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Export-Driven Adjustment in Portugal

Macroeconomic imbalances in the eurozone have decreased significantly since the beginning of the financial and economic crisis. In Portugal, the economic adjustment process is strongly being driven by growth in export activity. The recent improvement in price competitiveness has supported the positive export trend. However, there are structural challenges that limit the potential for growth in the tradable sector. To ensure that the adjustment process is sustainable, it needs to be backed up by targeted structural reforms. This article aims to contribute to the discussion about the reduction of macroeconomic imbalances in the eurozone by analysing the determinants of export growth in Portugal and the role played by the adjustment policies contained in the macroeconomic programme.

Portugal's three-year economic adjustment programme ended in May 2014. The external adjustment has been quicker than had been expected at the beginning of the programme. The massive slump in domestic demand from 2009 onwards increasingly prompted Portuguese businesses to identify alternative market opportunities abroad. This led to a rise in exports, while imports declined as a result of the fall in domestic demand. The export growth comes amid signs that the tradable sector is gaining attractiveness in relation to the non-tradable sector – a significant reversal of the trend observed before the financial and economic crisis. Thanks to rising exports, Portugal's current account is improving on a fundamental level. In 2013, the country's current account was balanced for the first time since 1995. The gradual rise in price competitiveness is likely to continue to boost export figures. The external adjustment is also enhancing Portugal's growth prospects. However, this trend is limited by substantial structural challenges in the tradable sector. The structural reforms backing up the adjustment process – including those that form part of the economic adjustment programme – are central to ensuring that the improvements are gaining further traction.

This paper first deals with the background to the crisis and the role of credit-financed domestic demand, which led to a misallocation of resources in favour of the non-tradable sector. It then analyses recent export dynamics, which have been a key driver of the adjustment process so far. The paper further looks into the competitiveness of the tradable sector and identifies the main obstacles to further growth. Finally, it addresses the role of the structural reforms that support the adjustment process as part of the economic adjustment programme.

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Background – imbalances build up

The accumulation of macroeconomic imbalances made Portugal susceptible to the global economic and financial crisis of 2008 and 2009. In the time leading up to the crisis, Portugal had a high structural current account deficit for many years and became one of Europe's most indebted economies. At the same time, growth rates declined. Initially, dynamic domestic demand channelled resources into the non-tradable sector, while the relative importance of the tradable sector declined. The contribution of manufacturing to gross value added for the economy as a whole fell from 19 per cent in 1995 to 15 per cent in 2006. Export growth did not keep pace with the rise in imports, especially due to the high levels of domestic demand, which opened up market opportunities for Portuguese compan–ies within the country. After having expanded by more than four per cent per year in the second half of the 1990s, the Portuguese economy slowed to a growth rate of only one per cent between 2001 and 2008. High levels of debt in combination with slow growth increased the country's vulnerability and ultimately resulted in Portugal having to apply for financial assistance in 2011.[1]

* The views expressed in this article are those of the authors and should not be reported otherwise.

1 For a detailed analysis of developments in Portugal before 2006, see European Commission: The Portuguese economy after the boom, in: European Economy, Occasional Papers, No. 8, 2004; P. Cardoso: Household behaviour in a monetary union: what can we learn from the case of Portugal?, in: ECFIN Country Focus, Vol. 2, No. 20, 2005, pp. 1-6; O. Abreu: Portugal's boom and bust: lessons for euro newcomers, in: ECFIN Country Focus, Vol. 3, No. 16, 2006, pp. 1-6.

Portugal's large current account deficit was caused mainly by the high demand for imports in conjunction with falling transfers from abroad and rising external debt-service obligations. As shown in Figure 1, Portugal's current account was still balanced in 1995, with the trade deficit of six per cent of GDP set off by equivalent transfers from abroad. Five years later, the trade deficit had almost doubled, while transfers from abroad had fallen by more than half. In addition, the investment income account went from being balanced in 1995 to a deficit of two per cent of GDP in 2000 as a result of rising levels of external debt. Overall, Portugal's current account deficit was ten per cent of GDP in 2000. On average, it remained at that level over the course of the following decade.

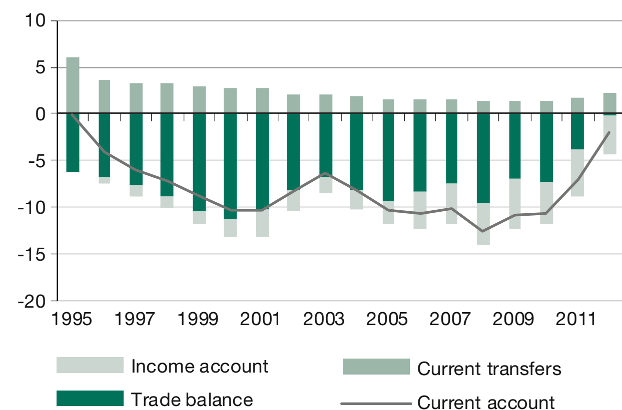
The dynamic growth of domestic demand and the corresponding increase in import levels led to a significant rise in the trade deficit. The boom in demand lasted throughout the second half of the 1990s, triggered by the expectation of sustained higher levels of economic growth as a result of the establishment of the Economic and Monetary Union. In real terms, domestic demand grew by five per cent every year between 1995 and 2000 and only subsequently dropped to a significantly lower level. Over the same period, imports increased by nine per cent per year, while exports grew at a slower pace of seven per cent annually. As a result, Portugal's trade deficit rose from 6.2 per cent of GDP in 1995 to more than 11 per cent in 2000 and subsequently remained at an average of 8.5 per cent until 2008.

Alongside the deterioration of the trade balance, the fall in transfers from abroad also contributed to the erosion of the current account and resulted in a rise in borrowing. Transfers dropped from 6.5 per cent of GDP in 1995 to 1.5 per cent in 2008. As a result of rising prosperity in Portugal, private transfers from Portuguese nationals living abroad decreased. At the same time, the flow of resources from the EU Structural and Cohesion Funds started to decline in the mid-1990s.[2] There was no correction in demand to reflect the fall in transfers. Instead, businesses and households replaced the transfers with borrowing.

The falling financing costs fuelled external borrowing as a means of financing the current account deficit. The introduction of the euro lowered interest rates, leading to a rise in capital inflows from the core countries of the eurozone and, as a result, causing levels of external debt to climb.

2 On the role of transfers (EU Structural and Cohesion Funds as well as private transfers) in current account trends in the peripheral eurozone countries, see European Commission: Surveillance of Intra-Euro-Area: Competitiveness and Imbalances, in: European Economy, No. 1, 2010; S. Kang, J. Shambaugh: The Evolution of Current Account Deficits in the Euro Area Periphery and the Baltics: Many Paths to the Same Endpoint, IMF Working Paper, No. 13/169, 2013.

Figure 1
Current account and components
in % of GDP

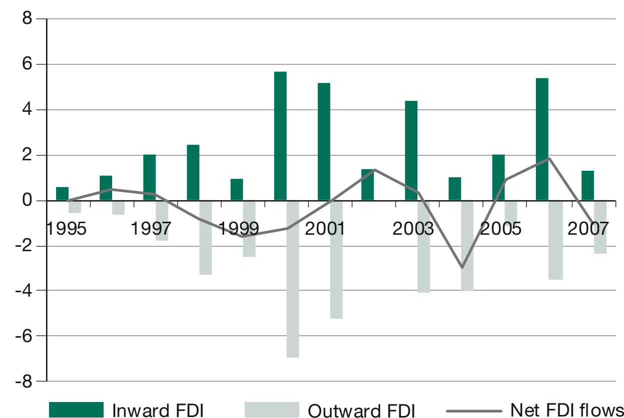


Source: Eurostat, 2013.

The increasing indebtedness of businesses, households and the public sector led to higher debt-service obligations to foreign creditors, which also had a negative impact on the current account. Thus, an improvement in the trade balance by 1.9 percentage points between 2005 and 2007 was by and large consumed by an increase in transfers to other countries of 1.7 percentage points in the same period, leaving the current account deficit at over ten per cent of GDP. As a consequence of the credit-financed current account deficit, Portugal became one of Europe's most indebted economies. Portuguese households and businesses have higher levels of debt than their counterparts in Spain and Italy, and Portugal's government debt is at a level similar to Italy's. Only its financial institutions have comparatively low debt levels. The high indebtedness increased economic agents' susceptibility to negative shocks and ultimately resulted in banks and the state losing access to the capital market.

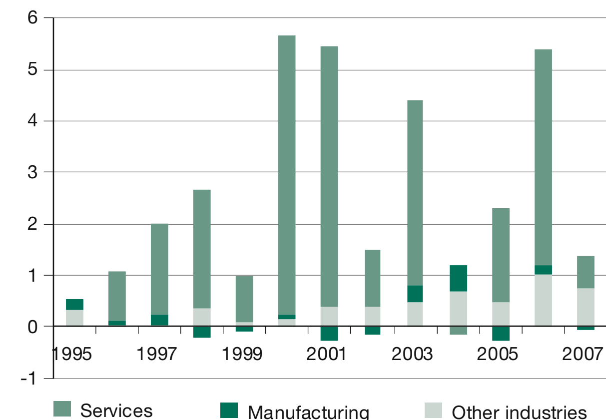
Foreign direct investment (FDI) did not play a significant role in financing the current account deficit, nor did it meaningfully contribute to productivity growth. The relatively high inflows of FDI were usually matched by similarly high outflows (see Figure 2). As a result, the balance of inward and outward direct investment made no positive contribution to financing the current account deficit (average for 1995-2007: -0.2 per cent of GDP). Moreover, flows of FDI into Portugal (2.7 per cent of GDP on average in 1996-2007, compared with 2.3 per cent for the OECD as a whole) mostly went to the non-tradable sector with muted effect on productivity. As shown in Figure 3, more than 80 per cent of foreign investment in the 1995-2007 period went to the services sector (including real estate) and only two per cent to manufacturing, meaning that its contribution to productivity growth was negligible. The International Mon-

Figure 2
Portugal's inward and outward FDI flows
in % of GDP



Sources: OECD, 2013; authors' calculations.

Figure 3
FDI inflows to Portugal, by industry
in % of GDP



Sources: OECD, 2013; authors' calculations.

etary Fund (IMF) attributes the one-sided investment flows to the higher profitability of the non-tradable sector compared with the tradable sector.[3] During this period, Portugal's role as a production base for multinational enterprises was minor, although there are examples of successful FDI from companies such as Volkswagen and IKEA.

Export growth was hampered by adverse specialisation effects and a loss of price competitiveness, which played a role in cementing the current account deficit. Although the contribution of exports to GDP rose from 22 per cent in 1995 to 32 per cent in 2008, imports also increased from 28 per cent to 41 per cent of GDP over the same period. As a result, the 5.1 per cent annual increase in exports was not sufficient to improve the current account balance. The problems experienced by the export sector included the focus on eurozone markets with low growth and Portuguese exporters' specialisation in labour-intensive products that face fierce competition from Eastern Europe and Asia. Partial competitive advantages in certain medium- to fast-growing sectors were unable to make up for the effects of these trends.[4] Unit labour costs rose by 23 per cent between 2000 and 2008, contributing to the erosion of price competitiveness. The increase in the real effective exchange rate of almost eight per cent between 2000 and 2008 also illustrates the loss of price competitiveness.

As a result of its excessive focus on the non-tradable sector, Portugal's integration in international trade flows fell behind that of other countries. At 30 per cent, Portugal's degree of openness (measured as an average of imports and exports as a percentage of GDP) in 1995 was above average among future eurozone members, but fell behind in subsequent years. In 2008, Portugal's degree of openness was 37 per cent, five percentage points below the eurozone average of 42 per cent.

An export-driven adjustment process

Since the onset of the crisis, the current account deficit has decreased quickly. While initially imports contracted strongly, following the start of the macroeconomic adjustment programme, the growth in exports became a major determinant of the current account correction. All in all, the current account deficit fell from a peak level of 12.6 per cent in 2008 to 1.5 per cent in 2012. Almost ten percentage points of this change can be attributed to the improved trade balance. In the 2008-2012 period, exports of goods and services rose by six percentage points of GDP, while imports fell by three percentage points. In other words, export dynamics have been a major factor in the adjustment process so far and will be analysed in more detail in this section.[5]

Compared with services exports, goods exports have been more significant in terms of volume and have experienced more dynamic growth (see Figure 4). Goods accounted for about 70 per cent of Portugal's exports, with a total volume of €45 billion in 2012 (exports of services: €19 billion).

3 See International Monetary Fund: Portugal Staff Report for the 2012 Article IV Consultation, IMF Country Report, No. 13/18, 2013.

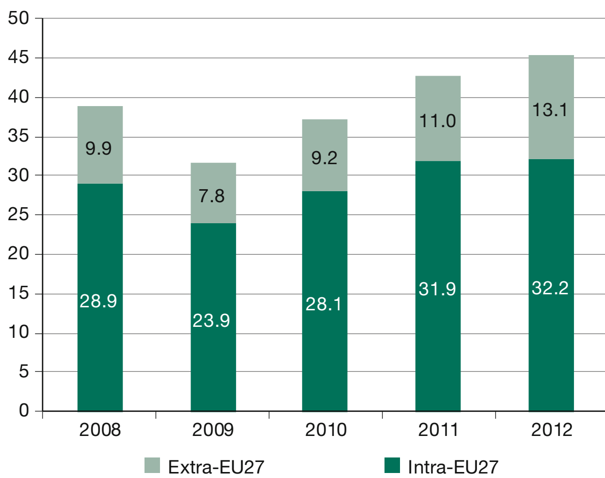
4 For an analysis of Portugal's export specialisation compared with that of competitors, see European Commission: The Economic Adjustment Programme for Portugal, in: European Economy, Occasional Papers, No. 79, 2011.

5 For further sectorial and geographical analysis of Portugal's recent export performance, see European Commission: The Economic Adjustment Programme for Portugal – Eighth and Ninth Review, in: European Economy, Occasional Papers, No. 164, 2013.

Figure 4

Portugal's intra- and extra-EU goods exports

in € billions



Source: Eurostat, 2013.

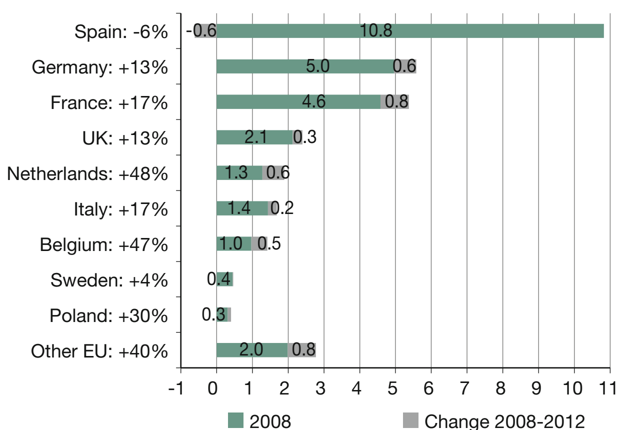
In the 2008-2012 period, exports of goods expanded by 17 per cent nominally, while exports of services rose by ten per cent. The positive trend in the export sector continued in 2013 with a growth of 4.9 per cent in the first three quarters of 2013 over the same period in 2012.[6]

6 Portugal's goods exports reached their lowest point following a sharp drop in 2009 (-18%), which was recouped almost entirely in the following year. For the purposes of this analysis, the year 2008 has therefore been chosen as the baseline year to examine the improvement compared with the situation before the crisis.

Figure 5

Portuguese goods exports to EU member states, 2008-2012

in € billions



Source: Eurostat, 2013.

The higher level of geographical differentiation of goods exports brightens the outlook for Portugal's export trade. Exports to countries outside the EU, including a number of emerging economies with high growth prospects in the medium term, rose in importance compared with exports to EU countries (see Figures 5 and 6). The diversification of exports by destination country, as measured by the Herfindahl index, increased from 0.88 to 0.91 in the 2008-2012 period.[7]

Within the EU, the slight fall in exports to Spain was more than compensated for by a climb in exports to other EU countries, such as Germany and France. Portugal's exports of goods within the EU rose by 11 per cent between 2008 and 2012 to a volume of €32 billion. Exports to Spain, Portugal's most important trade partner by far, fell slightly from €10.8 billion in 2008 to €10.2 billion in 2012. Exports to Germany, Portugal's second-largest export market, rose by 13 per cent in nominal terms (to €5.6 billion) and accounted for a tenth of total export growth over the period in question. Exports to Belgium and the Netherlands increased by almost 50 per cent.

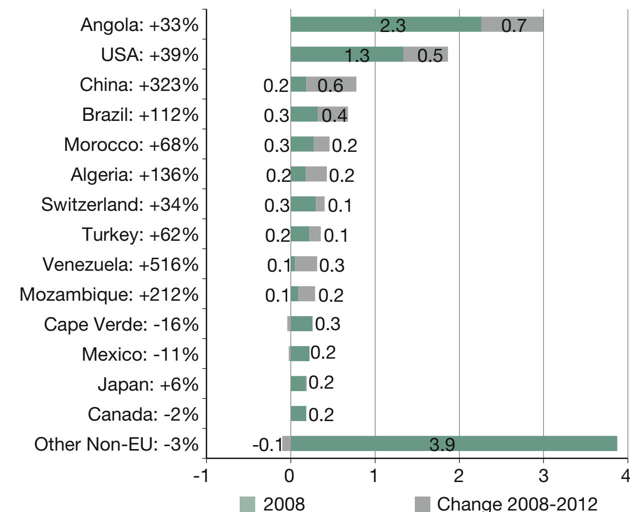
Exports to countries outside the EU experienced greater growth than intra-EU exports, mainly driven by increased export volumes to Angola, China, Brazil and the USA. Overall, exports to non-EU countries rose by 32 per cent from €10 billion in 2008 to €13 billion in 2012. Portuguese

7 The Herfindahl index measures the degree of diversification, whereby 1 represents perfect diversification (equal market shares for all countries) and a value close to 0 means a very low level of diversification.

Figure 6

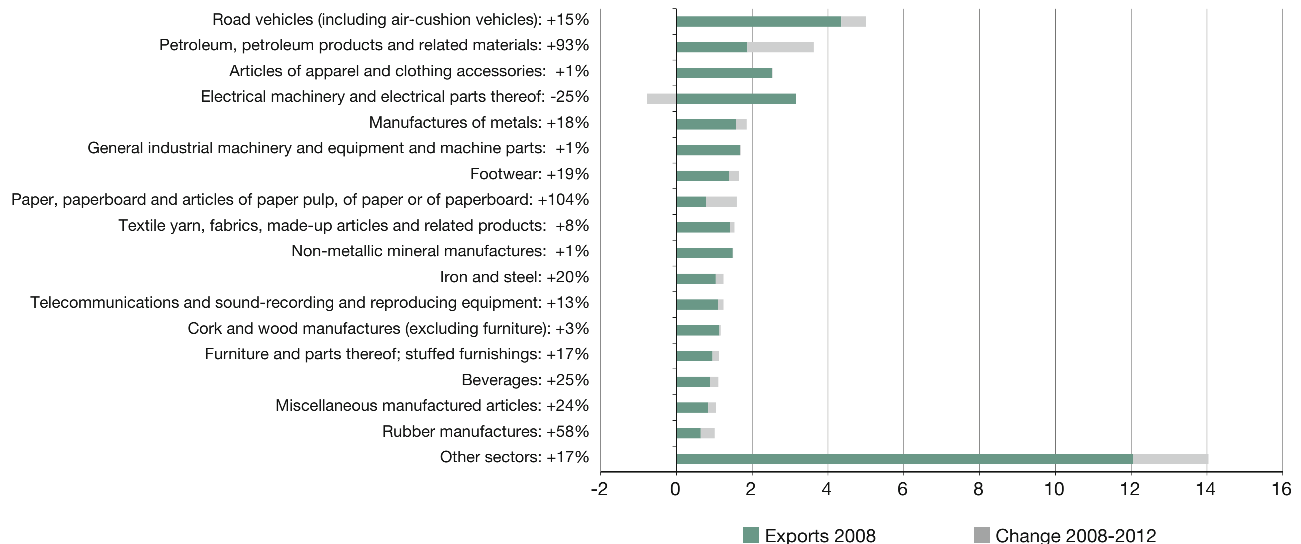
Portuguese goods exports to non-EU countries, 2008-2012

in € billions



Source: Eurostat, 2013.

Figure 7
Portuguese goods exports by product group, 2008-2012
in € billions



Source: Eurostat, 2013; classification of exports according to SITC.

businesses benefit from a competitive advantage in Portuguese-speaking countries, including Angola, Brazil and Mozambique. Goods exports to Angola, Portugal's most important trade partner outside the EU, increased by 33 per cent to almost €3 billion. Exports to Brazil more than doubled, while those to Mozambique tripled. Exports to China quadrupled in the 2008-2012 period, reaching €0.8 billion. China now ranks tenth among Portugal's export destinations. Because exports to non-EU countries grew at a comparatively high rate, their share of Portugal's total exports grew from 26 per cent to 29 per cent. As a result of its increasing focus on fast-growing economies outside Europe, Portugal's export sector is now in a better position to profit from future growth in these regions.

The rise in exports covers a wide range of products in the manufacturing sector, some of which are, however, characterised by a low level of technology intensity. The products with the largest share of export growth between 2008 and 2012 were refined petroleum products, paper goods, motor vehicles, motor vehicle tyres, chemicals, metal goods, pharmaceutical products, shoes and beverages (see Figure 7). In contrast, certain export products saw their sales figures stagnate or decline, including a range of technology-intensive products. For example, exports of electrical machines, which formed the second-largest export category in 2008, fell by 12 per cent, and exports of industrial machinery and equipment stagnated. Similarly, clothing exports, the third-largest export category, remained at the pre-crisis level.

The collapse of domestic demand prompted Portuguese companies to look for new markets abroad.[8] In real terms, domestic demand posted a decline of 14 per cent between 2008 and 2012, while exports of goods posted an increase of nine per cent, which helped to cushion the negative impact on growth. As a result, the stronger focus on foreign markets helped to mitigate the decline in production in Portugal. Nevertheless, the total output of the manufacturing sector, which is responsible for 90 per cent of Portugal's total goods exports, fell by 12 per cent between 2008 and 2012. Developments in the furniture industry illustrate the trend among Portuguese companies to concentrate more on foreign markets (see Box 1). Regarding motor vehicles, which are Portugal's most important export product and had an export volume of €5 billion in 2012 (€4.4 billion in 2008), higher exports could also partially make up for the decline in domestic demand. The demand for new cars in Portugal collapsed by over 50 per cent between 2008 and 2012. Total output of motor vehicles and components fell by 40 per cent over the same period. At the same time, exports in the Portuguese automotive industry expanded by 15 per cent. A large proportion of these exports went to the Chinese market, whose imports of vehicles from Portugal rose by €0.4 billion.

8 An important role must be assigned to falling domestic demand when modelling Portugal's export trends, as they cannot be explained purely on the basis of improvements in the real effective exchange rate and external demand. See A. Rua, P. Esteves: Is there a role for domestic demand pressure on export performance?, in: Banco de Portugal Working Papers, No. 03/2013.

Box 1

Taking advantage of the crisis – export opportunities for the furniture industry

The number of Portuguese furniture companies has fallen by 15 per cent since 2008, increasing the pressure on the sector, which was already struggling to keep up with cheap competition from Asia before the financial crisis. The lack of domestic demand meant that furniture manufacturers were increasingly forced to target the export market. Furniture exports expanded for three years in a row and reached €1.1 billion in 2012, an increase of 17 per cent in comparison with 2008. The most important markets for furniture exports are Spain, France, Angola, Germany and Sweden.

AM Classic Furniture, a medium-sized company based in the north of Portugal with an annual turnover of €7.5 million, was able to successfully adapt to the new situation by increasing its productivity and focusing more intensively on the export market. The company was able to boost its productivity by 15 per cent by switching to just-in-time production. In the past three years, the business has been able to access three new export markets – Germany, Russia and China. AM Classic Furniture expects to have achieved export growth of 20-30 per cent in 2013. The company's export successes are also reflected in its employment figures. It now employs 110 people, an increase of over ten per cent compared with the situation before the crisis.

In the services sector, the tourism and transport industries made a particular contribution to export growth. The tourism industry's share of total services exports was 42 per cent, followed by transport (28 per cent), business services (24 per cent) and the construction industry (three per cent). Export growth of 13 per cent in the tourism sector between 2008 and 2012 and of 16 per cent in the transport sector more than made up for declines in exports of business services (-14 per cent) and construction services (-20 per cent). The growth in the tourism and transport sectors is partly the result of the political situation in North Africa, which has attracted additional tourist flows to Portugal. In addition, the sector's attractiveness was enhanced by improving the quality and range of products through opening up new tourist areas and also by introducing strategies to reduce seasonality.

The recent increase in exports of a wide range of products to a variety of countries provides an important impetus for the reorientation of the Portuguese economy. However, this development will only be sustainable if Portuguese companies are able to prevail against competitors from other countries in the medium and long term. The next section will examine whether the current adjustment process will be able to invigorate the export sector in the long term and identify structural challenges in this respect.

Price competitiveness and structural challenges

A number of indicators suggest that competitiveness is increasing, underpinning the positive export trend. For instance, nominal unit labour costs declined by 4.5 per cent between their peak in the first quarter of 2009 and the end of the third quarter of 2013, supported by falling employment in the private sector. Compared with the eurozone, the improvement in unit labour costs was even higher, amounting to seven per cent in the same period. The public sector's contribution to the reduction in unit labour costs was only temporary, however. The 2011 decision to scrap bonuses equivalent to two months' pay (known as the 13th and 14th salary) for public sector employees was overturned in 2013 by Portugal's Constitutional Court. As a result, unit labour costs in the public sector returned to their 2008 level in 2013, following a short-lived dip in 2012, according to IMF estimates.[9]

A more positive trend involved unit labour costs in the private sector, which have fallen by seven per cent since their peak in 2009. However, the tradable sector saw a noticeably larger improvement than the non-tradable sector. The reduction of unit labour costs was mainly due to job cuts. Between 2008 and 2012, the employment rate fell from 73.1 per cent to 66.5 per cent. Wage rigidity and extensive employment protection meant that job cuts were largely effected through plant closures.[10] However, as shown in Figure 8, wage restraint also contributed to an improvement in unit labour costs relative to trading partners and hence supported the positive export trends. A recent study shows that the proportion of employees whose wages had been frozen increased from less than 15 per cent in 2008 to over 30 per cent.[11] This trend is connected to the freezing of the minimum wage, to which the government has committed

9 See International Monetary Fund: Portugal – Eighth and Ninth Reviews Under the Extended Arrangement and Request for Waivers of Applicability of End-September Performance Criteria, IMF Country Report, No. 13/324, 2013.

10 See A. Carneiro, P. Portugal, J. Varejao: Catastrophic Job Destruction, in: OECD Social, Employment and Migration Working Papers, No. 152, 2013.

11 See D.A. Dias, C.R. Marques, F. Martins: The determinants of downward wage rigidity: Some methodological consideration and new empirical evidence, in: Banco de Portugal Economic Bulletin Autumn 2013, Vol. 19, No. 3, 2013, pp. 91-106.

itself for the duration of the adjustment programme. In contrast, the proportion of employees whose wages had increased over the previous year fell from almost 70 per cent to less than 45 per cent. However, the group of employees whose wages had fallen in comparison with the previous year increased only slightly from 18 per cent to 22 per cent, illustrating the wage rigidity in the Portuguese labour market. Restrictions on the extension of sector-specific collective agreements that were implemented as part of labour market reforms should make it easier for companies to undertake future wage adjustments that are necessary to ensure they remain competitive.

Similarly, the trend in the real effective exchange rate points to an improvement in price competitiveness. The relevant indicator relative to 37 industrialised nations has fallen by 2.5 per cent since 2009, based on consumer prices, and by 9.5 per cent, based on unit labour costs.

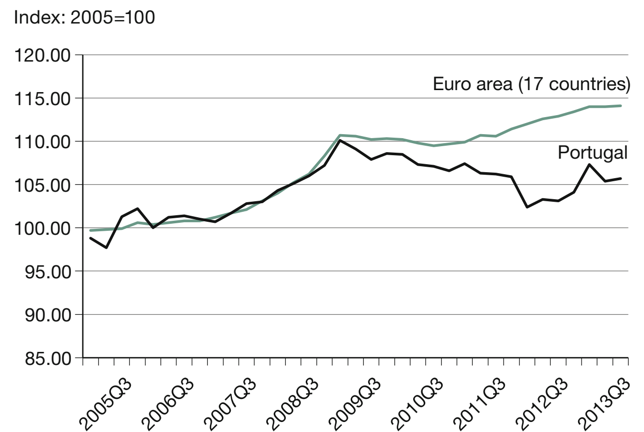
Gains in price competitiveness are accompanied by signs that the attractiveness of the tradable sector is increasing relative to the non-tradable sector. The prices of non-tradable goods have fallen 7.3 per cent from their peak in August 2011.[12] Relative price trends reveal an important turning point in favour of the tradable sector. Similarly, employment data points to a reallocation of resources towards the tradable sector. In a reversal of a long-standing trend the tradable sector's share in total employment is rising relative to the non-tradable sector: the tradable sector's share had seen a steady decline until reaching its low point in 2010 at 53.8 per cent and has since edged up to 54.1 per cent.[13]

The increase in price competitiveness reinforces the export growth induced by the collapse in domestic demand. Portugal's relative market share in terms of global exports has risen in comparison with the eurozone for the first time since the start of the crisis. Between 2008 and 2012, Portugal's share of the export market for goods shrank by 11 per cent compared to a decrease of 14.6 per cent for the eurozone as a whole. Before the crisis, Portugal's share of the export market had shrunk more than that of the eurozone (by 8.7 per cent between 2000 and 2008 for Portugal, compared with 2.5 per cent for the eurozone).[14] Overall, the country's positive export performance since 2008 was driven by an increase in price competitiveness and the fact

Figure 8

Nominal unit labour costs in Portugal and the eurozone, 2008-2013

Index: 2005=100



Source: Eurostat, 2013.

that Portuguese companies were forced to replace domestic with external demand. The adjustment process to date is caused by, on the one hand, employment and wage effects and, on the other hand, cyclical factors that have a positive short-term effect on export performance. The sustainability of the adjustment process will depend on the extent to which the structural challenges in the export sector can be resolved.

In the medium term, potential growth in the export sector is hindered by a low level of technology intensity and innovativeness as well as company structures and high financing costs. Small company sizes pose an obstacle when it comes to entering foreign markets and promoting innovation, both of which are associated with high fixed costs. Almost half the turnover in the manufacturing sector is produced by companies with fewer than 50 employees, compared with the EU average of 37 per cent (see Figures 9 and 10). These companies employ 63 per cent of the workforce, compared with the EU average of 50 per cent. Another problem is that the manufacturing industry in Portugal finds itself in fierce competition with emerging economies as a result of its relatively low level of technology intensity. Around 50 per cent of gross value added in the manufacturing sector is created in the low technology area, with only 16 per cent and five per cent respectively being created in the medium-high and high technology areas (compared with the eurozone averages of 22 per cent and 11 per cent respectively).

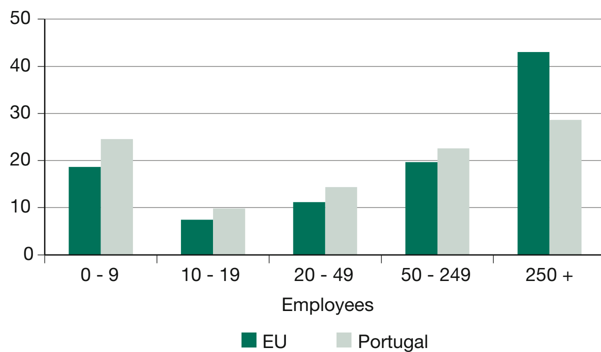
Productivity and innovativeness are also hampered by low qualification levels among the working-age population. In this respect, Portugal ranks among the lowest in the OECD. According to the IMF, human capital accounts for around one-third of the difference between Portugal's labour pro-

12 See International Monetary Fund: Portugal: Tenth Review Under the Extended Arrangement and Request for Waivers of Applicability of end-December Performance Criteria, IMF Country Report, No. 14/56, 2014.

13 See European Commission: Stylized facts on employment reallocation in Italy, Greece, Portugal and Spain (preliminary findings), Note for the attention of the LIME Working Group, 2014.

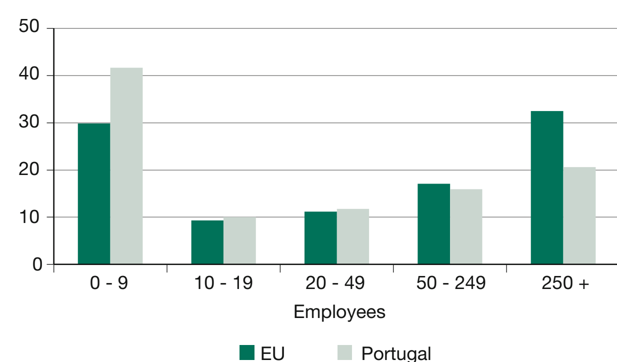
14 The overall shrinking export market shares of both Portugal and the eurozone reflect the continuing economic dynamism of the emerging economies and their increasing global economic importance.

Figure 9
Share of sales by company size
in % of total sales



Source: Eurostat, 2013.

Figure 10
Share of employees by company size
in % of total employees



Source: Eurostat, 2013.

ductivity and that of more highly developed OECD economies.[15]

Another obstacle for exports is the difficult financing situation. High capital costs for Portuguese companies thwart the recent reductions in unit labour costs and the unit costs of intermediate goods. Interest rates on new loans issued by Portuguese banks to companies have risen considerably since the beginning of the crisis and have become detached from the interest rate policy of the ECB and from the eurozone average. The average interest rate for all sizes of loans currently totals 4.5 per cent and is therefore more than one percentage point above interest rates in Spain or Ireland. Interest rates on bank loans totalling less than €1 million are even higher, with Portuguese companies having to pay six per cent interest on new loans.[16] In a survey for the Global Competitiveness Report 2013-2014 regarding the biggest obstacles to doing business, access to financing came top in the rankings for Portugal.[17] The high interest rates and restrictions on new lending by banks therefore represent a significant impediment to investment and expansion by exporters.

The role of structural reforms

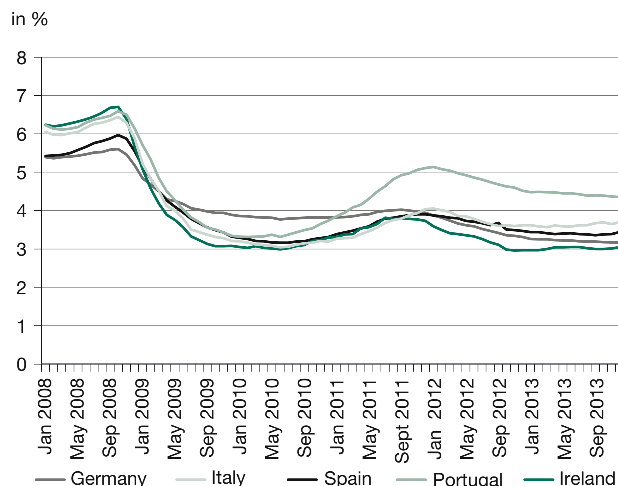
Portugal's economic adjustment strategy is based on targeted structural reforms, the implementation of which was anchored in the financial assistance programme and was regularly reviewed by the Troika until now. The reforms aim to promote resource allocation in favour of the tradable sector, to open up markets for investment, to increase competitiveness and, as a result, to create a sustainable foundation for growth and jobs.

Significant progress has been achieved with labour market reforms. Before the beginning of the programme, Portugal's employment protection provisions for employees with permanent contracts were among the strictest in Europe. The relatively high costs of dismissal caused companies to enter into a high number of fixed-term employment contracts. The incentives for investment in human resources, which would lead to increases in productivity, are generally low for both sides when such employment contracts are used. In order to counteract the segmentation of the labour market, redundancy payments were reduced significantly. For instance, the redundancy payment entitlement of 30 days per year worked, which existed prior to the programme, was reduced to 12 days for employees with permanent contracts and to 18 days for those with fixed-term contracts. Labour law was reformed with a view to making working hours more flexible, reducing the number of public holidays and holiday entitlement, and reducing overtime pay. Industry-specific wage agreements were restricted, and multi-year agreements to increase the minimum wage were suspended. The minimum wage was frozen for the duration of the programme. Working incentives for jobseekers were enhanced, and training and retraining programmes were introduced. The measures are aimed at reducing barriers to entry for new hires, increasing incentives to work, creating more employment opportunities and creating the necessary framework so that companies can more easily adjust wages to reflect productivity trends.

A further important element of the programme is the reform of the judicial system, which is almost complete. This reform aims to make it simpler to pursue claims and thus

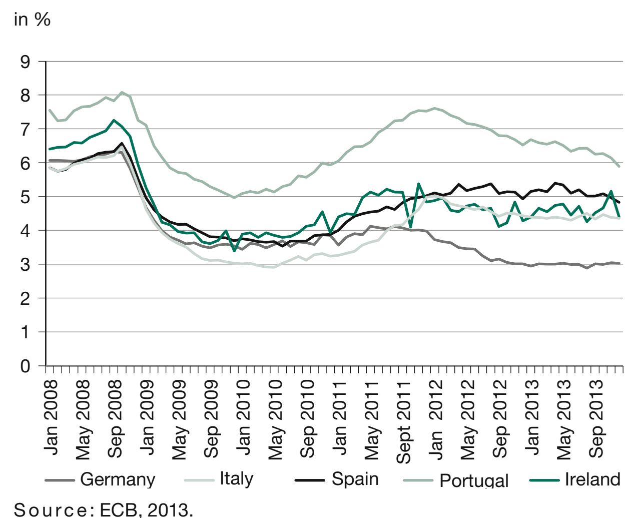
15 See International Monetary Fund: Portugal Staff Report for the 2012 Article IV Consultation, IMF Country Report, No. 13/18, 2013.
16 European Central Bank: Statistical Data Warehouse – MFI interest rates, available at http://sdw.ecb.europa.eu, accessed 3 March 2014.
17 See K. Schwab: The Global Competitiveness Report 2013-2014, World Economic Forum, 2013, available at http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf.

Figure 11
Interest rates for company loans (all sizes)
in %



Source: ECB, 2013.

Figure 12
Interest rates for SMEs (loans below €1 million)
in %



Source: ECB, 2013.

improve the regulatory framework for businesses. The new code of civil procedure which came into force in September 2013 is aimed at speeding up civil and commercial disputes. A new law to reorganise and streamline the judiciary will come into force in 2014. In addition, the regulatory framework for enforcement agents has been reformed in order to improve incentives for swift enforcement and hence bring open cases to a close more quickly. As well as these structural reforms, a working group was deployed that has developed measures aiming to reduce the backlog of open proceedings. In this way, it was possible to reduce the number of open proceedings by eight per cent by the end of the second quarter of 2013 in comparison with the peak level in 2012.

The programme also envisioned a range of legislative amendments to enhance competition and reduce surcharges in the non-tradable sector. A new competition law has expanded the powers of the Portuguese competition authority, and a special competition court has been established. Regulators are to be given greater autonomy with the aim of improving the regulatory framework. As a result of the transposition of EU law into national law in the telecommunications, electricity and services sectors and the already implemented reforms of sea ports, cost reductions and efficiency gains can be expected in the tradable sector in the medium term.

Additional measures under the adjustment programme were specifically aimed at alleviating the financing problems of export-oriented companies. The law to implement the EU directive on combating late payment in commercial transactions has already been passed by the Portuguese parliament. In the future, exporters will be able to apply for VAT refunds online, thereby reducing the time required for the provision of documents for VAT refunds from 42 days to four days. The lending capacity of PME Crescimento, a public credit line for SMEs and micro-enterprises, was increased by €1 billion in order to improve access to financing. In addition, a Portuguese development bank is being established with technical assistance from Germany's KfW (*Kreditanstalt für Wiederaufbau*). It will support SMEs from the second half of 2014 onwards.

Conclusions

Export trends in the tradable sector demonstrate Portugal's progress in reorienting its economy. With the improvement in competitiveness, there is encouraging evidence of a reversal in the undesirable developments of past years in the non-tradable sector in favour of the tradable sector. If this trend continues, it will lead to higher profitability and more investment in the tradable sector, including from abroad, with positive effects on innovation, employment and wages. The entire economy would profit from export-driven growth, via knock-on effects in other sectors and eventual recovery in domestic demand.

The high number of small companies, the low technology intensity of exports and the current difficult financing situation impose limits on further export growth, however. For this reason, the reform process needs to be continued in order to deal effectively with the remaining structural challenges and to increase the overall attractiveness for investment. A recovering export sector could play an important role in the public debate by providing further political support for structural reforms and open markets.