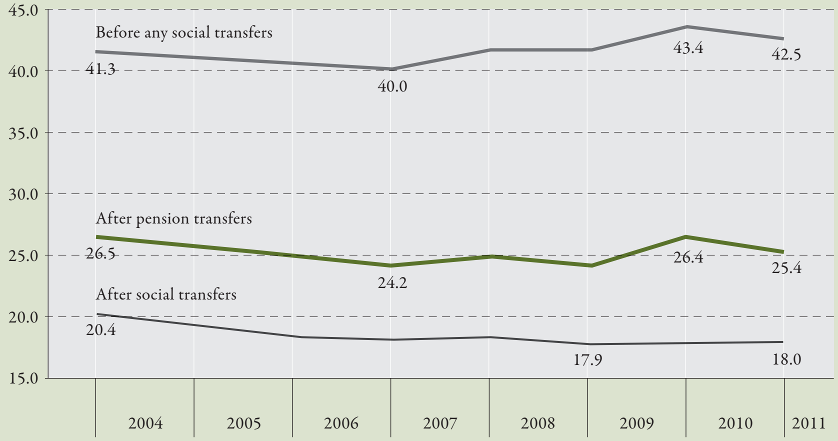
The at-risk-of-poverty rate before any social transfers has been stable at around 42 per cent from 2003 to 2010, but has recently decreased slightly. After social transfers are taken into account, the at-risk-of-poverty rate drops to around 18 per cent. Pensions have turned out to be the main anti-poverty device (Figure 1.9).

27 Decree-Law 64/2012, 15 Mar.2012; http://dre.pt/pdf1s/2012/03/05400/0123701242.pdf
28 Decree-Law 65/2012, 15 Mar. 2012; http://dre.pt/pdf1sdip/2012/03/05400/0124201244.pdf
29 Decree-Law No. 64/2012, 15 Mar. 2012; Calculation of the amount by Pestana Nascimento (2012). The Decree-Law is available at: http://dre.pt/pdf1s/2012/03/05400/0123701242.pdf
30 Alvaredo et al. (2011).

At-risk-of-poverty rates among households with small children (below 6 years old) increased from 15 per cent in 2009 to almost 19 per cent in 2010. The risk of poverty among families with children is lower than in other crisis-hit countries such as Greece and Ireland.

Figure 1.9 At-risk-of-poverty rate, before and after social transfers

(cut-off point: 60 per cent of median equivalised income, percentage of total population)



Note: Years correspond to the survey year, but the information about income provided to the respondents corresponds to the previous year to the survey.
Source: INE Portugal and EU-SILC.

B ECONOMIC PERFORMANCE AND DEMAND PATTERNS

The global financial crisis has exposed key structural weaknesses of the Portuguese economy. As noted earlier, between 2000 and 2008, living standards – as measured by average per capita income – had stagnated, in contrast to a positive trend recorded in the majority of EU countries. These trends have aggravated since the start of the crisis. In particular, the fiscal adjustments adopted since the launch of the financial assistance programme, combined with limited bank credit, have affected demand and output. The encouraging signs of export revival in recent years have not been enough to counteract the weakening of domestic demand. This Section provides a brief account of recent trends in demand and output, including a presentation of shifts in the macroeconomic policy stance.

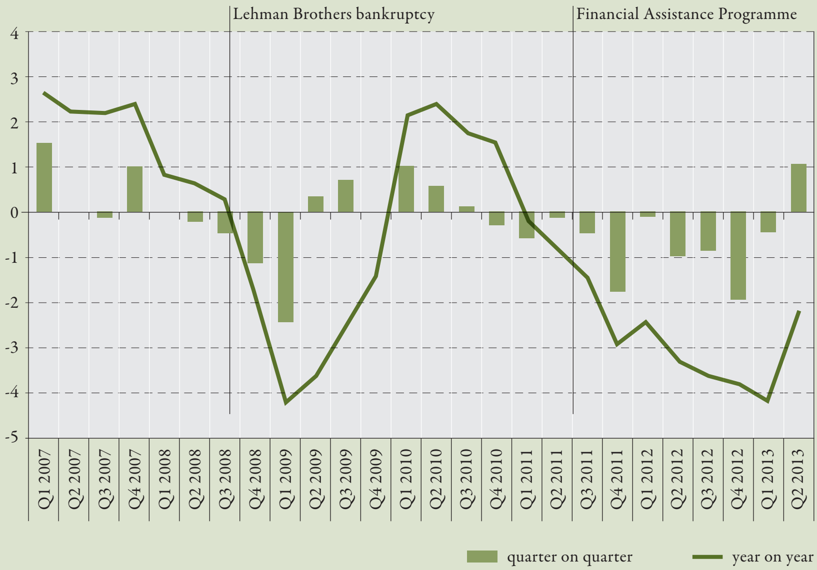
The Portuguese economy had stagnated before the advent of the global crisis ...

During the first seven years of the last decade, the Portuguese economy experienced a period of relatively weak economic growth of around 1 per cent per year. A mild recession was registered in 2003 – GDP fell by 0.9 per cent – and growth rates were consistently lower than 2 per cent between 2004 and 2008. Weak growth performance was accompanied by fluctuating exports (+4.9 per cent over the period 2000–2008) and decreasing investments (-0.6 per cent over the period 2000–2008). Moreover, the current account balance deteriorated, reaching a deficit of around 10 per cent of GDP over the period 2000–2008.

... and has entered into a crisis since 2011, with some recent signs of stabilization ...

Though economic growth declined in the wake of the global financial crisis (Figure 1.10), a tepid recovery was recorded in 2010 as a result of fiscal stimulus measures (the so-called Investment and Employment Initiative).

Figure 1.10 Real GDP growth in Portugal, 2007-2013
(quarterly real GDP growth rate, percentages)



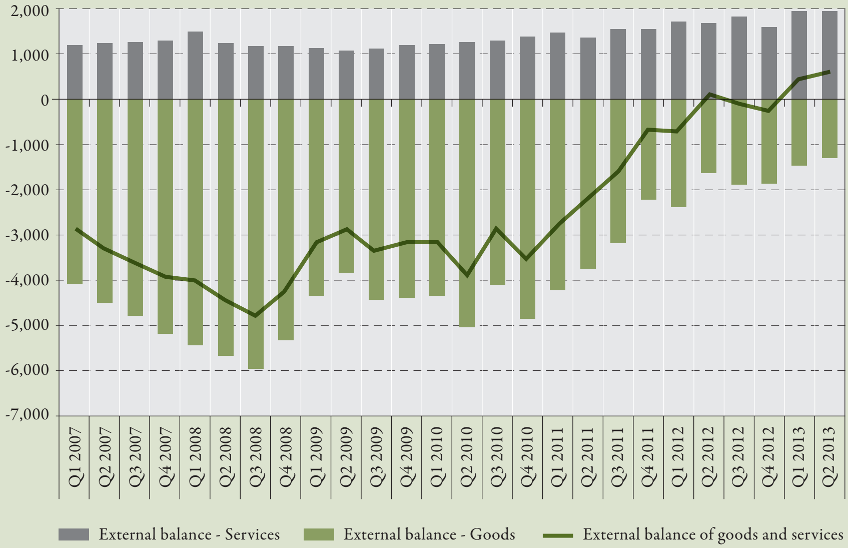
Note: Seasonally adjusted data.
Source: Banco de Portugal (2013a).

The economy has contracted again since 2011; from the first quarter of 2011, the main components of aggregate demand decreased substantially and both the growth rate of imports and private consumption turned negative by the end of 2012.

Some encouraging signs of export recovery may be noted in 2013. In the second quarter of 2013 exports rose by 7.3 per cent; likewise, imports increased by 6.3 per cent with respect to the same quarter of the previous year. Private consumption and investments were instead still decreasing, though at a slower pace than previously observed.

In short, the rate of contraction of the economy may have stabilized in recent months, but not enough to make inroads into the deteriorated employment situation.

Figure 1.11 **External balance of goods and services, 2007–2013**



Note: Aggregates at current prices. Seasonally adjusted data. Data in millions of euros.
Source: Eurostat.

... thanks to the improved export performance.

After a downward trend for most of 2012, the growth rate of exports began increasing again in the first half of 2013. Most of the increase in exports observed in the past two years was to countries outside the EU which surged by 19 per cent between 2011 and 2012, representing about 30 per cent of total exports. Exports to other EU countries grew by a mere 1 per cent in 2012.

Imports, on the other hand, have declined – much in line with the contraction of domestic demand. As a result, after accumulating external deficits in the last decade, the Portuguese economy registered a trade surplus of around €1 billion in the first six months of 2013 (Figure 1.11).

Since 2011, macroeconomic conditions have been tighter than ever in the recent economic history of Portugal ...

In 2009, the general government deficit reached 10 per cent of GDP. In view of the situation, the Government adopted a consolidation package in October 2010, including cuts in social protection expenditures and public sector wages, as well as tax increases, notably in VAT.

Yet, facing continuous difficulties in meeting the growing costs of public debt, the Government concluded a financial assistance programme with the IMF, EC and ECB in April 2011. This included a €78 billion financial assistance programme in May 2011. This programme was intended to provide enough funding to Portugal outside the global financial market, where financial resources became prohibitively expensive to Portugal.[31]

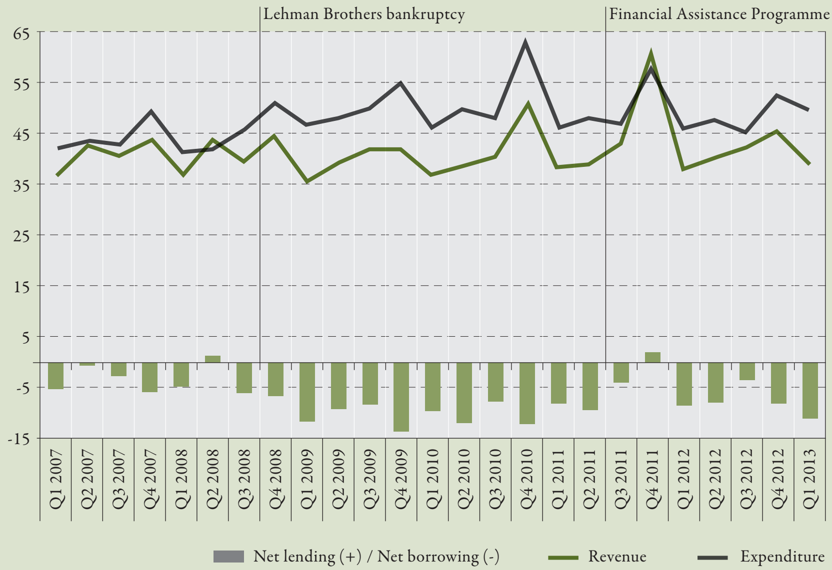
Government expenditure as a percentage of GDP increased by 7 percentage points between 2007 and 2010. At the same time, government revenues stagnated (Figure 1.12). As a requirement of the financial assistance programme, the levels of government expenditure were stabilized and government revenues increased. This represents a major effort, in view of the contraction in the economy and rising unemployment.

... and yet fiscal targets have not been fully met ...

Despite these significant efforts, the general government deficit has remained high. Indeed, the targets put forward in the financial assistance programme have been missed, largely because of a more significant contraction in the economy than was originally expected and high unemployment. The government deficit as a percentage of GDP was supposed to reach 4.5 per cent in 2012 and 3 per cent in 2013. In actual fact, the deficit was 6.4 per cent of GDP in 2012, and the target for 2013 has been revised to 5.5 per cent of GDP.

[31] The details about the timing and amounts of the financial programme are described in Appendix 2. The conditions of the Memorandum of Understanding affecting labour market regulation are described in Appendix 3.

Figure 1.12 General government accounts, 2007–2013
(percentage of GDP)



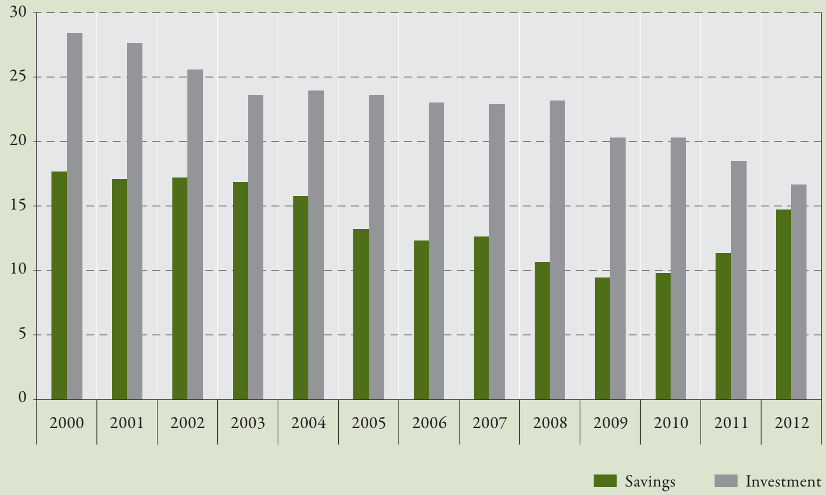
Source: Banco de Portugal (2013a).

... and the much-needed improvement in business investment has not materialized...

The increase in business investment that was expected as a result of fiscal consolidation measures has not materialized. Investment as a share of GDP (measured by gross capital formation) decreased by 5 percentage points over the period 2000–2008, and fell by further 6.5 percentage points between 2008 and 2012 (Figure 1.13). Residential investment has been particularly affected, but, investment in machinery and equipment also declined significantly. The result is that the capital stock in the Portuguese economy – which is crucial to the long-term growth potential and competitiveness of the country – may be shrinking. In fact, according to IMF estimates in 2011 and 2012 the capital stock decreased by 1 per cent per year, and projections are for a further contraction in capital stock at least until 2018.[32]

[32] IMF (2013b).

Figure 1.13 National savings and investment, 2000–2012
(percentage of GDP)



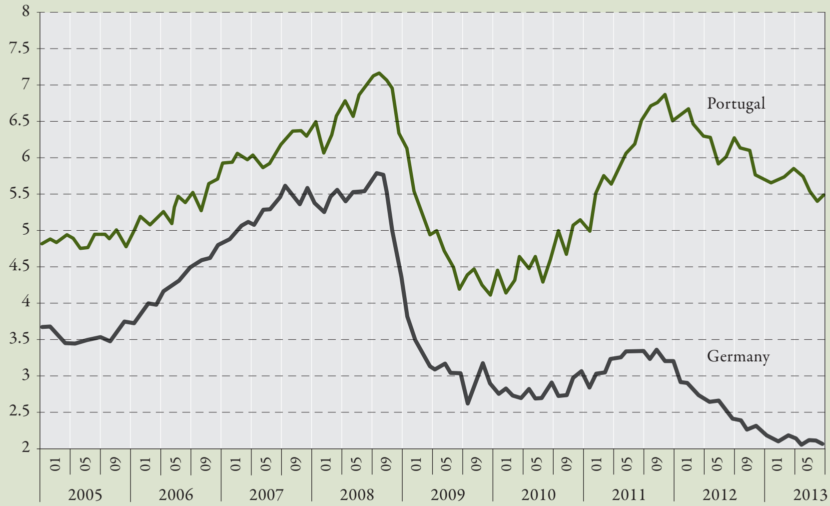
Note: Figures refer to gross values.
Source: ILO based on Eurostat.

The fall in investment is of course a reflection of limited demand. However, the state of the credit system has also contributed to this. Indeed, the interest rate on new loans for non-financial firms registered a value more than twice as high as in Germany in 2013, while before the crisis these rates were fairly close to each other (Figure 1.14). This decoupling of the evolution of interest rates for new loans in Portugal with respect to Germany is harmful mostly for small and medium-sized enterprises (SMEs) which are almost exclusively restricted to the national credit market and rely more on bank credit for their investment operations than their larger counterparts.

Indeed, total loans granted to non-financial corporations have decreased substantially (Figure 1.15). This reflects a strong contraction of credit allocated to SMEs. On a yearly basis, loans to SMEs decreased by 2.5 per cent in 2011 and by 9 per cent in 2012. In the first two months of 2013, loans to SMEs decreased by 10 per cent with respect to the same period of 2012. According to a recent survey,[33] 21 per cent of SMEs in Portugal mentioned (inadequate) access to finance as the most pressing problem in their business operations. The percentage of Portuguese SMEs reporting an increase in bank lending rates was 56 per cent.

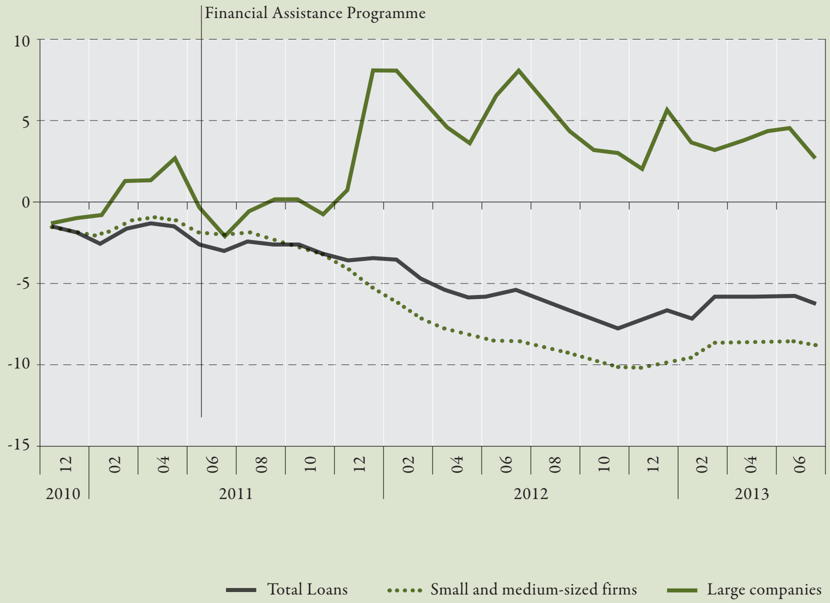
[33] European Central Bank (2013).

Figure 1.14 **Interest rates on new loans for non-financial firms, 2005–2013**
(percentages)



Source: European Central Bank.

Figure 1.15 **Total loans to non-financial corporations by firm size, 2010–2013**
(percentage change from previous year)



Source: Banco de Portugal (2013a).

CHAPTER 2
TACKLING THE LABOUR MARKET IMBALANCES AND SOCIAL GAPS

The previous chapter reviewed the extent of the deterioration in the socio-economic situation of Portugal. In particular, it traced how the unemployment rate had reached a historical peak. The chapter also examined the interaction between these trends and macroeconomic policy settings, notably the credit conditions facing small firms and the very strict fiscal consolidation measures adopted as part of the financial assistance programme.

The purpose of this chapter is to discuss policy options for tackling these trends. Given the magnitude of the imbalances, the tight macroeconomic conditions and commitments as a member of the eurozone, the task is truly exceptional. Nevertheless, the experience of Portugal and other countries in dealing with earlier crises suggest that it is possible to engage in a path of job-rich recovery. The strategy should take into account the fact that performance had deteriorated already before the advent of the global crisis – notably as a result of deficiencies in investment, education system and quality of jobs. So the aim is not only to recover, but also to correct earlier problems.

The chapter will discuss measures to promote the creation of decent jobs, maintain employment in enterprises that are viable and support jobseekers and vulnerable groups.

A BOOSTING JOB CREATION AND SUPPORTING PRODUCTIVE INVESTMENT

Domestic and external demand and macroeconomic conditions are essential ...

Attaining significant job recovery will require an improvement in demand and financial conditions for Portuguese enterprises. In this regard, the analysis of wage developments presented in the previous chapter suggests that, in general terms, the Portuguese economy does not face a cost-competitiveness constraint. Instead, the main barriers to job creation and investment lie in the dynamism of internal and external demand, and the ability of the financial system to channel resources in the most effective way to support firms, especially small ones.

The extent to which macroeconomic policies can facilitate this process, while meeting long-term goals of financial stability will be analysed in the next chapter. This section examines specific measures that would directly unlock job creation potential.

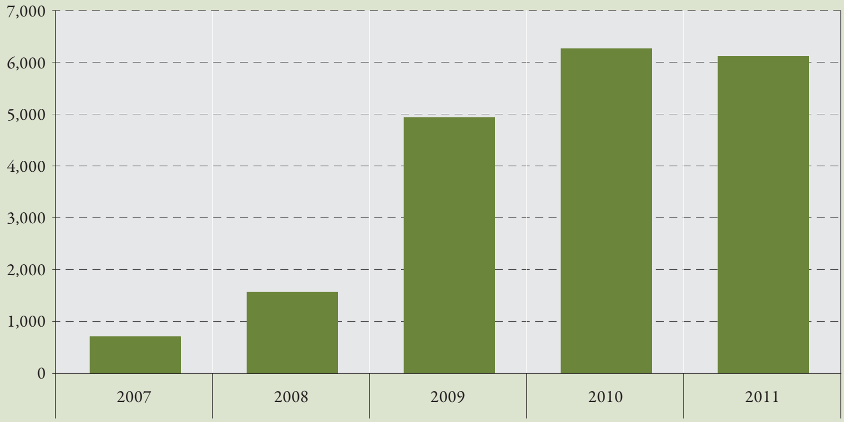
... but job-rich recovery would also benefit from financial reforms that support the creation and expansion of enterprises ...

The Government has undertaken initiatives to promote the creation and expansion of firms:[34]

- In January 2012, a credit line in support of the growth of SMEs (*Linha de Crédito PME Crescimento*) with a budget of €2,500 million was launched. As part of this policy, the public Mutual Guarantee Fund has been re-capitalized in recent years. The level of guaranteed loans to SMEs increased from €740 million in 2007 to €6,147 million in 2011. Most of this increase was observed in 2009 when government guaranteed loans were increased by 68 per cent over the previous year. On average, guaranteed loans cover between 50 and 75 per cent of total loans to SMEs. In

[34] Even before, as in the aftermath of the financial crisis, the Portuguese Government adopted a series of measures aiming at improving SMEs' access to finance. In the second half of 2008, a number of credit lines, *"INVESTE"*, were launched. These credit lines provided a total stock of credit of €12.2 billion with long-term maturities. Other preferential conditions, such as partially subsidized interest rates and risk-sharing through the use of public guarantee mechanisms also applied.

Figure 2.1 Credit guarantees for SMEs, 2008–2011
(€ million)



Note: The figure shows the total funding available in the Mutual Guarantee Fund in Portugal.
Source: OECD (2013) "SME and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises" (Table 3, p. 39).

January 2013, another credit line in support of SME growth (*Linha de Crédito PME Crescimento, 2013*) with a budget of €2,500 million was launched. In this context, specific lines for SMEs and export companies, amounting to €400 and €900 million respectively, were provided.

- In June 2012, *Portugal Ventures*, a venture capital company, was established as a result of a merger of three of the most representative venture capital and private equity firms in Portugal.
- In July 2012, the Portuguese Government launched *"INVESTE QREN"*, a new credit line for companies.[35] The Fund's limit was €1 billion, financed by the European Investment Bank and the banking system.
- In 2013, different initiatives were implemented, such as new regulations concerning the resolution of insolvencies and bankruptcies, facilitating international trade through an electronic single window for port procedures, easing of construction permits,[36] eliminating firms' licensing requirements, harmonizing the new Competition Law with EU legislation, etc.

[35] At the end of 2012, about 86,200 projects were eligible for the SME *"INVESTE"* and *"CRESCIMENTO"* credit lines. Around 60,000 SMEs (17 per cent of SMEs), were financed for a total amount of €9.2 billion. This supported more than 812,000 jobs (OECD (2012c)).
[36] According to data collected by the Doing Business 2013 report, dealing with construction permits requires 13 procedures, takes 108 days and costs 370 per cent of average income per capita in 2013.

- In early June 2013, the Portuguese Government presented a tax package promoting a special investment tax regime for qualified investments made in the second half of 2013.[37]

  Since May 2013, Germany's State-owned development bank, Kreditanstalt für Wiederaufbau (KfW), has undertaken to support investment and job creation in Portugal. Moreover, the KfW should also provide technical support to set up a new Portuguese development finance institution.

These measures may have helped attenuate the impact of the crisis on large enterprises that quickly managed to embrace the possibilities available in the new system and seize tax opportunities. Yet, the situation concerning small enterprises has continued to deteriorate, as documented in the previous chapter. Credit conditions remain too tight for small businesses in Portugal to be able to operate and create jobs.

Therefore, other measures are needed to complement previous efforts. This requires coordination in the euro area, but there is also room for action at the national level to complement recent initiatives.

First, resolving credit constraints of SMEs is critical to a job-rich recovery. This not only unlocks productive investment but would address constraints in commercial credit. Without this, some viable SMEs will disappear and Portugal will suffer additional employment losses in the short term and face decreasing potential employment in the medium term linked to a deterioration of the basic economic fabric for employment creation.

Policy proposals with a view to enhancing the access of SMEs to credit could include the following components:

- Following the capital increase agreed by the European Council in 2012, the European Investment Bank (EIB) has according to its own report significantly boosted its activity with a counter-cyclical impact on the

[37] The proposed tax credit represents up to 20 per cent of the investment made. Eligible investments are the ones made during 1 June 2013 and 31 December 2013 up to a maximum amount of €5 million per taxpayer. The tax credit might be carried forward for five years.

European economy. This could be used to tackle the credit constraints facing SMEs.[38] The Commission and the EIB are exploring joint risk-sharing mechanisms, and a joint instrument aimed at generating additional lending to SMEs would indeed be useful in European countries, particularly in those experiencing a major crisis. Boosting the role of commercial banks, enabling them to make more significant investments in the real economy possibly through public guarantees or long-term ECB funding at a reasonable interest rate, could also be considered in this context.

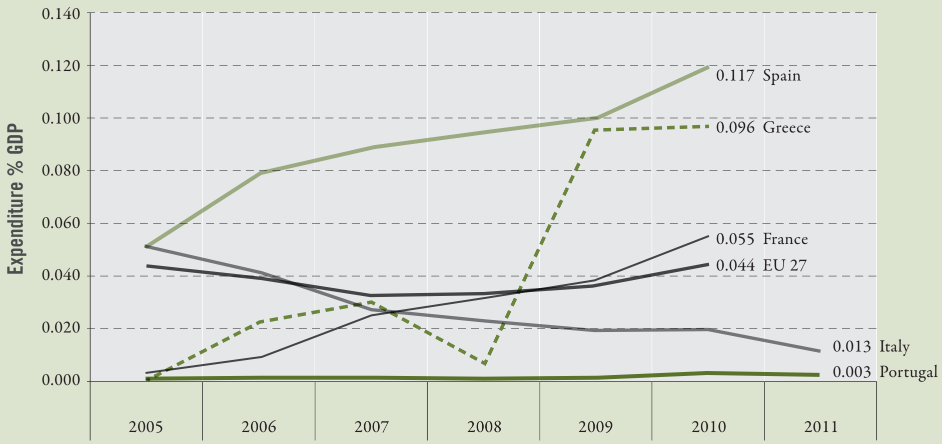
- An acceleration of plans to improve the financial position of commercial banks, notably those that have a high incidence of non-performing loans, is essential. This may require more rapid reform of the way banks operate, to ensure more effective performance of their role as intermediaries between deposits and investment in the real economy.

- A wider coverage of credit information systems could help improve access to credit among SMEs at relatively little cost. There is overwhelming empirical evidence suggesting that both the "quantity" and the "quality" of credit information provided by credit registers are important determinants of credit availability.[39] While the average share of firms and individuals covered by private credit registers in OECD countries is above 74 per cent, in Portugal private credit registers cover only 30 per cent of the adult population and just a small portion of existing firms. The New Zealand system, for example, offers a good benchmark, providing credit scoring, borrower monitoring, fraud detection, debt collection and marketing services.

- In order to improve the availability and efficiency of credit allocation, a better system for the dissemination of information related to credit collateral may also be desirable. Effective collateral loans allow firms to use their assets as security to generate capital and improve access to external financing. In particular, Portugal lacks an adequate and easily accessible system for sharing and verifying information on collateral assets.

[38] European Commission - European Investment Bank (2013).
[39] Jappelli and Pagano (2000), Jappelli and Pagano (2002), Pagano and Jappelli (1993), Sapienza (2002), Djankov et al. (2006).Djankov et al. (2006).

Figure 2.2 **Expenditure in incentives for start-ups**
(percentage of the GDP)



Source: Eurostat.

Secondly, in addition to financial reform, a redistribution of Active Labour Market Policies (ALMPs) towards firm creation could be envisaged. This is an area where Portugal is lagging behind other European countries (Figure 2.2). There are different interesting international experiences available on the implementation of new initiatives for promoting enterprise creation (see Box 2.1).

... as part of a broader growth strategy.

Promoting the expansion of existing firms is a way to create a more resilient economy capable of improving productivity and job quality. Smoothing fiscal and other legal requirements related to specific thresholds of the size of companies is an easy strategy for eliminating disincentives for their growth. In addition, deepening existing initiatives such as opening new markets for SMEs would help.

Box 2.1 **International experiences on enterprise creation**

- Regarding start-up incentives, two types of actions may be desirable: **improving the evaluation of targeted groups, and promoting new ways to develop projects with a high growth potential.** The ex-post evaluation 1994–1999 of the European Social Funds (ESF) shows that positive effects from start-up incentives may be obtained by adequately targeting specific beneficiaries and supporting ex-ante "training" for targeted people. Within the ESF funding programme, Germany adopted qualification projects to help beneficiaries establish start-ups, providing new ways out of long-term unemployment. Around 4,000 start-ups were provided with €3,300 each. Similarly, Sweden helped young people become self-employed. Several different measures were included in the programme, such as basic education, testing the business idea, work training and advice. Moreover, developing closer collaboration between the academic and business sectors may help to develop projects with a high technological component. Both Sweden and Finland have recently launched projects aimed at bringing together entrepreneurs and academics to evaluate the commercial potential of a project and promote technological innovation, and a university cooperation programme where arts/design, business and technology are brought together. In addition, while ex-post evaluations are crucial for efficient policy-making, the ex-ante evaluation of the beneficiaries of the start-up incentive is now more important than ever to avoid unintended public support to dependent self-employment. Other measures, such as providing temporary wage subsidies in the start-up phase, although potentially more expensive, could help to increase the survival rate of newly created start-ups.

- **Supporting and enlarging existing credit guarantee schemes is important to reducing market failures, derived from a lack of collateral or track record affecting SMEs**. For example, in the UK, the public Enterprise Finance Guarantee (EFG) is specifically devoted to addressing these problems. In the event of a default, the Government provides a guarantee up to a specified threshold (up to £1 million in 75 per cent of cases). The vast majority of EFG beneficiaries (around 95 per cent) considered it important in improving business prospects. Employment in firms that benefited from the EFG is 38 per cent higher than in the absence of the intervention, or equivalent to 5.8 jobs saved/created per firm (BIS, 2012).

- **Encouraging young people to accumulate savings for starting a business may be a strategy for helping young entrepreneurs to overcome barriers to entrance, such as initial fixed costs.** For example, the Bürges Förderungsbank, a State-owned Austrian public funding institution along with the Federal States and the Austrian Federal Economic Chamber, activated the Savings Programme for Young Entrepreneurs. The programme aims at promoting savings for founding or taking over a business by granting a premium of 14 per cent (up to €7,700) of the savings balance (€55,000). The minimum savings period is two years; the maximum six years. The Savings Programme for Young Entrepreneurs was identified as a best practice by the Third Round Table of Bankers and SMEs (Eurobarometer, 2001).

Box 2.1 International experiences on enterprise creation

- **Creating "knowledge-centres" for entrepreneurs to provide assistance with business-related management.** The Enigma start-up centre (in Hamburg) has been a successful experience. The Centre aimed at mentoring start-up entrepreneurs in areas such as: development of a business plan, development of knowledge and skills, financial guidance, legal advice, training and seminars. In the more than four years since its activation in January 2000, 2,393 people showed interest in the project and 625 were invited to take part in an assessment centre, out of which 378 participants were given the chance to implement their business idea in the 'garage'. Almost 90 per cent completed the projects, 83 per cent became self-employed, 8 per cent employed, and 2 per cent apprentices, while only 7 per cent remained unemployed (XV Malente Symposium, "Youth Employment, Empowerment and Participation: Securing the Future", 19–20 October 2004).

- **Creating incentives to attract FDI in venture capital may be a way to revive investments in innovative and "risky" projects.** Since investments in venture capital in Portugal have decreased dramatically in recent years, foreign investors may play an important role in the creation of new businesses and employment. For example, in Australia, the Federal Government supports a programme, the Venture Capital Limited Partnerships, to attract foreign investment in "high-risk start-ups and expanding Australian companies". Foreign investors are exempt from capital gains tax on their shares of any profits made by the funds. Interestingly, tax exemptions apply only if investments are held for a minimum of 12 months, the project is "risky", and at least 50 per cent of the employees and assets are to be located in Australia. Similar programmes may help the creation of highly productive business while helping to reduce the level of unemployment, especially among highly skilled individuals, to provide disincentives for the growing emigration of highly educated persons from Portugal, identified in Chapter A.

Such measures require a growth strategy, which takes into account comparative advantage and builds on the specific characteristics of each industry or sector. In this vein, the relevance of the tourism industry in Portugal shows that specific measures for this sector would be firmly based on an existing comparative advantage. For this sector, it would be helpful to develop new strategies, widening the scope of business to other areas of tourist activities in different seasons and places or promoting collaboration among different tourism firms covering different types of activities. A side result would be a decrease in employment seasonality linked with the tourism industry, eliminating incentives for an extensive use of temporary contracts and other flexible labour arrangements related to income instability and labour market segmentation. Concerning other sectors, developing policies specific to highly energy-dependent sectors may be important to improving Portugal's competitive advantage in export performance. Supply-dependent countries like Portugal may benefit from government intervention to limit energy-price volatility that negatively affects strategic industries, such as oil refineries, the petroleum and chemical industry and the entire industrial sector. Facilitating the expansion of renewable energy producers in Portugal could pave the way for a more diversified and competitive economy.

B MAINTAINING VIABLE JOBS AND HELPING JOBSEEKERS AND VULNERABLE GROUPS

There is further scope for preserving jobs in viable enterprises ...

Maintaining employment in viable enterprises should be considered as a key target in times of economic downturn. Indeed, avoiding job losses in competitive sectors prevents the loss of the specific human capital acquired by workers that otherwise would be displaced towards other industries and tasks. Moreover, if competitive enterprises are able to overcome the recession without undergoing significant lay-offs, their intact productive potential can be the driver of the recovery once internal and external demand rebound.

In order to reduce recourse to lay-offs, work sharing schemes and practices have multiplied in several European countries. As is well known, Germany has successfully avoided many lay-offs thanks to working time adjustments and social dialogue. Similarly, in Ireland the incidence of work sharing schemes and part-time work has increased significantly, cushioning the impact of the crisis on employment.[40] The effect of these measures has been generally positive during the recession. In Denmark – where work sharing schemes became increasingly popular – only 14 per cent of the workers that went into work sharing arrangements in 2008 became unemployed over the following year, while the rest were reabsorbed full time in the enterprise.[41]

In Portugal, there is room for improving the measures aimed at preserving jobs in viable enterprises. Short-time work arrangements may last up to six months. Facilitating the conclusion of such arrangements with social partners, with a possibility to extend the system beyond six months under certain conditions, would help.

[40] Russel and McGinnity (2011).
[41] Jørgensen (2011).

During the first years of the current crisis, incentives for training of workers in short-time work arrangements were increased.[42] Similarly, a system of working time accounts was created recently.[43] However, specific training programmes could be reinforced for the workers under reduced working hour arrangements. Here, public employment services could play a more active role in coordinating the provision of information and training.

Although the above-mentioned initiatives will definitely enhance employment duration and limit job losses, it is important to bear in mind that the most effective measure to preserve jobs in viable enterprises is to enhance employment quality. More qualified workers are more versatile, can adapt to a variety of different jobs and perform different tasks in the same firm if necessary. This should principally take the form of tackling labour market segmentation and limiting "dependent" self-employment and undeclared work, which are widely recognized as limitations for labour productivity increases. A careful analysis of these issues as well as a set of policy proposals aimed at overcoming segmentation and "dependent" self-employment is presented in Section 2.C.

... reinforcing support to jobseekers, notably youth ...

Policies promoting employment must focus on the groups of workers with the most severe problems in the labour market. One of these groups are young women and men. International experience supports the implementation of a set of measures especially designed for improving labour market integration, such as a Youth Guarantee Programme. Probably the most relevant international experiences on these programmes come from Sweden and Finland.

[42] Arpaia et al. (2010).

[43] Following commitments made in the Memorandum of Understanding, Law 23 of 2012 introduced 'time banks' (banco de horas) that, following an agreement between the employer and the worker, enable the firm to increase working hours by two hours per day and within a limit of 150 hours per year. The accumulated working hours can be compensated by an equivalent reduction in working hours, an increase in vacation and/or their relevant payment.

- In Sweden, a Job Guarantee for Young People (*Jobbgaranti för ungdomar*) enrolled in the public employment services was launched in 2009. This programme is focused on those aged 16–25 that are registered as jobseekers at public employment services for at least three months. The main objective of the programme is to assist these young people to find a job or to enrol in the regular education system. Key elements of the programme are the activation of different job search activities – such as guidance and coaching – as well as the provision in some cases of work internships, apprenticeships and other work placements.
- In Finland, the Youth Guarantee has a tailored approach where the public employment services carry out an assessment of the needs of the young unemployed and, accordingly, develop a personal plan for the young jobseeker.[44] The guarantee consists of offering a job, a study place or other activation measures. Importantly, the guarantee is targeted at the individual needs of the young jobseeker. In 2010, the intervention was successfully delivered to approximately 80 per cent of the participants. An evaluation of the Finnish programme showed different positive results, such as enabling early interventions, fostering territorial cohesion, and improving cooperation between different authorities and the relationship of the authorities with young people. At the individual level, the programme accelerated the activation of personalized employment plans, and reduced unemployment, leading to employment or further training.[45]

According to a Joint ILO/World Bank Synthesis Report, *Inventory of Policy Responses to the Financial and Economic Crisis* (2012), the majority (58 per cent) of the 77 countries investigated, adopted measures enhancing youth employment.[46]

[44] The first youth guarantee programme was introduced in Finland in 1996, with revised programmes launched in 2005 and in 2010. The scheme in its current format, including a training/study component, started operations on 1 Jan. 2013.
[45] EUROFOUND (2012).
[46] ILO/World Bank (2012), pp. 24–25.

Table 2.1 **ILO estimations of the implementation costs of a Youth Guarantee Programme**

	YGP	Adm. Costs	Total Costs	% YGP/GDP
EU-17	16,821.90	4,264.20	21,086.11	0.22
Austria	184.20	46.70	230.90	0.08
Belgium	372.10	94.30	466.47	0.13
Cyprus	49.60	12.60	62.14	0.35
Estonia	104.60	26.50	131.11	0.82
Finland	359.30	91.10	450.36	0.24
France	2,860.00	725.00	3,585.01	0.18
Germany	1,395.00	353.60	1,748.63	0.07
Greece	926.40	234.80	1,161.28	0.56
Ireland	347.60	88.10	435.71	0.27
Italy	3,081.20	781.10	3,862.28	0.24
Luxembourg	11.70	3.00	14.71	0.03
Malta	24.60	6.20	30.84	0.47
Netherlands	71.90	18.20	90.08	0.01
Portugal	*841.70*	*213.40*	*1,055.12*	*0.62*
Slovakia	491.00	124.50	615.41	0.89
Slovenia	83.40	21.10	104.56	0.29
Spain	5,617.50	1,424.00	7,041.49	0.66

Note: YGP, Adm. Costs and Total Costs are in thousands of euros.
Source: ILO. 2012.

The European Commission has recently proposed to its Member States the possibility of launching a youth guarantee programme with partial funding support from the European Union. Although information is very recent, direct funding of the proposal may amount to around €6 billion. This is much less than what would be needed according to ILO estimates (Table 2.1). The cost of a youth guarantee programme in Portugal would be slightly above an estimated €1 billion per year.

It is important to note that a Youth Guarantee Programme usually consists of providing unemployed young people with one or more of the following

[46] ILO/World Bank (2012), pp. 24–25.

options: a place in education; training opportunities to complete their educational background; participation in a work programme; and special job-search support. Therefore a Youth Guarantee Programme must work as a part of a coherent group of interventions, coordinated, designed and managed as a whole, under a broader youth action plan or framework.[47] In this regard, timing is crucial in activation measures jointly with individualized counselling and case management.[48] Further, training opportunities and work programmes must be adapted to the reality and needs of the Portuguese labour market, and implemented under the relevant national framework. In 2012, Portugal introduced a strategic plan on youth employment and SME support initiatives called *"Impulso Jovem"*,[49] which consolidates the national youth employment and SME support measures in three areas, namely (i) employment; (ii) competitiveness; and (iii) territorial cohesion.[50] Finally, international evidence also shows that the implementation of youth guarantees requires strong institutional coordination of the educational system, vocational training courses, and public employment services based on individual counselling and case management.

… as well as jobless households …

The increase in the number of jobless households over the last decade in Portugal is striking. It is worth noting that in 2000, the share of adults (people aged 18–59) living in households where no-one worked was actually much lower in Portugal than in many other European countries. In that year, the share was equal to 10.2 per cent in EU-27 (9.5 in EU-17) against a relatively low 4.5 per cent in Portugal. Interestingly, this share has only marginally increased across Europe in the years leading to 2012, while in Portugal it has surged by 5.4 percentage points up to 10 per cent of total households. A similar increase is also observed when the share of children (people aged 0–17) living in jobless households is considered. The share has indeed increased from 3.8 per cent in 2000 to 9.2 per cent in 2012.

47 See Quintini and Martin (2006).

48 Scharle and Weber (2011).

49 *Plano Estratégico de Iniciativas à Empregabilidade Jovem e de Apoio às PME.*

50 *"Impulso Jovem"* was introduced in 2012, responding to the challenging situation of youth in the labour market, as well as the European Commission's call for action in the area. The programme covers three pillars, namely (i) professional internships; (ii) support to recruitment, vocational training and entrepreneurship; as well as (iii) support to investments. The programme introduced "Passaporte Emprego" with the objective of integrating young people into the labour market with different measures, such as support to companies; training and incentives for recruitment (employment). The "Passaporte Emprego" exists in various areas, such as internationalization, innovation, industrialization, social economy, etc. The initiative also covers a support mechanism for the establishment of cooperatives, as well as a micro-credit programme.

The surge in the number of people living in jobless households only partly occurred before 2008; most of the increase is instead explained by the detrimental effect of the crisis on vulnerable individuals since then.[51] Therefore, activating specific policies designed for jobless households is crucial.

So far Portugal has through the Law 64/12 introduced a temporary increase (10 per cent) in the unemployment benefit for jobless households where both members of the couple are not working and have children; and correspondingly in single-parent households where the single parent is unemployed and does not benefit from a subsistence pension. This family dimension should also be an integral part of other measures addressing unemployment and in-work poverty. For example, the safety net created by the RSI in Portugal could reinforce its family dimension following international best practices, such as the French Active Solidarity Income (*Revenu de Solidarité Active* (RSA)) that addresses both joblessness and in-work poverty, providing specific social integration paths for each family member.

Further, in a crisis situation and beyond, availability of low-cost childcare may incentivize the participation jobless households in the labour market. In 2012, Luxembourg introduced a voucher scheme to reduce childcare costs while creating an incentive for the households to enter the labour market. The voucher enables parents to purchase a certain number of hours in a nursery or childcare centre.[52] Moreover, since 2008, child benefits are paid to families as an automatic tax rebate.

… making more resources available to effective active labour market policies …

ALMPs are central to preventing long-term unemployment and encouraging more rapid transitions towards employment. Spending on ALMPs increased at the beginning of the crisis, peaked in 2009 at 0.63 per cent of GDP, but

[51] As already mentioned in this report, in February 2013, there were 13,187 couples with both members of the family unemployed, two and a half times more than at the end of 2011.
[52] European Commission (2012).

declined in the following years. In 2011, expenditure on ALMPs was around 0.46 of GDP, slightly higher than in 2008. The evolution of ALMP expenditure has been similar in some other European countries, such as Germany, where the share of GDP devoted to ALMPs increased from 0.47 in 2007 to 0.63 in 2009, but declined to 0.45 in 2011. However, the expenditure on ALMPs in Portugal is clearly below that of the Nordic countries – above 1 per cent in Denmark from 2009 onwards, and increasing in Sweden from 0.66 in 2009 to 0.82 in 2011.

The Memorandum of Understanding on Specific Economic Policy Conditionality includes a recommendation to improve the effectiveness of ALMPs, including public employment services. In light of this recommendation, the Portuguese Government recently introduced a series of measures to promote vocational training, employment and self-employment.[53]

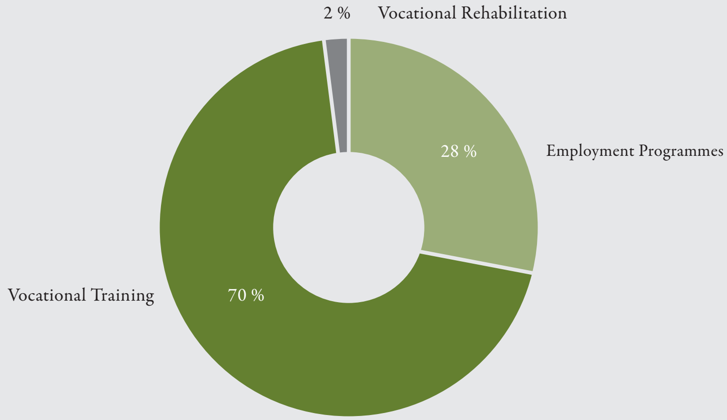
Nonetheless, the current context of macroeconomic adjustments and external financial restrictions exert significant pressure on the budget of public employment services. Bearing this in mind, we propose some general improvements to the ALMP framework, focusing on international policy experiences.

The ILO/World Bank synthesis report (2012) using data from 77 countries shows that most high-income countries responded to the crisis by employing more staff in public employment services in order to respond to the surge in the number of jobseekers.[54] In this vein, we recommend a similar general approach for Portugal, acknowledging the importance of attending to the needs of an increased number of jobseekers in an effective manner.

In Denmark, ALMPs are strongly linked with Passive Labour Market Policies (PLMPs). The main feature of this system is the growing intensity of ALMPs in relation to the duration of unemployment (i.e. receiving unemployment

[53] Programmes such as *"Impulso Jovem"*, including *"Passaporte Emprego"*; *"Estimulo 2012"* and the recent *"Estimulo 2013"* approved by Portaria No.106/2013 were introduced. Moreover, in order to strengthen public employment services, Resolution No. 20/2012 by the Council of Ministers was adopted to promote a closer monitoring of jobseekers.
[54] ILO/World Bank (2012).

Figure 2.3 **Beneficiaries of ALMPs**
Share of persons covered by type of programme, 2012



Source: Instituto do Emprego e Formação Profissional, I.P.

benefits). The rationale of this design is devoting a gradually increasing effort to persons with a relatively higher risk of long-term unemployment.[55] For Portugal, this type of linking of active and passive labour market policies would improve effectiveness of the public employment services. This approach is based on the reorganization of current resources, rather than on increasing expenditure (apart from the increase needed in human resources in employment offices mentioned above). Moving towards individualized counselling and case management are key elements of this common framework for active and passive labour market policies.

[55] In the Danish system, the jobseeker is asked to attend specific programmes aimed at increasing his/her opportunities of finding a job after six months of unemployment. If the worker remains unemployed, s/he has to attend new training courses every six months. If unemployment persists for more than 30 months, the unemployed person is permanently placed in these training programmes until employment, or until the end of the maximum legal period for receiving unemployment benefits (four years). The measures implemented cover different key areas, such as counselling, requalification, job training or employment with a wage subsidy. Andersen (2011).

… reinforcing public employment services, and …

In Portugal, most of the funding in public employment services is allocated to vocational training programmes. In December 2012, 70 per cent of persons covered by public employment services attended vocational training programmes (Figure 2.3).

The number of people covered by the various measures of employment, training and vocational rehabilitation at the end of 2012 was 570,000, representing an increase of 10 per cent compared to the previous year. While the number of persons covered by employment programmes has been quite stable over the 2010–2012 period, the number of persons involved in vocational training increased by around 17 per cent.

However, during the present crisis, total expenditure on the two main measures (employment and training programmes) decreased by 29 and 14 per cent respectively. As a result, expenditure by participant has also dropped in these programmes (Figure 2.4), putting the quality of the interventions at risk.

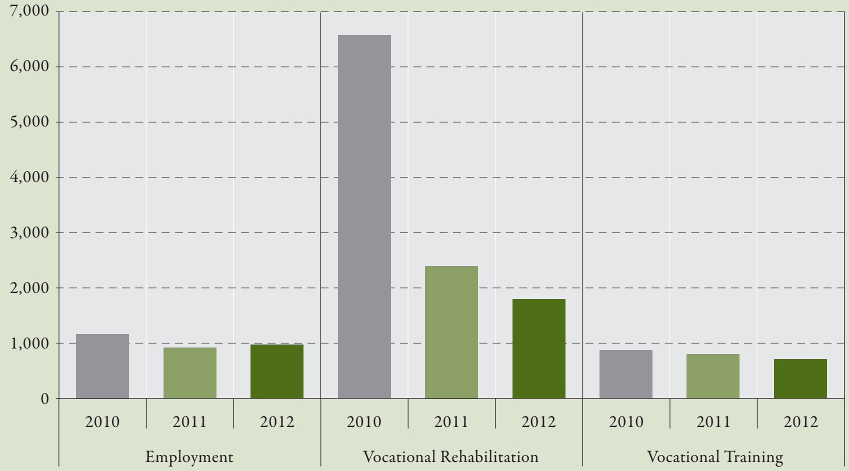
In view of the increased needs and the lower resources available, Portugal should consider boosting public employment services in order to at least maintain the current levels of quality in all active measures. International organizations should have an active role in supporting these efforts.

… and addressing long-standing weaknesses in the education system.

Despite significant improvements in recent years, many young people leave the education system prematurely. The share of young people who have attained upper secondary education is still low with respect to international standards. Only 68 per cent of young people complete upper secondary education, compared with 75 per cent, on average, in OECD countries.[56] When the share of population with upper secondary education or above is considered, the level of educational attainment in Portugal remains very low. In Portugal, only 50 per cent of the population aged 25–34 has attained at least upper secondary education, placing it on a par with Brazil in an international comparison.

[56] OECD (2013b).

Figure 2.4 **Expenditure per participant in Public Employment Services by type of programme, 2010–2012** (Euros)



Source: Instituto do Emprego e Formação Profissional, I.P.

Nevertheless, there is a promising positive trend. Efforts made by the Portuguese authorities in the last decade to enhance the educational system have resulted in an improvement in students' performance. According to the OECD Programme for International Student Assessment (PISA), Portuguese students have significantly improved their abilities in all areas evaluated, namely, reading, mathematical and scientific skills.

In general, these weaknesses in the education system are addressed through changes and adaptations to new realities of the labour market. However, as these changes are only visible in the long term, some interventions can be developed to smooth the current problems for the school-to-work transition, mainly through an apprenticeship system, work experience and internships as part of the curriculum. In addition, a new partnership between education authorities, enterprises, worker representatives and young people themselves should be considered. Advice on apprenticeships is one of the areas potentially suitable for any integrated Youth Guarantee Programme and it is also a field where the ILO can provide expertise.

C BOOSTING JOB QUALITY

Improved job quality can help tackle unemployment and social exclusion …

Evidence shows that employment quality represents a key economic comparative advantage both in the short and in the long term. In the first place, good and stable employment relations ensure that workers are willing to invest in acquiring firm-specific skills that enhance enterprise productivity and ensure sustainable development.[57] Moreover, employment quality leads to longer job tenure, which different studies have shown to be positively linked with labour productivity.[58] Employment quality could represent an even stronger competitive advantage in times of crisis, when stable employment relations facilitate the conclusion of flexible working time agreements – thus avoiding lay-offs – in face of demand and output fluctuations (see Chapter 2.B for further details).

… and in Portugal this implies efforts to facilitate transition from temporary forms of employment and undeclared work to more stable and formal arrangements.

In Portugal, reforms carried out in the 1990s permitting a wider use of temporary contracts entailed an increase in the incidence of temporary employment.[59] In addition, as documented in Chapter A, the phenomenon of "dependent" self-employment is on the rise and undeclared work remains significant. Young people are disproportionately represented among temporary forms of employment. For example, almost 60 per cent of employees below the age of 25 have a temporary contract, compared with 18.6 per cent among employees above that age. On the other hand, gender disparities seem less marked with respect to the incidence of temporary forms of employment.

[57] Davoine et al. (2008).
[58] Auer et al. (2005) and Fakhfakh et al. (2011).
[59] Centeno and Novo (2012).

A major reform of dismissal legislation took place in 2011 as part of the Memorandum of Understanding …

The Memorandum of Understanding between Portugal and the IMF, EC and ECB called for a reduction of labour market segmentation.[60] Subsequently, labour market reform measures were introduced progressively starting 2011, although additional legal changes concerning dismissals have been implemented until October 2013.

The reform entailed a cut in severance pay for open-ended contracts and reduced the gap in severance pay that previously existed between temporary and open-ended contracts. Indeed, the reform has also affected the design of the dismissal system: before, severance pay was made at the time of termination of the employment contract; henceforth, severance pay is made partly at the time of termination and partly before termination in the form of a monthly payment to an individual account in the name of each worker. The new system became applicable in October 2013, and consists of a fund to collect and pay the contributions to the individual severance accounts (following the Austrian system implemented in 2003).

… but the reform has not been followed by higher employment or improved job quality.

One of the labour market reform measures aimed at facilitating the transition from temporary to open-ended contracts with a view to boosting job creation. It is difficult to assess the impact of this reform, if only because the measures were introduced recently. The declining trend in the volume of employment has continued, or even aggravated, since the start of the reform. On the other hand, the incidence of temporary contracts may have declined slightly. Further research is needed in order to assess whether these trends are associated with the reforms or whether they reflect the general economic climate.

[60] See Appendix 3 for details about the labour market reform in Portugal. For legal details see Palma Ramalho (forthcoming).

In addition, the ILO Committee of Experts on the Application of Conventions and Recommendations[61] has invited the Government to include in its next report to the Committee an evaluation of the impact of the reduction of termination benefits in terms of maintaining and creating employment (Observation adopted in 2012 concerning the Termination of Employment Convention, 1982 (No. 158)).

Moreover, the issues of “dependent” self-employment and undeclared work require greater policy attention. In particular, it is estimated that income from undeclared work represents over 20 per cent of GDP.[62] Besides the economic environment, undeclared work may depend on a series of other factors, such as the institutional setting of countries and the individual characteristics of workers. In this vein, the proposals to limit segmentation must be related to the incentives affecting the firms, but also equalizing the conditions of workers in these two situations with regular workers.

The full implementation of an online public administration system could help to remove obstacles for enterprise registration and declared work.[63]

However, the incentives for “dependent” self-employment and undeclared work also need to be addressed. In this regard, the strengthening of labour inspection is crucial. Already, Portugal has developed a service targeting inspections in the hotel and restaurant sector where undeclared work is presumed to be particularly significant.[64] Nevertheless, sanctions can be designed with the ambition of generating more inclusion in the regular labour market.[65] For example, an articulation of inspection activities into two steps would help to detect part of this undeclared work and “dependent” self-employment, and to restore workers’ rights for “dependent” self-employed workers.

[61] From now on referred to as ILO Committee of Experts.
[62] Afonso and Gonçalves (2012), Dornelas et al. (2010), and Economics and Fraud Management Observatory (2012).
[63] In fact, Portugal developed in 2005 the Simplex programme, an administrative and legislative simplification for start-ups. One initiative of the programme is the ‘on-the-spot-firm’ (*Empresa na Hora*). Between 2005 and 2008, the average time taken to complete the procedures was 1 hour 14 minutes and the average cost of setting up a company was €360. In this period, 29,068 new firms were born. Williams and Renooy (2008), p. 27.
[64] ILO (2013a), Section 4.b5.
[65] As in past experiences in Portugal concerning the regularization of irregular immigrants (ILO, 2010).

As a first step, firms would receive advice about how to identify and regularize situations such as "dependent" self-employment and undeclared work. The main task in this phase would be helping employers to facilitate the transition of workers under these situations towards regular employment. Specialized and professionalized counselling, rather than sanctions, would be provided to avoid this type of segmentation. Of course, an option for some self-employed workers might be to work with more firms in order to become a 'true' self-employed worker. In the second step and after a specific deadline, labour inspections and sanctions might be implemented. Nevertheless, deterrence should be explicitly considered in policy design in order to limit these situations. In this respect, it should be ensured that the Law 63/2013,[66] which entered into force on 1 September 2013, will be implemented in a manner that supports the creation of decent jobs. In the case of regularizing the situation of "dependent" self-employment, the Law provides a grace period of ten days to the employer before a process can be initiated to the establishment of the existence of an employment contract. Considering this short period of time, preventive information campaigns should be part of the labour inspection strategy in carrying out this work, and individual counselling to the employer and the worker should be provided in cases where labour inspectors detect "misuse of service provider contracts". Social protection was extended to "dependent" self-employed workers for the first time through Decree-Law 65/2012.[67]

The problem of undeclared work and "dependent" self-employment is complex, and in considering any additional legal developments in this field, it would be important to design innovative measures with enough of a deterrent effect and not merely increasing penalties.[68,69] For example the fiscal and social contributions for regular employees might have a smooth marginal increase avoiding critical thresholds in firms' size, in order not to

[66] Law 63/2013, 27 Aug. 2013; http://dre.pt/pdf1sdip/2013/08/16400/0516805169.pdf
[67] Law 65/2012, 15 Mar. 2012; http://dre.pt/pdf1sdip/2012/03/05400/0124201244.pdf
[68] Recently, different EU countries have increased sanctions against undeclared work, such as Austria, the Czech Republic, Denmark, France, the Netherlands, Slovakia, and the United Kingdom (ILO, 2013a).
[69] See, for example, Williams and Renooy (2008), p. 14, for different measures tackling deterrence and enabling compliance.

provide negative incentives for hiring an additional regular employee. In a similar way, a smooth marginal increase in obligations and costs must affect working hours, to decrease incentives to perform undeclared working hours. As usual, influencing the incentives to change this type of behaviour is a crucial element of any policy-making strategy. Design of these measures is as important as the resources devoted to them.

Finally, the ILO Committee of Experts has taken note of persistent vertical and horizontal occupational sex segregation in the labour market, and inequitable distribution of family responsibilities.[70] More specifically on equal remuneration, the ILO Committee of Experts has said that pay differentials remain one of the most persistent forms of inequality between women and men, and requires that governments, along with employers' and workers' organizations, take more proactive measures to raise awareness, make assessments, and promote and enforce the application of the principle of equal remuneration for men and women for work of equal value. In its direct request on the Equal Remuneration Convention, 1951 (No. 100), adopted in 2011, the Committee asked the Government of Portugal to provide any relevant information concerning the impact of the austerity measures on equality and non-discrimination policies and measures.

[70] Direct request adopted in 2011 in connection with the Discrimination (Employment and Occupation) Convention, 1958 (No. 111).

D SOCIAL PROTECTION

Well-designed social protection is key to a job-rich recovery ...

Chapter 1 has shown that people in the lowest part of the income distribution have been severely affected by the economic crisis. In addition, the recent wage cuts will probably move part of the middle-income population to lower income levels. On the other hand, undeclared work and, in general, segmentation is also associated with 'precariousness', which means long-term challenges related to limited access to regular employee rights (such as unemployment and sickness benefits, pensions rights, etc.). Therefore, reinforcing the social protection floor and preventing further deterioration are needed, not only because of the negative labour market outcomes of the last years, but also because of the long-term problems related to labour market segmentation.

Moreover, well-designed social protection represents a complementary element to supporting employment quality. In the presence of quality employment, demand prospects are more predictable, thereby encouraging productive investment. Improved domestic demand is particularly important for small businesses and in depressed areas, where the recovery crucially depends on internal increased willingness to consume. Well-designed social protection also provides workers with a partial insurance against labour market risks and promotes participation. Of course, good measures with bad design will always obtain poor results. Therefore, a key element is the design and implementation of the social protection system, which should be able to guarantee security while maintaining labour market incentives.

The fiscal consolidation process significantly affects any decision related to social protection. Therefore, probably some of the proposals detailed below must be discussed in the context of the programme conditions and the general policy design to be launched in the medium term by Portugal after the financial assistance programme expires in 2014.

… and this requires addressing important gaps in social protection coverage and benefit adequacy.

Key elements to be considered in Portugal's efforts to achieve a job-rich recovery:

- First, reinforcing the basic floor should attend to the safety net created by RSI, providing enough funding to avoid an additional decline in coverage, and focusing even more on families with children. As shown in Chapter A, there has been a recent change in the poverty trends affecting households with children, and even more in households where the parents have low educational levels and whose potential wages are therefore also relatively lower. Reinforcing RSI would mean changing the recent trend towards lower budget for this policy against poverty and social exclusion, and mainly focusing more attention on households with children. Reinforcing the articulation of the RSI with existing social protection programmes for children can be considered.
- Second, updating the minimum wage could be considered in order to avoid an additional increase in wage inequality and, indirectly, income inequality. In the same way, the 'Social support indicator' (Indexante de Apoios Sociais (IAS)) should be updated accordingly. The ILO Committee of Experts in its observation on the Minimum Wage Fixing Convention, 1970 (No. 131), adopted in 2012, stated that the regular adjustment of minimum wages in the context of economic crisis can avoid deflationary wage spirals and promote economic recovery as a result of stimulation of demand, as underlined in the Global Jobs Pact of 2009.[71]
- Third, social protection is needed to prevent long-term unemployment and to encourage more rapid transitions to employment. In this vein, the relatively low coverage of unemployment benefits and, even more significantly, the declining trend in the coverage of jobseekers (as shown in Chapter A) are very worrying. An initiative potentially useful to attend to these problems would be a full articulation of ALMPs and unemployment benefits, with a gradual increase in active measures in cases of enduring unemployment. As explained in previous sections of this chapter, this is a deep change in the performance of public employment services, and it needs time, administrative reorganization and, probably,

[71] ILO (2013c).

additional resources. Nevertheless, it is a preventive measure for long-term unemployment, which means relevant savings of public resources in the long term and lower risks of poverty and social exclusion. The resources saved could be reallocated to improve access to unemployment benefits and increase step by step the coverage of jobseekers.

- The ongoing process of reform of the Portuguese economy affects the pension and the health systems. Important measures have already been taken or are to be taken in the near future. Nevertheless, reforms in these areas need to be guided by considerations of equity. In fact, in 2011, 19.2 per cent of retired persons (65 years and over) were at risk of poverty, compared with the EU-27 average of 14.7 per cent. Such evidence clearly indicates the need for an adequate reorganization process of pension expenditure favouring the most vulnerable pensioners. As has been stated already, there is evidence suggesting that around 40 per cent of old-age pension spending is received by the richest 5 per cent of the population.[72] A well-designed redistribution may also help to rationalize public resources so that an adequate coverage can be maintained and further extensions of the retirement age avoided. At the same time, reforms of the health system cannot be to the detriment of low-income individuals. There is evidence that clearly associates income inequality to health inequality that in turn is linked to lower labour productivity.[73] Savings from reducing coverage and treatment availability to low-income groups may hamper economic growth and in turn be finally detrimental for public finances.

[72] IMF (2013a).
[73] WHO (2002).

E COLLECTIVE BARGAINING AND SOCIAL DIALOGUE

Major changes in collective bargaining have taken place since 2011 ...

In Portugal, collective bargaining has traditionally taken place at the sectoral or multi-employer levels, with collective agreements extended to non-parties to the agreement. In an economy dominated by small firms with limited capacity to engage in collective bargaining, the focus on sectoral or multi-employer bargaining, with extension mechanisms, was a way to ensure the wide coverage of agreements. Until 2008, around 75 per cent of workers in the private sector were covered by collective agreements – either directly or indirectly through extension arrangements.

Over the past two years, these collective bargaining arrangements and practices have undergone significant changes (see Appendix 3 for details). In 2011, the mechanism for extending collective agreements to non-parties was practically suspended. This suspension continued into 2012 and, at the end of that year, a new regulation was adopted, providing tight criteria for the extension of collective agreements (Resolution 90/2012). According to the new criteria, the firms for which extension is sought should represent at least half of the workers in the branch, geographical area, professional category or type of company in order for the extension to be granted. The Resolution further states that the requirements are not applicable when the extension request excludes small and medium-sized enterprises.

In addition, an attempt has been made to bring collective bargaining closer to the level of the enterprise (instead of the sectoral, branch or other multi-employer level). Thus, in 2012, the third modification to the Labour Code was introduced, stipulating among other things an "organized decentralization" of collective bargaining (Law 23/2012).[74] According to the new legislation, workers' councils can negotiate at plant level in firms with at least 150 employees (compared with 250 before the reform), subject to

[74] The Memorandum of Understanding with the EC, ECB and IMF of May 2011 had envisaged a wider range of reforms, including with respect to the legal effects of collective agreements that come to expiration and are not followed by a new collective agreement. These other reforms were not retained in Law 23/2012.

delegation by trade unions. The need for promoting collective bargaining was acknowledged through the establishment of a Labour Relations Center (Decree-Law No. 189/2012). These changes were agreed by employers and certain unions, via a tripartite commission (the so-called "Comissão Permanente da Concertação Social").

… leading to a decline by over 80 per cent in the number of workers covered by a collective agreement …

So far, these important changes have resulted in an unprecedented decline in the number and coverage of collective agreements. While nearly 300 collective agreements were registered in 2008 and around 230 in 2010, the number of agreements fell to 170 in 2011 and a mere 85 in 2012 (Figure 2.5).[75] A similar trend was recorded concerning the number of workers covered by collective agreements (Figure 2.6). In 2012, around 300,000 private-sector workers were covered by a collective agreement compared with 1.2 million the year before.

The main factor behind this trend is that while the measures have had the intended effect of reducing the role of sectoral or multi-employer agreements, they have failed in boosting enterprise-based agreements. As illustrated in Figure B.5, the number of enterprise-based agreements has remained constant.

… which, if unaddressed, may entail significant social and economic consequences.

The result of the above trends is that wages and working conditions are increasingly determined by direct negotiation between management and individual workers. In the presence of asymmetric bargaining positions (especially in times of acute crisis), downward pressures on wages and working conditions may be difficult to resist.[76] This may further weaken domestic demand and postpone recovery.

[75] UGT (2012). This analysis is developed further in section 4 of the next chapter.
[76] See, for instance, Palma Ramalho (forthcoming).

Figure 2.5 Number of collective agreements by level of negotiation, 2008–2012

Source: UGT (2012).

Figure 2.6 Number of workers covered by collective agreements in the private sector, 2008–2012 (millions)

Source: UGT (2012).

In the longer term, if the individual contract becomes the rule, enterprises would face significant administrative costs as they would have to negotiate separately for each worker. Issues of fairness and uncertainty would inevitably arise, thereby weakening the commitment of workers to the enterprise and affecting the employment relationship. Low-productivity traps may arise as a result.

On the contrary, empirical evidence indeed suggests that collective bargaining increases workers' morale and attachment to the firm, by directly involving employees in the decision-making process and ensuring that they will participate in the benefits of growth. Collective bargaining may also facilitate job-sharing arrangements and may help to avoid recourse to lay-offs in the face of a recession.

Research shows that maintaining a certain degree of coordination could strengthen sustainable economic growth. Cross-country evidence for advanced economies showing that coverage and centralization of collective bargaining play a role in reducing wage inequality[77] is corroborated in country studies.[78] More generally, collective bargaining reduces wage inequalities with respect to a situation in which no bargaining takes place.[79] So, a further advantage of collective bargaining is that it could enhance social support for pro-growth policies.

Social dialogue is crucial to rebuilding a job-friendly collective bargaining system.

It is therefore important to devise a new approach to collective bargaining. This is not an issue of moving back to where the system was before the crisis. Among other limitations, the earlier system was overly centered on wages and not enough attention was devoted to skills development, mobility and competitiveness. Instead, the challenge is to build an environment that allows wages and working conditions to move in line with productivity while supporting job recovery.

[77] Nevertheless, the size of these effects is debatable. See, for e.g. Wallerstein (1999) and Golden and Londregan (2006).
[78] As Kahn (1998) finds for Norway, for example.
[79] Hayter (2011).

This is particularly the case when it comes to the determination of minimum wages. In this respect, the ILO Committee of Experts recently stressed the fundamental nature of the principle of full consultation and direct participation, on an equal footing, of the social partners in the application of minimum wage fixing machinery. The Committee expressed its hope that the Government would conduct consultations with employers' and workers' organizations before taking decisions on the minimum wage in Portugal. It also underlined the importance of taking full account of the needs of workers and their families as much as of economic policy objectives of the Government.

In addition, a better articulation of different levels of agreement could be considered, with a view to increasing coverage while taking into account economic circumstances. In this regard, it is helpful to examine the situation in other countries where small firms are dominant. In Denmark, for example, collective bargaining at the company level operates within a broader framework that is first set at the national level by representative organizations and then discussed at the industry level. Company-level negotiations can produce changes in the agreements at the industry level, provided that such changes respect the ground rules fixed at the industry level. Around 80 per cent of workers are covered by collective agreements in Denmark, one fifth through industry agreements and the rest by company-level agreements which are often an extension of higher level agreements.

In Italy, social partners agreed recently to give a greater role to company-level negotiations. As part of this effort, the Italian Government has budgeted €2.1 billion in tax incentives to support company level bargaining.

In short, various options exist to improve coverage while taking into account that most firms in Portugal are SMEs and, therefore, the costs for employers to bargain a firm-level agreement are high. What matters is to consider the various options through social dialogue.

[80] Palma Ramalho (forthcoming).

CHAPTER 3
POLICY SCENARIOS AND ROLE OF ILO

In this final chapter, medium-term scenarios to provide a more job-friendly strategy are discussed. The chapter also explains how the ILO could support such an employment-rich approach.

A shift to job-friendly policies would speed up recovery …

More than two years after the start of the financial assistance programme, the Portuguese economy is undergoing a process of correcting macroeconomic imbalances (with a contractive impact on economic activity and jobs), in the context of weak external conditions, especially in Europe.[81] Available indicators[82] show a continued contraction of economic activity in 2013, associated with a sharp decline in domestic demand that outweighs the positive contribution to economic growth arising from net exports. The fall in business investment is especially problematic, given the need for recapitalizing the economy, diversifying its production base and boosting productivity – key underlying determinants of competitiveness.

On current trends, according to the latest IMF projections, economic growth could turn positive in the coming months and reach 0.8 per cent in 2014. However, this would not be enough to arrest the deterioration in the labour market. The unemployment rate would increase slightly to reach 17.7 per cent in 2014.

Therefore the issue arises as to how to improve the employment situation while meeting medium-term macroeconomic goals, notably with respect to budget balances and external competitiveness. The previous chapter has offered some policy options in this regard. In certain cases, for example in relation to improved access to credit by job-rich SMEs, wage policies or

[81] See ILO (2013b), especially Chapters 1 and 2.
[82] Banco de Portugal (2013b), pp. 37 ff.

employment regulations, the shift to a more job-friendly approach does not directly entail a budget impact. In addition, if well designed, such policies would strengthen the ability of enterprises and workers to cope with change, thus boosting external competitiveness.

In other cases, for example in connection with measures to support jobseekers and disadvantaged groups, job-friendly policies entail a cost to the public purse. The issue is whether this cost is compensated by the benefits arising from the advocated policies in terms of improved job matching and enhanced labour market participation.

In order to assess the various impacts of a shift towards a job-friendly strategy, a simulation of the Global Economic Linkages model has been carried out.[83] The simulation includes, first, a reduction in interest rates such as could be obtained through a fall in the risk premium associated with a more rapid move to a banking union in the eurozone. This is reflected in a cut in the interest rate by 1.5 percentage points as from the end of 2013 – which is equivalent to cutting by half the interest rate spread relative to Germany accumulated since 2008 as a result of the crisis.[84] Secondly, the scenario considers a strengthening of labour market policies. This is captured by way of an increase in spending on active labour market policies per jobseeker: spending per jobseeker is brought to the average level in the EU, entailing an additional spending effort of 0.57 per cent of GDP.[85] Appendix 4 provides a detailed explanation of these simulations.

The decrease in the interest rate helps to unlock the investment potential and provides a demand stimulus to the economy and job creation. The increase in the spending on active labour market policies boosts aggregate demand, while also exerting a positive supply effect by improving the job matching process and thus facilitating the re-employment of jobseekers.

The combined effect of these policies is projected to increase employment by about 108,000 by the end of 2015, resulting in a 2 percentage point reduction

[83] The Global Economic Linkages model is explained in detail in the last chapter of the ILO *World of Work Report* 2013 and references therein.
[84] The spread was 1 percentage point in 2008 and had risen to 4 percentage points in 2013.
[85] More specifically, in the simulation, spending per jobseeker in Portugal is doubled to €2,400 per year, which is the average of spending per jobseeker observed in the EU in 2011 (latest year for which information is available). The simulation is based on Eurostat data.

Table 3.1 **Employment and output effects of a shift to job-friendly policies, 2014-15**

		Rise in number of people who have a job (thousands)	Reduction in unemployment rate (percentage points)	Rise in GDP (percentage points)
2014	**Q1**	39,4	-0.7	0.8
	Q2	60,2	-1.1	1.1
	Q3	78,7	-1.4	1.5
	Q4	91,3	-1.7	1.8
2015	**Q1**	99,1	-1,8	2.0
	Q2	104,0	-1.9	2.2
	Q3	106,8	-1.9	2.3
	Q4	108,1	-2.0	2.3

Source: ILO Research Department, based on simulations of the Global Economic Linkages model (see Appendix 4).

in the unemployment rate (Table 3.1). Around two-thirds of the improved employment situation arises from the cut in interest rates and the remaining one third from the strengthening of active labour market policies. Importantly, by end-2015, output would be 2.3 percentage points higher as a result of these policies. This would therefore support the achievement of fiscal goals.

… while meeting key macroeconomic goals.

Importantly, these achievements would be consistent with macroeconomic balances over the medium run. Indeed, in the simulation, the reduction in the budget deficit would be slower than planned in 2014, with a convergence vis-à-vis fiscal goals in 2015. And an overall external balance would be maintained over the simulation period. In general, Portugal would benefit from a longer term orientation of the policy strategy.[86]

These findings are consistent with earlier ILO research.[87] According to this analysis carried out for the global economy, a relatively small increase in

[86] Silva Costa (2013) describes three pillars for the design of the future economic and social policy: first, a fiscal policy based on sustainable rules in the medium term; second, a distribution policy (based on a Social Pact) improving competitiveness, according to effective increases in productivity; and, third, the development of institutions supporting investment in sectors and industries with the highest value added, in order to respond to consumption and social protection expectations of the European social model.
[87] See, for example, chapter 5 in ILO (2013b).

government investment and enabling labour incomes to grow in line with productivity would boost global GDP and employment prospects. These results also underlie the need for international policy coordination, especially among EU countries.

The ILO can play a key role in the implementation of job-friendly policies in Portugal …

The ILO has consistently promoted an inclusive job-rich approach to crisis recovery at the international level. At the joint meeting of G20 Finance and Labour Ministers of July 2013, the need for a more inclusive, job-rich growth process was recognized.

With these goals in mind, and based on its expertise in employment and labour relations as well as in crisis-response strategies, the ILO could provide support to Portugal in various ways. This could come through an assessment of good practices in the area of employment, with other dimensions of decent work taken into account. The ILO could also assist in policy-making and facilitating the role of social dialogue in the process.

Based on the analysis in Chapters 1 and 2, the response would be more effective if it covered the following components as part of a fruitful environment for social dialogue: (i) strengthening labour market institutions; (ii) supporting vulnerable groups; (iii) unlocking the investment and job potential of SMEs; (iv) addressing social protection gaps; and (iv) promoting social dialogue on rebuilding collective bargaining and a competitive production base.

… by supporting tripartite constituents in their search for stronger labour market institutions …

Some key measures were proposed in the study with a view to strengthening the functioning of the labour market and labour administration, particularly in relation to increasing employment levels and improving the quality of employment. Policies that promote employment must focus on the groups of workers with the most severe problems in the labour market that, in Portugal's case, particularly concern the youth, long-term unemployed and jobless households.

Youth guarantee programmes have been able to facilitate school-to-work transition in other countries, and Portugal could draw from their experiences. The ILO could support the process through the collection of international best practices and analysis of comparative information, including recent evaluations and estimated costs of these systems. It could also assist Portugal in setting up a Youth Guarantee Scheme adapted to its needs. In this context, particular focus should be placed on the fact that Portugal has several programmes in support of youth in place. So the Youth Guarantee Scheme could serve as a coordination device, placed in a broader framework of youth development strategies. Apprenticeships, generally one of the pillars of such schemes, are an additional area where the ILO can provide specific and recognized expertise.

With a view to addressing groups with a high risk of social exclusion, ALMPs are needed to prevent long-term unemployment and to encourage a more rapid transition to employment. Through its expertise, the ILO could assist in the development of ALMPs as well as the process of transformation of the public employment services, with greater focus being placed on individualized counselling and programme management.

Enhancing the quality of employment would mainly focus on addressing segmentation in the labour market. Furthermore, in view of the fact that measures have recently been introduced in relation to disincentivizing the use of temporary contracts, the proposed action would tackle the issues of "dependent" self-employed workers and undeclared work. The ILO could support Portuguese constituents in developing appropriate multi-pronged strategies, based primarily on specialized counselling rather than sanctions, to encourage practices that respect workers' rights in these situations. In addition, the ILO could assist in the assessment of the relevant legislative framework in order to increase predictability for employers and workers. Labour inspection services have a key role to play in this regard. In this context, the ILO could offer targeted training programmes to labour inspectors in order to facilitate the implementation of the strategies developed.

… sharing good practices on enterprise development …

Various best practices exist in support of enterprise development with a view to stimulating start-ups and to supporting the creation of sustainable enterprises that are able to create and maintain jobs in crisis situations. The main problem at the moment in Portugal relates to inadequate financing options for enterprises. In addition, there is a need for a deliberate strategy to promote the growth of enterprises and to attract job-rich investments to stimulate growth. The ILO can make available international best practices in these areas and support the setting-up of necessary programmes and structures in cooperation with the appropriate national entities and other relevant organizations in Portugal. The ILO can also provide specialized training in the creation and expansion of enterprises and related areas.

… addressing social protection gaps …

The ILO has vast experience in working with partners in support of social protection systems worldwide. This study identified the need to reinforce the Social Protection Floor in Portugal through the safety net of RSI, and through developing systems that enable the maintaining or expansion of current coverage, with greater focus on families with children. The ILO, notably with the expertise of its International Financial and Actuarial Service (ILO FACTS), would be able to support the country in the actuarial, financial and fiscal questions necessary to evaluate the situation and to find ways of ensuring a solid safety net in times of crisis and beyond, as well as in the design of required policies and programmes through a tripartite process. Finally, the ILO could provide capacity-building through specialized training programmes to ascertain effective implementation.

… and promoting fruitful social dialogue to rebuild industrial relations and boost a competitive production base.

The analysis presented in the previous sections of this study together with broader international research results indicate a need to balance the various interests in the area of bargaining so as to ensure an inclusive recovery from the crisis and subsequent economic development. The ILO could leverage its vast expertise in social dialogue and assess various international best practices in collective bargaining at different levels.

In addition, the proposed discussions on minimum wages on the one hand, and productivity-linked pay on the other, should take place in the appropriate forums for social dialogue. The ILO could facilitate the process through the provision of expert services and experiences from other countries.

Box 3.1 A century of collaboration between the ILO and Portugal

Portugal was a founding member of the ILO in 1919 and, since then, the country maintains a close relationship with the organization, especially since the shift to democracy in 1974.

The country has formally ratified 81 ILO Conventions and the process of ratification has been particularly intense over the past few decades. By 1974, the country had ratified 30 Conventions of the 140 adopted by the ILO by that time. Since then, Portugal has ratified more than 50 ILO Conventions, especially in areas such as: freedom of association, collective bargaining and industrial relations (4 Conventions); elimination of child labour (5); tripartite consultations; labour administration and inspection (4); employment policy and promotion, vocational guidance and training (5); wages (including minimum wage fixing) and working time (6); occupational safety and health (9); maternity protection, social policy and social security (4); and seafarers (7).

In 1983, the Portuguese Government and the ILO agreed to develop a set of technical cooperation programmes in the socio-labour field in developing countries. Since the early 1990s, collaboration has mainly focused on child labour in Portugal, multilateral cooperation programmes in the Portuguese-speaking African countries (in which Portugal became an important donor), labour statistics and on tackling the economic and jobs crisis.

In 1998 and 2001, two important statistical surveys on child labour were carried out in cooperation between the Portuguese authorities and the ILO. These two instruments have become an international reference on collecting information on child labour, and an innovation in the European context.

In 2003, the Portuguese Republic and the ILO established an ILO liaison office in Lisbon. Since then, cooperation with the Government of Portugal, the political parties with parliamentary representation, the social partners and other organizations, such as the Community of Portuguese Language Countries, has been reinforced.

For the last few years, the ILO office in Lisbon has provided assistance to help tackle the economic and social crisis. These activities have been carried out in close collaboration with the Portuguese tripartite constituents.

Sources: ILO Lisbon office; www.ilo.org; www.ilo.org/lisbon; Rodrigues, Cristina, “Portugal and the International Labour Organization (1933-1974)”; Portuguese legislation.

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APPENDIX 1:
PORTUGUESE CRISIS TIMELINE SINCE APRIL 2011

2011

Apr. Portugal makes a request for the activation of an international aid mechanism.

5 May Financial Assistance Programme: Portugal and the European Union (EU), the European Central Bank (ECB) and the International Monetary Fund (IMF) agree on an economic and financial adjustment programme of €78 billion (the EU/ECB/IMF Financial Assistance Programme translated into a set of measures and legislative initiatives, including of a structural nature, related to public finances, financial stability and competitiveness, to be introduced during a three-year period).

17 May A Memorandum of Understanding on Specific Economic Policy Conditionality is signed with the European Commission (EC) on Portugal's request for aid. A Memorandum of Economic and Financial Policies (MEFP) is signed with the IMF.

Aug. Staff teams from the EC, the ECB and the IMF conclude their first regular quarterly review of the Portuguese Government's economic programme: "The programme's objectives are to restore competitiveness and to put Portugal's economy on a path of sustainable growth, sound public finances and job creation" (ECB).

Sep. The first regular quarterly review leads to the first regular update of the Financial and Economic Assistance Programme in September 2011.

Oct. Law 53/2011 was passed, decreasing severance payments (from 30 to 20 days per year of tenure). See more details in Appendix 3.

Nov. Staff teams from the EC, ECB, and IMF visit Lisbon for the second quarterly review of Portugal's economic programme: "The mission has reached staff-level agreement on economic and financial policies to meet the programme's objectives. Strict implementation of these policies will be needed to restore external competitiveness, bolster confidence in the sustainability of public finances, and maintain financial stability while ensuring adequate credit in support of sustainable growth" (ECB).

Dec. The second review leads to the second regular update of the Programme in December 2011.

In line with the commitments of the Memorandum of Understanding, the target was to reduce at least 15 per cent of management positions and administrative units in the central administration by the end of December 2011. At the end of December 2011, the number of civil servants was in total 611,801, of which 458,353 in central administration, representing an approximate reduction by 6 per cent (or 36,511 persons) in the total number of civil servants and a reduction of about 11 per cent (or 54,071 persons) in civil servants in central administration compared to December 2010.

2012

Jan. Law 3/2012 was adopted, introducing a possibility to extend fixed-term contracts beyond ordinary limits (see more details in Appendix 3).

Feb. Staff teams from the EC, the ECB and the IMF visit Lisbon for the third quarterly review of Portugal's economic programme: "The mission concludes that policies are generally being implemented as planned and economic adjustment is under way but challenges remain. A determined implementation of reforms remains essential to ensure economic recovery and fiscal sustainability" (ECB).

Mar. The third review leads to the third update of the programme in March 2012.

Decree-Law 64/2012 is approved, introducing various changes into the unemployment benefit regime (see more details in Appendix 3).

June Staff teams from the EC, the ECB and the IMF visit Lisbon for the fourth quarterly review of Portugal's economic programme: "We conclude that the programme remains on track amidst continued challenges. While the authorities are implementing reform policies as planned and external adjustment is proceeding faster than expected, rising unemployment is becoming a pressing concern. The need to combine fiscal consolidation with deleveraging private balance sheets while restoring external cost competitiveness remains a difficult balancing act" (ECB).

The fourth review leads to the fourth update of the programme in June 2012.

Minister of State and Finance announces the recapitalization of the banking system. A governmental injection of more than €6.6 billion in three Portuguese banks, including approximately €5 billion from the Bank Solvency Support Facility (BSSF) within the financial assistance programme to Portugal, is carried out.

Law 23/2012 introducing the third modification of the Labour Code is adopted (see more details in Appendix 3).

July IMF completes fourth review under the Extended Fund Facility (EFF) arrangement with Portugal and approves a €1.48 billion disbursement after a request for a waiver of applicability of end-June performance criteria.

Sep. Staff teams from the EC, ECB and IMF visit Lisbon for the fifth quarterly review of Portugal's economic programme: "In 2012, despite headwinds from abroad, real GDP growth remains in line with projections, exports are performing better than expected, and the fast reduction in the external deficit is contributing to alleviating the external financing constraint. Nevertheless, higher unemployment, lower disposable incomes, and a shift in tax bases away from more highly-taxed activities are weighing on revenue collection. Against this backdrop, policy choices need to strike a balance between advancing the required fiscal adjustment and avoiding undue strains on the economy. Swift progress on structural reforms remains key to put the economy on a sustainable growth path. Maintaining broad political and social support for the revised adjustment program will also be important" (ECB).

Oct. IMF completes fifth review under the EFF arrangement with Portugal and approves a €1.5 billion disbursement.

The fifth review leads to the fifth update of the programme in October 2012.

Resolution No. 90/2012 is adopted by the Council of Ministers, introducing new criteria for the administrative extension of collective agreements (see more details in Appendix 3).

Nov. Staff teams from the EC, ECB and IMF visit Lisbon for the sixth quarterly review of Portugal's economic programme: "The program is broadly on track, despite stronger headwinds. With much already accomplished, strong commitment and perseverance need to be maintained as the program enters its second half. External and fiscal adjustment continues to advance, adequate capital and liquidity buffers have reduced financial stability risks, and structural reforms are proceeding apace. At the same time, rising unemployment, lower incomes, and uncertainty are weighing on confidence, while the recession in the euro area is beginning to bear on export dynamics. Given financing constraints and high debts, the program adequately balances the need to adjust, against the unavoidable costs of adjustment for economic activity and jobs" (ECB).

Dec. The sixth review leads to the sixth update of the programme in December 2012.

By end of December 2012, the number of civil servants had been reduced to 584,228 with 436,103 persons working in central administration. This represented a reduction of about 4.5 per cent (27,573 persons) overall, and of about 4.9 per cent (22,250 persons) in central administration and 3.5 per cent (5,323 persons) in regional and local administration. The reduction targets in the Memorandum of Understanding are 1 per cent yearly cuts in central administration and 2 per cent yearly cuts in regional and local administration. The reduction target was raised to 2 per cent for central administration in the December 2012 update of the Memorandum (to be achieved by limiting staff admissions 2012–2014).

2013

Jan. IMF completes sixth review under the EFF arrangement with Portugal and approves a €838.8 million disbursement.

Portugal makes its comeback on the financial market for the first time since the Financial Assistance Programme was entered into in May 2011.

Mar. Staff teams from the EC, the ECB and the IMF visit Lisbon for the seventh quarterly review of Portugal's economic adjustment programme: "Program implementation remains broadly on track, against the background of difficult economic conditions. The end-2012 fiscal deficit target was met, financial sector stability has been safeguarded, and a wide range of structural reforms is progressing. External adjustment continued to exceed expectations. And the government has resumed issuance in the bond market, while domestic financing conditions have eased somewhat. At the same time, weakening export demand, particularly from the euro area, low confidence, and the private sector debt overhang are providing stronger-than-expected headwinds to economic activity. As during previous reviews, policy choices and implementation of the program were re-evaluated in light of the new circumstances" (ECB).

5 Apr. The Constitutional Court rejects some of the austerity measures in the 2013 Annual Budget considered essential by the Government to meet the mandatory deficit targets (four measures ruled unconstitutional, including cuts in public sector and state pensions, estimated at about €1.3 billion in expected revenue and savings, more than 20 per cent of the total planned from austerity measures).

7 Apr. The Prime Minister, in an address to the nation, calls for severe cuts in public spending to keep the country's financial assistance programme on track. Passos Coelho says there would be no new tax hikes in 2013 but that measures would be taken to "contain public spending in the areas of social security, health and education".

11 Apr. The Prime Minister sends a letter to the IMF, EC and ECB indicating changes underway on wages, labour legislation and pensions (levelling wages in public and private sectors). He also announces that the Government has a plan to cut €4 billion and, if necessary, to substitute the measures rejected by the Constitutional Court by others of equivalent value.

15-16 Apr. The IMF, EC and ECB visit Lisbon to discuss the alternative compensatory measures proposed as well as the State reform.

3 May The Prime Minister, in an address to the nation, announces, among other measures, a €4.8 billion cut in public spending over the next three years, including an increase in the legal retirement age from 65 to 66, a reduction of 30,000 civil servants, an increase of the weekly working hours in the public sector from 35 to 40, a reduction of the annual leave from 25 to 22 days in public administration and the creation of a new permanent tax on pensions.

7 May Portugal issues its first new government bonds since the start of the Financial Assistance Programme (May 2011), in a heavily oversubscribed offer of ten-year debt that raised €3 billion, at a 5.69 per cent rate (6.72 per cent in January 2011).

12 June The Government of Portugal sends a letter of intent to the IMF describing the policies that Portugal intends to implement in the context of its request for financial support from the IMF. On the basis of the policies defined in the letter, and in light of the country's performance under the programme, the Government requests the completion of the seventh review under the Extended Arrangement and the eighth purchase under the arrangement in the amount of SDR574 million.

The Executive Board of the International Monetary Fund (IMF) completes the seventh review of Portugal's performance. The completion of the review enables the immediate disbursement of an amount equivalent to SDR574 million (about €657.47 million), bringing total disbursements under the EFF arrangement to SDR19.700 billion (about €22.56 billion).

The IMF's seventh review under the Extended Arrangement and request for modification of end-June performance criteria, following discussions with the officials of Portugal on economic developments and policies that ended in May 2013, is undertaken.

Seventh regular update of the programme is undertaken.

20-21 June A decision on maturities extension is taken by the Economic and Financial Affairs Council (Ecofin) (seven years).

31 June By the end of June, the number of civil servants has been reduced to 574,946 overall, of which 428,187 in central administration. Overall, this represents a reduction of about 2 per cent compared to December 2012.

29 Aug. The Constitutional Court examines the compatibility of new austerity measures with the Constitution, finding one of them unconstitutional (see more details in Appendix 3).

1 Sep. Law 63/2013 enters into force, introducing a procedure concerning the enforcement of the Labour Code's (2009) stipulations about "presumed employment contract" in the case of misuse of service provider contracts in an employment relationship (so-called "falsos recibos verdes"; see more details in Box 1 in the main text).

1 Oct. Law 69/2013 (adopted in August 2013) enters into force, further reducing severance payments (see more details in Appendix 3).

Law 70/2013 (adopted in August 2013) enters into force, establishing a compensation fund for severance payments (see more details in Appendix 3).

18 Oct. Parliament approves the law proposal on convergence of pension systems in the public and private sectors, entailing cuts in public sector pensions (see more details in Appendix 3).

8 Nov. The IMF completes the eighth and ninth reviews under an EFF arrangement with Portugal, and approves an immediate €1.91 billion disbursement (SDR 1.679 billion), bringing total disbursements under the EFF arrangement to SDR 21.379 billion (about €24.34 billion).

APPENDIX 2
OVERVIEW OF THE FINANCIAL ASSISTANCE PROGRAMME FOR PORTUGAL

The 2011–2014 EU/IMF Financial Assistance Programme for Portugal has a total volume, agreed over the three years, of around €78 billion (the IMF amount, in euros, is subject to fluctuations in the exchange rate at time of disbursements).

This value is to be lent by the European Financial System Mechanism (EFSM) to an amount of €26 billion; by the European Financial Stability Facility (EFSF) to an amount of another €26 billion (altogether €52 billion from the EU); and by the IMF Extended Fund Facility (EFF) to an amount of SDR23.742 billion (around another €26 billion at the time of agreement).

Summary Table 1 EU financial assistance to Portugal (EFSM – European Financial Stabilisation Mechanism)

Date	Euros	Maturity (yr)	Sub-totals in Euros
May 2011	1.75 billion	10	1.75 billion
June 2011	4.75 billion	5	6.5 billion
Sep. 2011	5.0 billion	10	11.5 billion
Sep. 2011	2.0 billion	15	13.5 billion
Oct. 2011	600 million	7	14.1 billion
Jan. 2012	1.5 billion	30	15.6 billion
Apr. 2012	1.8 billion	26	17.4 billion
May 2012	2.7 billion	10	20.1 billion
Oct. 2012	2.0 billion	15	22.1 billion
TOTAL AGREED			**26.0 billion**

Note: Principal repaid at each tranche's maturity. Disbursements: up to 14 instalments (which may be disbursed in one or more tranches), subject to conditionality. Programme carried out by 85 per cent. Average maturity: 7.5 years.

Summary Table 2 EU financial assistance to Portugal (EFSF – European Financial Stability Facility)

Date	Euros	Maturity (yr)	Sub-totals in Euros
June 2011	3.7 billion	25 (2036)	3.7 billion
June 2011	2.2 billion	14 (2025)	5.9 billion
Dec. 2011	1 billion	14 (2025)	6.9 billion
Jan. 2012	1.7 billion	23 (2035)	8.6 billion
Jan. 2012	1 billion	15 (2027)	9.6 billion
May 2012	3.5 billion	20 (2032)	14.8 billion
May 2012	1.7 billion	23 (2035)	16.5 billion
July 2012	1.5 billion	26 (2038)	18 billion
July 2012	1.1 billion	28 (2040)	19.1 billion
Dec. 2012	800 million	16 (2028)	19.9 billion
Feb. 2013	800 million	13 (2026)	20.7 billion
June 2013	1.05 billion	20 (2033)	21.75 billion
June 2013	1.05 billion	21 (2034)	22.8 billion
Nov. 2013	3.7 billion	20 (2033)	24.8 billion
TOTAL AGREED			**26.0 billion**

Note: Principal repaid at each tranche's maturity. Disbursements: up to 14 instalments (which may be disbursed in one or more tranches), subject to conditionality. Programme carried out by 98.38 per cent. Average maturity: 7.5 years. http://www.efsf.europa.eu/about/operations/index.htm

Summary Table 3 IMF disbursements under EFF (Extended Fund Facility) (total amount agreed SDR 23.742 billion)

EU-17	Euros	SDR	Sub-totals SDR	Moment of disbursement
May 2011	6.1 billion	5.6 billion	5.6 billion	Programme
Sep. 2011	3.98 billion	3.467 billion	9.078 billion	1st review
Dec. 2011	2.9 billion	2.425 billion	11.503 billion	2nd review
Apr. 2012	5.17 billion	4.443 billion	15.946 billion	3rd review
Aug. 2012	1.48 billion	1.197 billion	17.143 billion	4th review
Nov. 2012	1.5 billion	1.259 billion	18.402 billion	5th review
Jan. 2013	838.8 million	724 million	19.126 billion	6th review
June 2013	657.47 million	574 million	19.700 billion	7th review
Nov. 2013	1.91 billion	1.679 billion	21.379 billion	8th, 9th reviews
TOTAL AGREED			**23.742 billion**	

Note: Disbursements: up to 13 quarterly tranches subject to conditionality. Repayments to IMF: from 2015 to 2024 (for each tranche; 12 equal semi-annual repayments between 4.5 to 10 years from original drawing date). Programme carried out by 90 per cent. Average maturity: 7.5 years. The totals in euros for the IMF funds refer to the time of disbursement. Payments in euros are subject to fluctuations in the exchange rate. http://www.imf.org/external/pubs/ft/scr/2013/cr13324.pdf

The disbursements, as of November 2013, attained a high degree of execution (EFSM by 85 per cent; EFSF by 98.38 per cent; IMF by 90 per cent), for a total volume disbursed of around €71.4 billion.

Repayments are planned in various stages until 2042. A decision on maturities extension was taken on 20–21 June 2013 by the Economic and Financial Affairs Council (Ecofin) (by seven years, from 12.5 to 19.5 years).

APPENDIX 3
THE LABOUR MARKET REFORM IN PORTUGAL

Prior to the Economic and Structural Adjustment Programme launched in 2011, Portugal was ranked at the top of listings of European countries in terms of strictness of labour regulation. The legal framework of employment contracts followed the model of "typical labour relations", and from the mid-1970s onwards, collective agreements were conceived as a way to introduce better conditions of work than provided by legal provisions, and collective agreements would only be replaced by ones with more favourable conditions. Against this background, among the main motivations for the changes in the Labour Code in 2003 and in 2009 was the need to increase the competitiveness of the companies and the economy as a whole, and through that to boost job creation – a tendency towards more "external and internal flexibility" that was witnessed all the way from the 1990s. These modifications to the Labour Code introduced (or integrated) already, among others, a "time bank" (through IRCT)[91] and concentrated working hours; part-time work, telework and work on call; as well as functional and geographical mobility.[92, 93] The flexibility measures concerning temporary contracts in these reforms were, de facto, changes affecting new hires, which means that they mainly applied to the new entrants into the labour market (such as young people) or high rotation workers (such as those with a low educational level).

The turning point in the legal regulation reform was May 2011, when the Memorandum of Understanding negotiated between the Portuguese authorities and the EC, the IMF, and the ECB (troika), was signed. The Economic Adjustment Programme for Portugal includes a joint financing package of €78 billion and covers the period 2011 to mid-2014. The conditionality package for financial assistance required the Portuguese Government to introduce a series of reforms aimed at tackling the rising unemployment through increasing labour market flexibility (but also fighting duality) and through

[90] For a detailed review on Labour Law changes implemented after the Memorandum, see Palma Ramalho (forthcoming).
[91] *Instrumento de regulamentação coletiva do trabalho* (IRCT).
[92] See, for example, Pestana Nascimento (2012) and Palma Ramalho (forthcoming).
[93] Palma Ramalho (forthcoming).

wage reductions with a view to decreasing the operating costs for companies. In line with the Memorandum and its subsequent revisions,[94] significant changes were thus introduced in five different areas: unemployment benefits, employment protection legislation, working time arrangements, collective bargaining and active labour market policies. These changes were negotiated at the national level with the social partners, and led into the adoption of an Agreement for growth, competitiveness and employment (*Compromisso para o Crescimento, Competitividade e Emprego*)[95] on 18 January 2012 with the social partners (excluding Confederação Geral dos Trabalhadores Portugueses (CGTP)). In addition, the Government adopted measures with a view to reducing public sector employment, wages and pensions in order to meet the savings targets, which to some extent were also mentioned in the January 2012 Agreement.

The Portugal Memorandum of Understanding on Specific Economic Policy Conditionality of 17 May 2011, and its updates, list as the objectives of the labour market reforms: (i) revision of the unemployment insurance system to reduce the risk of long-term unemployment while strengthening social safety nets; (ii) reform of employment protection legislation to tackle labour market segmentation; (iii) fostering job creation; (iv) easing the transition of workers across occupations, firms and sectors; (v) easing working time arrangements to contain employment fluctuations over the cycle; (vi) better accommodation of differences in work patterns across sectors and firms and enhancing firms' competitiveness; (vii) promotion of labour cost developments in line with job creation and enhanced competitiveness; and (viii) ensuring good practices and appropriate resources to ALMPs (employability of the young and disadvantaged categories of people; tackling labour market mismatches). In addition, the objective was to address early school leaving and to improve the quality of secondary education and vocational education and training for more efficient access to the labour market. Differing from

[94] The Memorandum of Understanding was updated for the seventh time in June 2013: http://www.imf.org/external/np/loi/2013/prt/061213.pdf
[95] http://www.portugal.gov.pt/media/424132/compromisso_crescimento_competitividade_emprego.pdf

the other sections of the Memorandum, the chapter on "Labour market and education" refers to the *social partners* and their role in the reform process: according to the text, reforms in labour and social security legislation would be implemented after consultation of the social partners. In addition, the labour market reforms would be undertaken taking into account possible constitutional implications, and in respect of *EU Directives* and *Core Labour Standards*.[96]

The major legal changes introduced as a result of the reform commitments in the above-mentioned areas during 2011–2013 were:

Unemployment benefits

- Reduction in the maximum limit of unemployment benefit from €1,257.66 to €1,048.05,[97] with a reduction of 10 per cent after six months of unemployment. In addition, a reduction in the maximum length of time the benefit can be paid (from 900 to 540 days; or 30 months to 18 months) with a view to disincentivizing the permanence of workers in a situation of unemployment (Decree-Law 64/2012).
- Decrease in the necessary contributory period to access unemployment benefits from 450 to 360 days (or from 15 to 12 months) (Ibid.).
- Temporary increase (10 per cent) in the unemployment benefit in the case of jobless households where both members of the couple are not working and have children; and correspondingly in single-parent households where the single parent is unemployed and does not benefit from a subsistence pension (Ibid.).
- Extension of the unemployment insurance to clearly-defined categories of "dependent" self-employed workers,[98] working mainly with one contractor, on certain conditions (Decree-Law 65/2012,[99] see more details in the main text, Box 1).

[96] Portugal, Memorandum of Understanding on Specific Economic Policy Conditionality, 17 May 2011.
[97] Decree-Law 64/2012, 15 Mar. 2012; Calculation of the amount by Pestana Nascimento (2012). The Decree-Law is available at: http://dre.pt/pdf1s/2012/03/05400/0123701242.pdf
[98] Referred to as "falsos recibos verdes" in the article by Pestana Nascimento (2012).
[99] Decree-Law 65/2012, 15 Mar. 2012; http://dre.pt/pdf1sdip/2012/03/05400/0124201244.pdf

Employment protection (see a more in-depth discussion below)

- Equalisation of the severance payment regime of open-ended contracts with that of fixed-term contracts, and alignment of the amounts of severance payment to those of other EU countries (Law 53/2011;[100] Law 23/2012[101] and Law 69/2013[102]). Law 70/2013,[103] entering into force 1 October 2013, established a fund responsible for the payment of a part of the severance payment in case of a dismissal.
- Introduction of new and less restrictive definitions of fair dismissal for open-ended contracts, linked particularly to the extinction of a work position and also to the unsuitability of the worker, although for the latter the impact of the changes in practice may not be major (Law 23/2012).[104] In order to avoid increased unemployment during the present crisis, a possibility was introduced to extend fixed-term contracts beyond maximum time limits or maximum number of extensions maximum twice and up to 18 months in total (Law 3/2012).[105]
- Introduction of a procedure concerning the enforcement of the Labour Code's (2009) stipulations about "presumed employment contract" in the case of misuse of service provider contracts in an employment relationship (Law 63/2013;[106] see more details in Box 1 in the main text).

Working time arrangements

- Introduction of changes into working hours through permitting the adoption of a "time bank" (for individuals and groups),[107] negotiated at the plant level (Law 23/2012).

[100] Law 53/2011, 14 Oct. 2011; http://dre.pt/pdf1s/2011/10/19800/0463604638.pdf
[101] Law 23/2012, 25 June 2012, http://dre.pt/pdf1sdip/2012/06/12100/0315803169.pdf
[102] Law 69/2013, 30 Aug. 2013 (Fifth modification to the Labour Code). This law further reduced severance payments and entered into force 1 Oct. 2013. http://dre.pt/pdf1sdip/2013/08/16700/0525105254.pdf See further below.
[103] Law 70/2013, 30 Aug. 2013 (*Estabelece os regimes jurídicos do fundo de compensação do trabalho, do mecanismo equivalente e do fundo de garantia de compensação do trabalho*); http://dre.pt/pdf1sdip/2013/08/16700/0525405264.pdf
[104] This was against a background where in Portugal it was very difficult to terminate indefinite contracts, which led to major contracting on a fixed-term basis as well as to "dependent self-employment" or "falsos recibos verdes".
[105] Law 3/2012, 10 Jan. 2012; http://webmanager.ipc.pt/mgallery/default.asp?obj=4175
[106] Law 63/2013, 27 Aug. 2013; http://dre.pt/pdf1sdip/2013/08/16400/0516805169.pdf
[107] According to Article 208 of the Labour Code, an individual time bank (*banco de horas individual*) can be constituted based on an agreement between the employer and the worker, and enabling an increase of daily working hours by two hours, reaching 50 hours per week, and with a limit of an increase of 150 hours per year. The additional working hours can be compensated by a corresponding reduction in working hours, increase in vacation and / or payment in money.

- Reduction by 50 per cent of both the minimum additional pay for overtime work and of compensatory time-off for overtime work (Ibid.).
- Revision of provisions concerning layoffs in case of industrial crisis.
- Cuts in paid holiday entitlements and the abolition of four public holidays (Law 23/2012).

Collective bargaining (see a more in-depth discussion below)

- Introduction of criteria for the administrative extension of collective agreements, leading to significantly fewer extensions[108] (Resolution No. 90/2012 by Council of Ministers)[109].
- Introduction of "organized decentralization" of collective bargaining (Law 23/2012).[110]

Wages

- Tying minimum wages to competitiveness and productivity, and subjecting any increases to an agreement in connection with a programme review.[111]
- Freezing the minimum wage at €485 per month since January 2011.

Furthermore, measures directly affecting the labour market were introduced under the Fiscal Policy and Fiscal-Structural Measures sections of the Memorandum of Understanding. The objective of the Fiscal Policy,

[108] In 2012, according to the 9 Dec. 2011 update of the Memorandum of Economic and Financial Policies commitments, no automatic extensions on Collective Bargaining Agreements were to be approved, whilst waiting for the final changes in the criteria for extensions passed into law through the Resolution 90/2012 by the Council of Ministers on 10 Oct. 2012.

[109] Resolution 90/2012 by the Council of Ministers, http://dre.pt/pdf1sdip/2012/10/21100/0626506266.pdf

[110] The Memorandum of Understanding refers to the following modifications in this regard: (i) the possibility for works councils to negotiate functional and geographical mobility conditions and working time arrangements; (ii) the creation of a Labour Relations Centre supporting social dialogue with improved information and providing technical assistance to parties involved in negotiations; (iii) the lowering of the firm size threshold, above which works councils can conclude firm-level agreements, to 250 employees; (iv) promotion of the inclusion in sectoral collective agreements of conditions under which works councils can conclude firm-level agreements without the delegation of unions. In Portugal, Law 23/2012 allows workers' councils to negotiate at plant level in firms with a minimum number of 150 employees, but still under the delegation of trade unions. Another regulation, Decree-Law No. 189/2012, introduced the Labour Relations Centre.

[111] In the Memorandum, the Government made a commitment that, over the programme period, any increase in the minimum wage will take place only if justified by economic and labour market developments and agreed in the framework of a programme review. Wage moderation was also ensured in 2012 by not extending collective agreements until clear criteria for extensions were defined, and also after that through restricting the use of automatic extensions.

as outlined in the 2011 Memorandum and its updates, was to reduce the government deficit gradually from 5.9 per cent of GDP in 2011 to 3 per cent of GDP in 2013. The reductions were to be done "minimizing impacts of consolidation on vulnerable groups". In addition, the objective was to bring the government debt-to-GDP ratio on a downward path as of 2013 and to maintain fiscal consolidation over the medium term up to a balanced budgetary position, by containing expenditure growth and by supporting competitiveness. Fiscal-Structural Measures, in turn, aimed at improving the efficiency of the public administration by – among others – eliminating redundancies, simplifying procedures and reorganizing services.

Public Sector Employment

In the Memorandum of Understanding, the Government committed itself to the following savings objectives in the public sector:

- Reduction in the number of government employees through limiting admissions in public administration to achieve annual decreases of 1 per cent in the staff of central and 2 per cent in the staff of local and regional administration during the period 2012–2014.[112] The reduction target was raised to 2 per cent also for central administration in the December 2012 update of the Memorandum of Understanding (to be achieved by limiting staff admissions 2012–2014).
- Reduction of management positions and administrative units by at least 15 per cent in the central administration by end of 2011. The same objective covered also the local administration, with reductions expected by the end of June 2012 (Memorandum of Economic and Financial Policies, 17 May 2011). In the update of the Memorandum of Understanding 9 December 2011, the target was set to a reduction of management positions and administrative units in the central administration by 27 per cent and 40 per cent, respectively.

[112] In real terms, at the end of 2012 there was a nearly 5 per cent decrease in the staff of central administration (compared to Dec. 2011) and a 3.5 per cent decrease in the staff of local and regional administration (compared to Dec. 2011).

- Introduction of a freeze in wages in nominal terms during 2012–2013. According to the plan presented in the Memorandum of Understanding, the reduction of wages for all general government sector employees in 2012 would be carried out through (i) suspending the 13th and 14th monthly salary payments for those workers with monthly salaries of €1,100 or more, and (ii) suspending on average and in a progressive way the equivalent of one of those two salaries for workers with monthly salaries between €600 and €1,100. These measures also covered State-owned enterprises.

Social Protection

In the Memorandum of Understanding, the Government committed itself to the following savings objectives in social protection:

- Reduction of pensions above €1,500 according to the progressive rates applied to public sector wages as of January 2011 (savings target €445 million in 2011).
- Suspension of the application of pension indexation rules; and introduction of a freeze in pensions, except for the lowest pensions (savings target €1,140 million in 2012).[113]
- Reduction of the costs to employer of government employees' health schemes.

[113] In 2012, the objective was thus to (i) suspend the 13th and 14th monthly payments for those pensioners with monthly pension benefits of €1,100 or more; and (ii) suspend on average and in a progressive way the equivalent of one of those monthly benefits for pensioners with monthly pension benefits between €600 and €1,100. The pensions for those receiving benefits below €600 were to be frozen whilst the lowest pensions were to be marginally increased.

CONSTITUTIONAL COURT'S RULINGS ON AUSTERITY MEASURES

Austerity measures addressing the public sector in Portugal have faced major difficulties in implementation. The measures adopted in line with the Memorandum of Understanding were first ruled unconstitutional by the Portuguese Constitutional Court on 5 April 2013. In this case, four out of nine austerity measures in the 2013 state budget were found unlawful and in breach of the country's constitution. The Court ruled that the measures were in breach of the principle of equality laid down in Article 13 of Portugal's Constitution, as the measures suspending holiday allowances (14th monthly payment) to public sector workers were deemed discriminatory in relation to private sector workers. The extension of these cuts to pensioners was equally declared unconstitutional. In addition, based on the principle of proportionality, the court ruled that introducing a levy of 5 per cent on sickness allowance and 6 per cent on unemployment benefit also infringed the Constitution.

Faced with the need to maintain the planned level of savings, the Government introduced new austerity measures in May 2013. This savings package encompassed various measures,[114] including reforms on civil servants' jobs, salaries and working time, as well as pensioners' incomes: the update of the Memorandum 2013 foresaw a reduction in the size of the public sector workforce, addressing "excessive employment in particular sub-sectors" with the aim of increasing the share of "highly-skilled and better-trained civil servants"; a convergence of the public sector working arrangements towards private sector regimes (working hours, working time arrangements, holiday entitlements); an increase in the workers' health contributions; and a simplification of the remuneration policy. One way of reducing the workforce was the introduction of 40 working hours in a week. A new tax was to be introduced for pensioners with earnings surpassing a set level, and retirement age (without financial penalties) raised to 66.[115] According to the latest update of the Memorandum, the reform measures on the public sector wage bill were to generate at least one third of the planned savings (€2.2 billion); and the comprehensive pension reform was expected to bring significant

[114] According to the update of the Memorandum of Understanding 12 June 2013, these measures included mainly (i) expenditure compression in line ministries; (ii) a reprogramming of EU structural funds; and (iii) a minimum threshold for applying the contribution on illness and unemployment benefits. The Government noted that some of these savings were of a temporary nature (update 12 June 2013, Attachment 1, p. 5).

[115] Campos Lima (2013).

savings as well. In addition, various sector-specific reforms mainly relied on "targeted dismissals of personnel and intermediate consumption cuts". The Constitutional Court examined the new measures' compatibility with the Constitution, and ruled on 29 August 2013 that one of the planned austerity measures aiming at public sector employment cuts was unconstitutional in that it violated employment security and the trust between the employer and the employee. In addition, certain articles were found disproportionate. With this ruling, it will not be possible to carry out the reductions in the number of civil servants in the planned manner.[116]

EMPLOYMENT PROTECTION LEGISLATION

Before 2011, Portugal had one of the largest compensations for dismissed workers with open-ended contracts among European countries. Especially at long tenure, severance payments for open-ended contracts were highly costly, as entitlements to severance pay increased with seniority and had no upper bound. Another characteristic of the Portuguese labour regulation was the relatively strict definition of fair dismissal concerning open-ended contracts, deriving from the Constitution itself, and leading to a situation where employers would see it very complicated in practice to dismiss a worker on an open-ended contract. In contrast, legislation for fixed-term contracts was significantly eased in the last decade. As a result of such an acute asymmetry between open-ended and fixed-term contracts, the proportion of employees with temporary contracts increased substantially over the past years (the so-called 'duality' of the labour market).

The Memorandum of Understanding identified the gap in firing costs (mainly in severance payments) as one the main sources of labour market duality in Portugal. Following the recommendations set in the Memorandum, Law 53/2011 established a new framework based on two pillars: (i) alignment of the severance payments for open-ended contracts to those of fixed-term contracts; and (ii) institution of a mutual fund to partly finance severance payments.

[116] See the original judgment at: http://www.tribunalconstitucional.pt/tc/acordaos/20130474.html

Law 53/2011 decreased total severance payments for new open-ended contracts from 30 to 20 days per year of tenure (out of which ten days were to be paid by a fund financed by employers) with a cap of 12 months. With the aim of closing the gap between open-ended and fixed-term contract severance payments, the three months of salary for open-ended contracts irrespective of tenure were eliminated.[117] The dismissal fund[118] was established with Law 70/2013 which entered into force 1 October 2013.

During the seventh review of the Memorandum, the Portuguese Government pointed at further limits for severance payments in order to align them with the EU average (8/12 days). The desired changes were passed into law through Law 69/2013 of 30 August 2013, which entered into force 1 October 2013. This law further reduces severance payments: from 20 days of base remuneration and seniority per year of service, the basis was reduced to 18 days of base remuneration and seniority per year of service for fixed-term contracts (*contrato de trabalho a termo certo*); and to 18 days of base remuneration and seniority for the first three years of service and 12 days for the following years for unfixed-term employment contracts (*contrato de trabalho a termo incerto*). In the case of collective dismissal, the corresponding number of days is 12. There is a transitory regime in the case of terminating open-ended (*contrato de trabalho sem termo*), fixed-term (*contrato de trabalho a termo*) and temporary contracts (*trabalho temporário*) which started before the entry into force of the Law in question.

Law 23/2012 defined fair dismissal for open-ended contracts in a less restrictive manner in two respects, namely concerning (i) extinction of a work position; and (ii) inadaptability/unsuitability of the worker. In the case of inadaptability or unsuitability of the worker, the requirement of introduction of new technologies in the company as the initial basis for later establishment of inadaptability, was removed from the law. However, despite this, the process of dismissal based on inadaptability/unsuitability continues to be complex, leading some authors to suspect that the clause will be little used in

[117] While according to the Law 53/2011 the above reductions first applied to new hires, Law 23/2012 extended these measures to all employment contracts.
[118] The Law introduced the following institutions: *fundo de compensação do trabalho, mecanismo equivalente; fundo de garantia de compensação do trabalho.*

practice.[119] More significant changes happened with respect to the extinction of a work position. Before the entry into force of Law 23/2012 there was a detailed process described by law concerning the seniority order,[120] in which an employer should dismiss workers in a case of extinction of a work position. Law 23/2012 abolished the obligation for the employer to follow this order of criteria, but requested the employer to define relevant and non-discriminatory criteria in relation to the extinction of the work position. Also, the employer was required to demonstrate a causal link between the basis for the extinction of the work position and the defined criteria. In addition, prior to the changes, an employer could only eliminate a work position in case s/he could not offer another job suitable for the worker's professional profile. This requirement was removed from the law, but academics believe that it would not come to bring significant changes in practice in that if the employer indeed eliminated a work position, but at the same time would need to recruit workers of the same professional category, it would hardly be accepted, as the dismissed worker could do the new job.[121]

With a view to tackling labour market segmentation through the use of so-called "dependent self-employment" or "falsos recibos verdes", Law 63/2013 was enacted to provide tools to labour inspectors in the enforcement of the Labour Code's (2009) stipulations about "presumed employment contract". In a case where a labour inspector detects "misuse of service provider contracts" in an employment relationship, the new law stipulates a procedure to follow in order to tackle the situation, first by giving the employer the possibility to regularize the situation, and then – if not successful – leading to a process with a view to establishing the existence of an employment contract (Law 63/2013;[122] see more details in Box 1 in the main text). The new law came into force 1 September 2013.

[119] See Pestana Nascimento (2012). Dismissal for inadaptability or unsuitability can happen if – cumulatively – the following requirements are met: (a) substantial and permanent change in the worker performance which leads to continued decline in productivity or quality, repeated mistakes or risks for security and safety of the worker, other workers or third parties; (b) employer informs the worker, with relevant documents, about his/her performance before, the facts of the case, demonstrating substantial change in performance; (c) after a response by the worker or elapse of the time period assigned, the employer needs to provide instructions in writing to the worker with a view to correcting the situation. In addition, the employer must assure that appropriate vocational training will be given to the worker (by a vocational training institution), including a period of adaptation of at least 30 days after the training. After this, if the required improvement has not happened, the actual legislated dismissal process will begin.

[120] In a case where there were several work positions of the same type, the employer was obliged to terminate the position of a worker with (a) less seniority in the position; (b) with less seniority in the professional category; (c) with a lower class in the same professional category; and (d) with less seniority in the company. Thus issues such as qualifications or effectiveness of the worker did not play a role in the process.

[121] See, for example, Pestana Nascimento (2012).

[122] Law 63/2013, 27 Aug.2013; http://dre.pt/pdf1sdip/2013/08/16400/0516805169.pdf

COLLECTIVE BARGAINING

There is a long tradition of collective bargaining and collective agreements at the branch and professional level in Portugal.[123] As seen above, over the years collective agreements became instruments which would improve the conditions set by law and previous collective agreements, thus they stayed in force often for a long time if more favourable conditions could not be negotiated (apart from updates to wages).[124] Up to the changes introduced as a result of the Memorandum, the Portuguese industrial and labour relations were further characterized by the frequent use of administrative extensions (*portaria de extensão*) to cover non-affiliated workers due to the low trade union membership in Portugal.

However, in the last four years the number of collective agreements as well as the coverage of workers has decreased considerably. According to the Direção-Geral do Emprego e das Relações de Trabalho (DGERT-DERT), 304 negotiated instruments of collective bargaining were concluded in 2008,[125] whilst in 2012 these were 93.[126] The most significant decline happened from 2011 to 2012, when the number of negotiated agreements dropped by almost 50 per cent.[127] In relative terms, the share of company-level agreements out of all agreements negotiated was rising during 2008–2012, but in absolute numbers even the number of company-level agreements decreased. In 2008, 95 company-level agreements were negotiated whilst at the same time altogether 200 collective agreements (ACTs and CCTs) were concluded. In 2012, agreement was reached on 39 (40)[128] company-level agreements, whereas the number of concluded branch and professional agreements was altogether 46 (ACTs and CCTs). In relative terms, company-level agreements made up 32 per cent of the bulk of collective agreements

[123] In 2002, 84.1 per cent of collective agreements were top-level sector agreements. See more in Palma Ramalho (forthcoming).
[124] See Palma Ramalho (forthcoming).
[125] *Instrumentos de regulamentação coletiva negociais*.
[126] According to the latest statistics available from the Directorate-General of Employment and Industrial Relations, these 93 agreements consisted of CCTs (*Contrato colectivo de trabalho*, 36); ACTs (*Acordo colectivo de trabalho*, 9); AEs (*Acordo de empresa*, 40) and AAs (*Acordos de adesão* (extension agreed between the parties), 8). In addition to these, in 2012 there were 12 administrative extensions, as well as one extension concerning working conditions, as well as one arbitration award, thus bringing the total number of collective instruments (*Instrumento de regulamentação colectiva do trabalho*) to 107. http://www.dgert.mtss.gov.pt/trabalho/trabalho_p.htm; [accessed 27 Sept. 2013].
[127] DGERT ; *Relatório sobre regulamentação coletiva de trabalho publicada no ano de 2012*.
[128] The latest DGERT statistics refer to 40 company-level agreeements, whilst UGT refers to 39 company-level agreements concluded in 2012 (*Relatório Annual da Negociação Colectiva de 2012*).

concluded in 2008,[129] whilst in 2012 the corresponding figure was about 46 per cent (47 per cent).

On the basis of the above, there seems to be a trend towards more company-level agreements in relative terms, but at the same time the absolute number of enterprise-level agreements has been reducing, despite Law 23/2012 promoting decentralization of collective bargaining by allowing workers' councils (estrutura de representação coletiva dos trabalhadores na empresa) to negotiate at the plant-level with a minimum number of 150 employees, after delegation by a union. It should be noted, however, that Law 23/2012 entered into force only 1 August 2013, which is why its effects could be better seen in the figures for 2013. Figures for the first half of 2013 indicate that the number of enterprise-level agreements (24) has exceeded that of branch and professional agreements (CCTs and ACTs altogether 21),[130] whilst the trend towards fewer agreements overall seems to continue, with altogether 45 agreements concluded in the first half of the year.

When discussing the coverage of workers by collective bargaining agreements, we need to bear in mind that trade union membership in Portugal is traditionally quite low. Less than 20 per cent of workers were members of a union in 2010,[131] and estimates prior to that move between 20-30 per cent. In order to broaden the share of workers benefiting from collective agreements, it was common practice to extend the agreements to workers not belonging to signatory organizations, as seen above. Such extensions used to lead to about 70–80 per cent of coverage of workers by collective agreements.[132] One of the objectives originally set in the Memorandum was to ensure wage moderation by limiting the extensions of collective agreements until clear criteria for extensions were defined. As a result, only 12

[129] ACTs, CCTs and AEs.
[130] http://www.dgert.mtss.gov.pt/trabalho/trabalho_p.htm [accessed 27 Sept. 2013].
[131] OECD statistics accessed at http://stats.oecd.org/Index.aspx?DataSetCode=UN_DEN [27 Sept. 2013).
[132] GEE/MEE (2006).

extension ordinances were published in 2012 in contrast to the 116 adopted in 2010. This led to a sharp decline in the number of workers covered by collective agreements, as worker coverage in the private sector dropped from 1,236,000 in 2011 to only 327,600 workers in 2012.[133] The overall figure for workers covered in 2012 reached 404,756 workers, and the 45 collective agreements concluded in the first half of 2013 so far cover 194,538 workers. The major declining trend in worker coverage is thus clearly visible, and possibly this could also discourage negotiating collective agreements in general, as the parties know that the agreements will not be given general effect.[134]

Precise criteria for extending collective agreements to non-unionized workers and to companies not affiliated to employers' organizations were defined by Resolution No. 90/2012 of the Council of Ministers (10 October 2012). According to the new criteria, the employer party to the agreement, for which extension is sought, should cover at least 50 per cent of workers in the branch, geographical area, professional category and type of company in order for an extension to be granted. The Resolution further states that the requirements are not applicable when the extension request excludes micro-, small and medium-sized enterprises.

ACTIVE LABOUR MARKET POLICIES (ALMPS)

The Memorandum of Understanding envisages ALMPs targeting in particular the employability of young people and the disadvantaged categories of people, as well as tackling labour market mismatches. In addition, through policies relating to vocational training, the objective was to address early school leaving and to improve the linkages from education to the labour market. As a response to this, according to the Memorandum update of 15 March 2012, the Portuguese Government introduced short-term stimulus programmes to provide wage subsidies for companies to hire and train job seekers registered with public employment services (PES); whilst youth unemployment was being tackled through a cross-country task force.

[133] UGT (2012).
[134] See more details about this in Palma Ramalho (forthcoming), who indicates that both employers and workers have expressed this opinion.

APPENDIX 4
TECHNICAL DETAILS ABOUT SIMULATIONS INCLUDED IN CHAPTER 3

The policy assessments presented in Chapter C are based on the ILO Global Economic Linkages (GEL) model. The GEL belongs to the class of dynamic stochastic general equilibrium models, which share the property that, under a set of hypotheses, the dynamic adjustment of the economy to any unforeseen (stochastic) shock would eventually bring all markets (general) back to their initial equilibrium.

Three features of the GEL model are particularly relevant to the policy simulations presented in this report.[135]

First, the GEL establishes a link between income distribution and consumption by acknowledging that not all households have access to the financial market.[136] Unlike higher income households, finance-constrained households receive labour income only. This feature implies that, unlike in other models, income support measures can stimulate demand, output and employment in the short-run – a counter-cyclical effect.

Second, involuntary unemployment occurs as a result of an imperfect search and matching process between jobseekers and open vacancies. Therefore, policies aiming at improving the matching process[137] – such as training and well-functioning public employment services – contribute to reducing unemployment.

Finally, the model is well suited to assessing the economic and employment dynamics in the context of aggregate demand gaps and where interest rates reach a floor. In such circumstances, firms tend to reduce prices in an attempt to boost demand. However, as nominal interest rates are already low and cannot become negative, a decrease in prices implies an increase in real interest rates – a situation known as "liquidity trap". Such an increase in real interest rates reduces consumption, investment and employment and deepens the downward spiral of the economy.

[135] Kühn (2013); Torres et al. (2013).
[136] In the calibration used for Portugal, the share of credit-constrained households is set equal to 0.5.
[137] The matching elasticity to public spending is set equal to 0.085, based on the estimates by Boeri and Burda (1996).

The report uses the GEL model to simulate the employment effects of two policy measures in Portugal. The first measure consists in a decrease in the interest rate by 1.5 percentage points. This is equivalent to cutting by half the spread relative to Germany accumulated since 2008 as a result of the crisis.[138] The decrease in the interest rate stimulates an increase in investment and in private consumption. As a result of higher demand, employment increases by about 64,500 and the unemployment rate falls by 1.2 percentage points by the end of 2015.

The second policy option is an increase in spending on active labour market policies (ALMP) per jobseeker from the 2011 value (€1,200 PPP) to the EU-25 average in the same year (€2,400 PPP). The increase in ALMP spending has two effects. In the short run, government spending on ALMPs raises aggregate demand. In the long run, training and public employment services improve the efficiency of the job matching and increase the probability for an unemployed person to find a job. A more efficient job matching reduces the structural unemployment rate, i.e. the part of unemployment not due to the crisis, by 0.5 percentage point. As a result of both effects, employment increases by about 43,500 and the unemployment rate falls by 0.8 percentage point by the end of 2015.

The combined effect of both policies would raise employment by about 108,000 and reduce the unemployment rate by 2 percentage points.

Equally important, these policies together would help to reduce the government debt. The cut in the interest rate would boost investment, income and tax revenues.

The strengthening of ALMPs would raise government spending and fiscal deficits in the short run. However, to the extent that unemployment is stabilized and later reduced, spending on unemployment benefits would decline and the tax base would be boosted. As a result, the combined effect of these two policies (a reduction in the interest rate differential and a strengthening of ALMPs) would be a decrease in the ratio of government debt to GDP by 5.9 percentage points by 2015.

[138] The spread was 1 percentage point in 2008 and has risen to 4 percentage points in 2013.

PORTUGAL:

TACKLING THE JOBS CRISIS IN PORTUGAL

This report analyses employment and social trends in Portugal in the wake of the financial assistance programme agreed with the European Commission, the European Central Bank and the IMF. It also discusses international best practices available to inspire Portugal in its efforts towards cutting unemployment and boosting economic recovery.

Historically high unemployment rates, notably for youth, and rising poverty among families with small children are particularly alarming. The inability of banks to provide credit under normal conditions has hurt small enterprises and has depressed much-needed productive investment. Policies introduced to address the problems have not yielded the desired results so far.

The report therefore addresses the following questions:

- To what extent is the present situation the result of pre-crisis imbalances?
- How to put in motion a job-rich economic recovery?
- What can be done to ensure that the costs of the crisis do not fall disproportionately on vulnerable groups?
- How can the European Union help Portugal in its efforts to tackle the employment crisis?

Importantly, the report finds that Portugal possesses remarkable strengths – such as a relatively efficient policy implementation system – which could prove crucial for a successful recovery. The ILO could play a key role in supporting a strategy which meets both economic and social goals.

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