

# LABOUR MARKET REFORMS IN PORTUGAL 2011-2015

## A PRELIMINARY ASSESSMENT

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# **Labour Market Reforms in Portugal 2011-2015**

**A PRELIMINARY ASSESSMENT**



## FOREWORD

This report, commissioned by the XIX Government of Portugal, provides an evaluation of the comprehensive labour market reforms undertaken in Portugal over the period 2011-2015. It describes reforms in the areas of employment protection legislation, unemployment benefits, activation, collective bargaining, minimum wages and working time. The report reviews the reforms in detail and assesses the available evidence on the impact they have had on the labour market.

Assessing the impact of these reforms on the labour market is not an easy task, not least because they were introduced in a relatively short period of time and together with other reforms outside the labour market. They also coincided with a second dip in GDP growth and a gradual recovery. Disentangling the effects of the labour market reforms from these contemporaneous events is not straightforward. In addition, many of the effects of the reforms will become fully evident only in the medium- to long-run.

The present report should therefore be seen as a preliminary assessment of those reforms. That being said, it is possible, even at this stage, to make some observations about key policy priorities for the future – and the report offers some recommendations to that effect. While further reforms of labour market institutions, policies and practices will be required, achieving higher levels of employment and greater inclusiveness in Portugal will also depend on factors that lie outside the realm of labour market policy – not least on a return to higher and more sustainable levels of growth.

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## EXECUTIVE SUMMARY

Portugal was badly hit by the global financial crisis and suffered unprecedented job losses. Total employment fell by 767 000 (-15%) between mid-2008 and the beginning of 2013 and, at its peak, the unemployment rate stood at 17.3% (up from 8.6% at the beginning of 2008). The crisis added to Portugal's labour market problems. Unemployment had been rising even before the crisis (from 5.1% in 2000), its labour market was highly segmented, and the long-term unemployment rate was among the highest observed in the OECD. In order to deal with these deep-rooted structural weaknesses, a comprehensive set of labour market reforms was implemented over the period 2011 to 2015. More specifically:

- Portugal significantly reduced severance pay and eased the definition of fair dismissals as part of one of the most substantial reforms of *employment protection legislation* (EPL) among OECD countries in recent years, bringing strictness of the country's regulations closer in line to the EU average. There is some early indication that these reforms have incentivised on-the-job search (a lead indicator of job-to-job flows) as well as hiring. While the reforms have narrowed the regulatory gap between permanent and temporary contracts (and appear to have encouraged hiring on permanent contracts), it remains important and continues to contribute to labour market duality.
- Against a backdrop of rising unemployment and EPL reforms which made it less costly for employers to dismiss workers, Portugal widened the safety net provided by *unemployment benefits*. At the same time, the maximum duration of these benefits was reduced in an attempt to reduce long-term unemployment, although the full impact of this reform will take time to materialise because the new rule only applies from the second unemployment spell after the reform. These changes have brought the Portuguese unemployment benefit system more in line with standard practice across the OECD, but coverage remains relatively low and maximum benefit duration high.
- To help the unemployed back into work Portugal strengthened its *activation framework*. While eligibility criteria for unemployment benefits have always been strict on paper, recent measures tightened the way these criteria are implemented in practice – and there is some evidence that this has increased exits from unemployment. Portugal has also significantly increased its offer of short-term training programmes and hiring subsidies for the unemployed, set up a Youth Guarantee, and put in place a comprehensive strategy to modernise the Public Employment Service (although some measures included in this strategy have yet to be implemented).
- Reforms of the *collective bargaining* system aimed to promote a closer alignment between wages and productivity at the level of the firm by: introducing representativeness criteria for the extension of collective agreements; allowing firm-level agreements to be negotiated by works councils in firms with at least 150 employees (500 prior to the reform); and introducing a possibility for employers to temporarily suspend a collective agreement during times of crisis. While some of the initial reforms and measures (which have since been reversed) may have contributed to a reduction in collective bargaining coverage, the decline in the number of sector agreements was also crisis-induced and is, in fact, part of a longer-term trend which started in the mid-1990s. More generally, it is unlikely that the recent reforms will have much impact given that the current representativeness criteria for extensions are easily fulfilled; worker representation at the firm-level is weak; and the conditions for opting out of sector agreements remain vague and therefore open to conflict.

- In face of the crisis, the Portuguese Government also attempted to achieve *wage moderation* by freezing the national minimum wage between 2011 and 2014; reducing compensation for overtime work; and cutting public sector pay. Although low in absolute terms, the minimum wage in Portugal remains quite high compared with other OECD countries when expressed as a proportion of median wages. Moreover, employers also face a high rate of taxes and social security contributions on minimum wage workers (23.75% versus 19% across the OECD on average). Both of these factors raise some concern about a possible negative impact of future increases in the minimum wage on the employment of low-wage workers.
- Finally, as in a number of other European countries, firms facing economic difficulties were granted additional flexibility towards the middle of 2012 to adjust *working time* instead of employment. This is a welcome development given that the adjustment in labour input to the crisis in Portugal had primarily occurred through job destruction, in contrast to what had happened in some other OECD countries. That being said, the use of flexible working-time practices is likely to remain low in Portugal as long as there is a high share of temporary employment, which makes it easier for firms to adjust labour inputs along the extensive employment margin.

The Portuguese labour market reforms were a move in the right direction. Since economic growth turned positive again in early 2013, Portugal has experienced significant improvements in both employment and unemployment rates – greater, in fact, than what one would have expected given the pace of the recovery. However, despite the progress made, many challenges remain. Unemployment remains high (particularly among youth) and this situation has fuelled an increase in both poverty and long-term unemployment (although there are signs of improvement in the latter). The labour market remains highly segmented and, in the context of very low inflation, the presence of downward nominal wage rigidity is likely to remain a barrier to the competitiveness of the Portuguese economy – unless productivity growth is strengthened.

In view of these remaining challenges in the labour market, tackling segmentation should be a key priority for the Portuguese Government, and this can be partly achieved by further reducing the regulatory gap between permanent and temporary contracts. At the same time, the safety net for those out of work needs to be strengthened by a further widening in the coverage of unemployment benefits, but the maximum duration of these benefits could be reduced further in a bid to tackle long-term unemployment. But, to be effective, employment programmes to support the reintegration of jobseekers into employment should also be strengthened.

Competitiveness needs to be improved by aligning collective bargaining processes more closely with firm performance. In particular, the potential for negative effects of administrative extensions of collective agreements on non-signatory firms should be minimised, and the procedures for firms facing economic hardship to opt out of such agreements should be clarified. Finally, further increases in the minimum wage might help address in-work poverty but, to minimise any potential job losses, reductions in employers' social security contributions on minimum-wage workers should be considered.

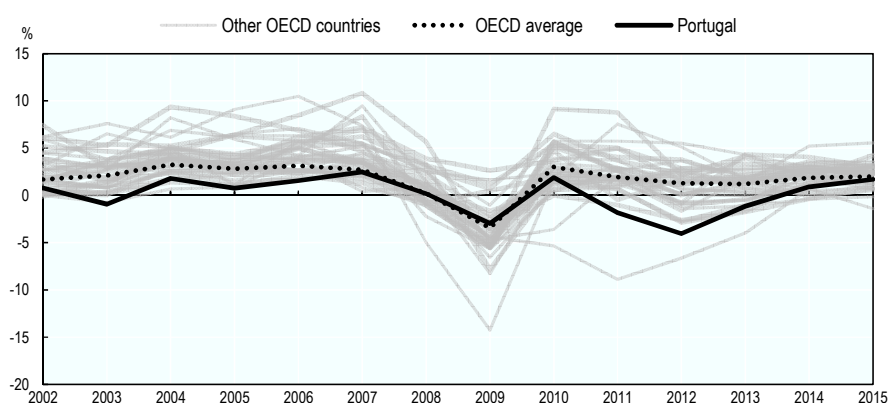
More generally, further improvements to Portugal's job market performance will require tackling other economic challenges. These include: the need to return to higher and more sustainable levels of growth; further reforms of product market regulations; better access to credit for firms; a reduction in employers' non-wage labour costs; and additional investments in skills.

## ASSESSMENT AND RECOMMENDATIONS

The global economic and financial crisis triggered a severe recession in Portugal, leading to a significant increase in unemployment. Between mid-2008 and the beginning of 2013, an estimated 767 000 individuals (or one in seven workers) lost their job. At its peak (Q1 of 2013), the unemployment rate in Portugal stood at a record high of 17.3% – more than twice the OECD unemployment rate at that time.

However, economic and labour market performance was poor in Portugal even before the crisis hit, and the recession painfully exposed pre-existing weaknesses and imbalances. Over the period 2002 to 2008, annual real GDP growth in Portugal was consistently among the lowest in the OECD area: less than 1%, compared to 2.3% across the OECD on average (Figure 1) and the unemployment rate increased from 5.0% in 2002 to 7.6% in 2008. Since the mid-1990s, unit labour costs had been rising faster than in core European countries, eroding competitiveness (OECD, 2010a), and external and public deficits were persistently high (Portugal, 2015).

Figure 1. Annual real GDP growth rate, Portugal and OECD, 2002-2015



Source: OECD Economic Outlook No. 98, November 2015.

When the crisis hit, the public deficit ballooned as high public spending (partly driven by countercyclical measures) coincided with a fall in public revenue. Investors and creditors became nervous about Portugal's ability to rein in its budget deficit and debt, and access to international financial markets became increasingly difficult. As a result, Portugal faced growing difficulties in meeting international payment obligations and, in April 2011, ended up requesting financial assistance from the European Union, the European Central Bank and the IMF (the "Troika") to solve its sovereign debt crisis. A financial assistance programme, amounting to EUR 78 billion over a period of three years, was agreed in May 2011. The programme was made conditional on a set of fiscal consolidation measures and structural reforms, which were described in detail in the Memorandum of Understanding signed between Portugal and the three institutions.<sup>1</sup> These reforms focused on the following key objectives: i) budgetary

1. Many of the reform proposals included in the MoU had already been included in a tripartite agreement that preceded Portugal's request for assistance (*Acordo Tripartido para a Competitividade e Emprego* signed on 22 March 2011- although the MoU went beyond the measures included in this document) and had been the subject of an earlier white paper (*Livro Branco das Relações Laborais*). In addition, Portugal had already been implementing important labour market reforms since 2003 (Távora and González, 2015).

consolidation; ii) financial sector stabilisation; and iii) structural reforms to boost growth and competitiveness.

Among the structural reforms to boost growth and competitiveness in Portugal, the Troika gave high priority to reforms of labour market institutions and policies, including: unemployment benefits; employment protection legislation; working time arrangements; wage-setting mechanisms; and active labour market programmes. Among the key challenges to be addressed were:

- *A highly segmented labour market.* Portugal had very rigid employment protection legislation on open-ended contracts, making it an outlier on the OECD's EPL indicator. The difficulty of making workforce adjustments through permanent contracts, a high degree of (nominal) wage rigidity, and the relative ease of use of temporary contracts, led to a share of temporary employment which was one of the highest in the OECD area (affecting one in five Portuguese workers in dependent employment, and young workers in particular).
- *One of the highest long-term unemployment rates in the OECD.* Even prior to the crisis, nearly one in two unemployed individuals in Portugal had been out of a job for more than a year (compared to just one in eight in OECD countries on average). This was partly driven by deep structural changes resulting from globalisation and technological change, which have led to a large number of displaced workers with poor skills facing significant barriers in finding new jobs. However, Portugal's generous unemployment benefit system (for those eligible) and a weak activation framework were also partly to blame. At the same time, the coverage of the unemployment benefit system was relatively low.
- *A high level of (nominal) downward wage rigidity.* Portugal's collective bargaining system and legal restrictions around nominal wage cuts resulted in significant downward wage rigidities. Consequently, during a period of low inflation (like the recent crisis), employers have very little leeway to adjust real wages, which leaves employment (and temporary employment in particular) as the main margin of adjustment. This partly explains the surge in unemployment Portugal experienced during the crisis (Carneiro, Portugal and Varejão, 2014).

In January 2012, the government signed the “Growth, Competitiveness and Employment Pact” (*Compromisso para o Crescimento, Competitividade e Emprego*) with the social partners.<sup>2</sup> The set of measures outlined in the pact corresponded closely to the reforms that were eventually implemented, and also gave them their legitimacy. The reforms (discussed in Chapter 1 and in more detail in Annex A) were implemented over several years (see timeline in Annex B), and with some difficulties. Some reforms were strongly opposed by the social partners (and therefore never implemented).<sup>3</sup> Others were implemented, but subsequently revoked by the Constitutional Court since they were considered unconstitutional.

Despite the long and tortuous path, a lot has been achieved by Portugal over this period: within the context of the Memorandum of Understanding alone (but including reforms in areas outside the labour market), over 450 measures were implemented – equivalent to around three measures per week (Government of Portugal, 2014). As the timeline in Annex B testifies, labour market reforms over the period were implemented almost on a monthly basis. While additional reforms are undoubtedly necessary, it is important to also take stock of what has been achieved to date, and assess how well the measures implemented have succeeded in meeting their intended objectives. In this spirit, the government committed

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2. Although one of the union federations (the General Confederation of Portuguese Workers – *Confederação Geral dos Trabalhadores Portugueses* – CGTP) refused to sign it.

3. These include the proposal to increase the daily maximum working time by half an hour, as well as the proposal to increase the compulsory social security contributions of workers (public and private sector) from 11% to 18%, and to decrease employers' contributions from 23.75% to 18%.

to monitoring carefully its labour market reforms to assess if they are having the intended impact and fine-tune accordingly (Government of Portugal, 2014).

The present report, commissioned by the Government of Portugal, is one contribution to this process of monitoring and evaluation. It focuses primarily on the labour market reforms carried out during the period 2011 through to the first semester of 2015. Chapter 1 describes these reforms in some detail, the rationale behind them, their expected outcomes, as well as the available evidence on the actual impact they have had on the labour market. Chapter 2 then assesses the performance of the Portuguese labour market over the past few years, and the final chapter discusses areas where further reforms/fine-tuning may be necessary.

The main findings and recommendations of the report are as follows:

### **Employment protection legislation**

- Prior to the reforms, Portugal was a significant outlier among OECD countries in terms of the strictness of its employment protection legislation (EPL) for individual workers on permanent contracts, driven primarily by: demanding procedural requirements for employers initiating a dismissal process; high severance payments; and the strong likelihood of reinstatement in cases of unfair dismissal. At the same time, a large regulatory gap existed between permanent and temporary contracts, contributing to the high degree of segmentation in the labour market.
- As part of the reforms, Portugal significantly reduced the amount of entitlements to severance pay for new hires (while largely preserving the accumulated rights of existing workers). The reduction was particularly large for permanent contracts, and, for the same job tenure, severance pay for dismissals on permanent contracts is now lower than it is on temporary contracts. Portugal also attempted to ease the definition of fair dismissal through the introduction of a new reason for dismissal (inadaptability without change to the nature of the job) and the introduction of more objective (performance-related) criteria for dismissing workers in the case of extinction of a work position. However, these latter reforms were only a mixed success as important aspects of them were ruled unconstitutional.
- The Portuguese EPL reforms rank among the most substantial of those implemented by OECD countries in recent years. Preliminary analysis carried out for the purpose of this report suggests that the reductions in severance pay may already have had a positive impact on on-the-job search (a lead indicator of job-to-job flows), as well as on hiring and the share of hiring that is on permanent contracts. At the same time, the preservation of accumulated severance pay entitlements appears to have protected existing workers from an increased risk of dismissal as a result of the reforms. In the long run, the cuts in severance pay are expected to result in significant gains in both productivity and growth. It will be important to build on the positive impact of these reforms on Portugal's labour market performance, and a number of areas remain where these reforms could be bolstered.
- While Portugal's reforms have moved the stringency of its EPL closer to the OECD average, permanent workers still benefit from the highest level of protection against individual dismissal in the OECD. In addition, the regulatory gap between permanent and temporary contracts remains significant, which continues to contribute to labour market segmentation.
- Reducing further the disincentives to hire workers on a permanent contract could be achieved by clarifying the conditions under which employers can dismiss individual workers for economic reasons – similar to the reforms that have recently been undertaken in both France and Spain.<sup>4</sup> This is likely to require a change to the Constitution (Article 53 which prohibits dismissals without “just cause”, but without defining what the latter means) and may be difficult to achieve in practice. Even in the absence of a constitutional change, however, further reductions in employment

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4. OECD (2013b, 2013c).

protection for workers on permanent contracts can and should be achieved by: reducing the compensation following unfair dismissal and reducing the possibilities for reinstatement.

- Another option to reduce labour market duality would be to make hiring on temporary contracts relatively more expensive, for instance by charging higher social security contributions (as was done in Slovenia, France and Italy). However, while this would help reduce segmentation, there is a risk that higher labour costs would reduce employment opportunities, particularly for the marginal worker. This may be particularly problematic in sectors with a large share of seasonal workers (like tourism and agriculture).
- The reforms also introduced changes to the way severance payments are to be made. Two dismissal funds collecting regular contributions from employers were set up which are intended to: i) cover part of the severance pay in case a worker is dismissed; and ii) guarantee a minimum amount of severance pay for the employee in case the employer cannot pay. While this new system reduces the up-front cost of dismissal to the employer and offers some insurance to the employee, it does not solve the problem that high accumulated severance pay rights act as a disincentive to mobility for the workers concerned.
- Another aspect of labour market segmentation in Portugal is the high incidence of dependent (or “false”) self-employment, which puts many workers in a very vulnerable position *vis-à-vis* their employer. While Portuguese labour law already defined the conditions under which an employment contract would be presumed, the recent reforms gave labour inspectors (*Autoridade para as Condições do Trabalho* – ACT) additional tools for enforcing the law and regularising contracts in the case of non-compliance. At the same time, however, there are indications that there is a lack of resources for effective implementation of these new provisions.

#### OECD recommendations: Employment protection legislation

1. Clarify the conditions under which employers can dismiss individual workers on permanent contracts for economic reasons, following the recent examples of both France and Spain.
2. The above recommendation may be difficult to implement because it requires an amendment of Article 53 of the Constitution. Nevertheless, even without such a change, further reductions in employment protection legislation for workers on permanent contracts can still be achieved by:
  - Reducing compensation following unfair dismissal; and
  - Limiting the possibility of reinstatement in the case of unfair dismissal. A reduction in the risk of litigation and reinstatement for employers could be achieved by making the receipt of (ordinary) severance pay conditional on individuals renouncing their right to litigation – similar to current practice in Germany.
3. Labour market duality could also be reduced by raising the relative cost of hiring on temporary contracts (e.g. by charging higher social security contributions) – however this may come at the expense of employment, which would affect marginal workers in particular. Therefore, one may wish to waive these higher social security contributions when firms hire marginal workers (e.g. low-skilled, youth and the long-term unemployed).
4. Disincentives to worker mobility could be reduced by making severance pay funds portable from one employer to another (as in Austria) – although the costs of moving to such a system should be carefully weighed against the benefits.
5. Strengthen the capacity of the labour inspectorate (ACT) to further clamp down on “false” self-employment (i.e. self-employed workers who are economically dependent on a single employer).

## Unemployment benefits

- Prior to the recent reforms, Portugal had a relatively generous unemployment benefit system for those eligible compared to other OECD countries, which is likely to have contributed to a high rate of long-term unemployment. To address this issue, Portugal lowered the cap on the maximum benefit amount and introduced a declining replacement rate to incentivise a more rapid return to work. In addition, the maximum duration of unemployment benefits was shortened – although this would only apply from the second unemployment spell onwards, so that an element of protection was kept in place during the recent episode of high unemployment. This also means that the impact of this latter reform on long-term unemployment will take time to materialise and that, unfortunately, its impact cannot yet be assessed. At the same time, preliminary evidence on the impact of the reductions in benefit levels suggests that they may have increased exits from unemployment – although the estimates are statistically insignificant. These reforms have moved Portugal closer to the OECD average in terms of the generosity of unemployment benefits and, to the extent that international evidence and past experience in Portugal provide useful insights, they should eventually help shorten unemployment spells and reduce the level of long-term unemployment. That said, the average maximum duration of unemployment benefits remains relatively high in Portugal compared with the OECD average.
- With unemployment soaring and EPL reform making it easier and less costly for employers to dismiss workers, there was also a need to widen the safety net provided by unemployment benefits. By international standards, the coverage rate of unemployment benefits (measured as the ratio of beneficiaries to the number of LFS unemployed) is relatively low in Portugal. Therefore, Portugal relaxed the contribution requirements for gaining access to unemployment insurance. The evidence suggests that, despite a significant increase in unemployment between 2011 and 2013 (and, in particular, an increase in long-term unemployment and the number of individuals with shorter contribution histories), the coverage rate of unemployment benefits held up well – but it remains at a low level. Of particular concern is the coverage of youth and others with short or incomplete contribution records (including those on non-regular employment contracts). In addition, the reduction in generosity of the *Rendimento Social de Inserção* (RSI) – a means-tested benefit of last resort – resulted in an important decline in the number of beneficiaries, causing significant hardship among the poor.

### OECD recommendations: Unemployment benefits and social assistance

6. Provide greater protection for the unemployed by widening further the coverage of unemployment benefits. One option would be to raise the means test threshold for unemployment assistance and uprate it annually in line with inflation.
7. At the same time, further reduce the maximum duration of unemployment benefits to strengthen incentives for job search and tackle the high incidence of long-term unemployment – particularly for older workers. This should include restricting the possibility of extending unemployment assistance until the age of retirement to only those older people who remain unemployed despite taking active steps to find work. However, these reforms should be combined with measures to reinforce employment programmes to support the reintegration of jobseekers into employment (see below).

## Activation

- Moving individuals from unemployment into jobs also requires an effective activation framework to connect people with jobs. This includes the incentives to find work contained in the unemployment benefit system, but also other determinants of motivation, measures to promote employability, as well as policies to increase the number of opportunities available to jobseekers.



- Over the period 2011-2015, Portugal took several steps to strengthen its activation framework. While eligibility criteria for unemployment benefits (i.e. the criteria determining ongoing eligibility which require recipients to actively look for work, take up suitable job offers or take part in active labour market programmes) have always been strict on paper, recent measures have tightened the way these criteria are implemented in practice, with some proven success in terms of exits from unemployment.
- Portugal has also significantly ramped up its offer of short-term training and hiring subsidies for the unemployed, which international evidence suggests can be particularly effective for the long-term unemployed at times of crisis. However, the coverage of these programmes has broadened over time and there may now be a need to re-focus some of these measures (including those covered under the Youth Guarantee) on those who need them most (i.e. disadvantaged youth and the long-term unemployed). In addition, there have been numerous and frequent changes in these programmes in recent years, which may make it difficult for jobseekers and employers to know exactly what help is available to them. While new analysis contained in this report suggests that hiring subsidies and subsidised internships may be particularly helpful to assist the unemployed back into work, there is generally very little evaluation of the effectiveness of active labour market programmes in Portugal.
- There has also been a concern that some of the active labour market programmes, by encouraging hiring on temporary contracts, have not led to sustainable job creation. One option forward would be to build stronger incentives to hire on permanent contracts into active labour market programmes. For example, some OECD countries train the unemployed to fill existing vacancies and, in return, expect the employer to hire the individual on a permanent contract (e.g. Individual Job Training in Flanders, Belgium and Work and Income Support in New Zealand). The risk, however, is that this would reduce the overall take-up of such programmes. In addition, many of Portugal's existing active labour market programmes already offer larger subsidies to employers if they hire on permanent contracts – but there is no evidence as to whether these measures are actually effective or not.
- Finally, a comprehensive strategy has been defined to strengthen the Public Employment Service, which is a critical driver of the success of any activation programme. However, not all measures included in this strategy have yet been implemented and, going forward, it will be essential that they are.

#### OECD recommendations: Activation

8. Ensure that more costly active labour market programmes (ALMPs) are more closely targeted on those who need them most (i.e. disadvantaged youth and the long-term unemployed) and that programmes are well-tailored to the specific needs of jobseekers.
9. Consider building stronger incentives to hire on permanent contracts into active labour market programmes, but ensure that take-up by employers is not reduced unduly as a result and evaluate existing measures that incentivise hiring on permanent contracts.
10. Aim for more stability in the ALMP measures on offer to ensure jobseekers and firms have a better understanding of what help is available to them.
11. Devote more resources to the careful monitoring and evaluation of ALMPs. In particular, all new programmes should be trialed on a random, pilot basis.
12. Fully implement the measures outlined in the programme to modernise the Public Employment Service (*Programa de Relançamento do Serviço Público de Emprego*).

## Collective bargaining

- The issue of representativeness in Portugal's *collective bargaining* system remained unresolved despite important pre-crisis reforms. In particular, the combination of low coverage rates of both employer organisations and trade unions, on the one hand, and the practice of quasi-automatic extensions of collective agreements, on the other, led to the imposition of a large number of sector/occupation wage floors which did not necessarily represent the economic realities of non-signatory firms (and even less so the views of potential start-ups and the unemployed more generally). Moreover, firms are legally prohibited from reducing base wages (unless this is permitted by collective agreement) and rules around the validity of collective bargaining agreements meant that, in some cases, it was extremely difficult for employers to re-negotiate an agreement with unions. The consequence was a high level of downward nominal wage rigidity in the labour market. This can be particularly harmful at times of crisis with low inflation: if firms cannot adapt to worsening economic conditions by lowering (real) wages, the only other adjustment channel left for firms is to reduce employment (short of shutting down altogether). To make matters worse, when collective agreements were extended, the corresponding wage clauses often applied retrospectively, forcing employers affected to pay the resulting wage arrears. This tended to exacerbate the potential negative effects of administrative extensions on competitiveness and employment.
- A significant number of reforms were implemented during the crisis, all aimed at making the collective bargaining system more representative, decentralised and dynamic. Extensions of collective agreements were temporarily frozen in May 2011, and, from November 2012 onwards, they were only granted if the collective agreement met certain criteria in terms of the representativeness of the employers that signed up to it. These measures helped achieve some wage moderation during the crisis (and therefore saved jobs) – but the issue of representativeness has not yet been fully resolved. In particular, while the first condition introduced (requiring signatory employers to represent 50% of workers in the relevant sector/occupation/geographical area) was restrictive, a second, alternative condition added later (which also allows extension when 30% of signatory firms are small or medium enterprises) is very easy to fulfil given that 99.7% of firms in Portugal are SMEs.
- As part of the package of reforms, Portugal also allowed firm-level agreements to be negotiated by works councils in firms with at least 150 employees (previously this threshold was set at 500 employees) – but the lack of worker representation in smaller firms raises questions about how much difference this will make in practice. Portugal also took steps to encourage more frequent and swifter re-negotiations of collective agreements by placing additional constraints on the time for which they remain valid. Finally, a possibility was introduced for employers to temporarily suspend a collective agreement (or certain terms contained in it) at times of crisis. While (for obvious reasons) this can only occur upon agreement with the relevant unions, it is also likely to reduce the effectiveness of the measure unless: i) the conditions under which firms may opt out are further clarified (as was done in Spain); and ii) clear and swift procedures for resolving inevitable conflicts are established.
- The crisis period and the implementation of a large number of reform and austerity measures have put significant strain on the relationships between the social partners, and trust in social partners in Portugal is lower than in the OECD on average. Given the growing evidence that trust between social partners may be almost as important a determinant of collective bargaining outcomes as the collective bargaining institutions themselves, it is of critical importance that this trust be strengthened.

### OECD recommendations: Collective bargaining

13. Limit the negative consequences of administrative extensions of collective agreements by:
  - Making the representativeness criteria that regulate the extension of collective agreements more challenging (which would encourage employers to organise), while keeping them realistic (i.e. not impossible to meet).
  - Granting administrative extensions only if they are in the “public interest”, i.e. if they meet clearly defined criteria by the government which are announced well in advance and known by the social partners before they enter into negotiations. In other words, such public interest conditions would set the parameters within which collective bargaining would be expected to take place.
  - Alternatively, making the extension of collective agreements conditional on the inclusion of opening clauses which clearly specify the issues (including wages and working conditions) that can be delegated to the individual firm, and under what conditions.
  - Setting up an independent body responsible for deciding (or advising the government on) whether extensions should be granted – similar to those currently operating in Finland and Germany. This body could consist of representatives from unions, employers, as well as independent experts.
14. Make it easier for firms to opt out of collective agreements at times of crisis by:
  - Clarifying the conditions under which firms can opt out due to “inability to pay” or hardship. In Spain, for example, sectoral agreements have to include objective conditions (such as a fall in sales or productivity over a specified period of time) that specify when firms may opt out of what was agreed.
  - Introducing a swift arbitration process in case of disagreement between employers and worker representatives. Again, this could be modelled on the system in Spain where, following disagreement, employers can unilaterally refer the issue to arbitration with no right for either party to appeal against the decision.
15. Making it easier for firms to opt out should go hand in hand with measures to strengthen worker representation at the firm-level, for example by making works councils compulsory for firms of a certain size (like in France) or providing financial incentives for firm-level bargaining (Italy).
16. Enshrine in legislation the current practice whereby the retroactive effects of collective bargaining agreements which have been extended are limited to the first day of the month in which the extension occurs.
17. Build more trust between the social partners. While building trust is a complex process, it can be partly achieved by implementing some of the above recommendations, including: making unions and employer organisations more inclusive; promoting worker representation at the firm level; introducing objective criteria for both extensions and opt-outs; and encouraging regular negotiations (e.g. by reducing the maximum length of time for which agreements can remain valid).

### Wages

- Additional wage moderation was achieved by freezing the national minimum wage between 2011 and 2014; significantly reducing pay (and other compensation) for overtime work; and cutting public sector wages. The freezing of the minimum wage led to a slow erosion of its real value over the period 2011-2014 and hurt low-wage workers. OECD estimates for 2013 show that, in comparison with other OECD countries, minimum-wage workers in Portugal had to work a high number of hours to earn enough to move above the relative poverty line (50% of median income). At the same time, however, minimum wages are closer to the median wage in Portugal than in most other OECD countries. In addition, the rate of employer taxes and social security contributions for minimum-wage workers is higher than in most other OECD countries. Both these factors raise concerns about the possible dis-employment effects among unskilled workers

of the intended increase of the minimum wage to EUR 600 by 2019. While employers currently benefit from some reduction in social security contributions on minimum-wage workers, these are available for existing employees only.

#### OECD recommendations: Minimum wage

18. Reduce employer social security contributions on all minimum-wage workers, including new hires, to soften the impact of planned increases in the minimum wage on labour demand.
19. Set up an independent commission comprised of experts and representatives of the social partners to provide the government with impartial information and advice on future changes to the minimum wage, carefully considering current and future labour market conditions.

### Working time

- Firms in Portugal were given additional flexibility to respond to changes in demand by adjusting working time instead of employment. This is a welcome development, given that: i) in contrast to what happened in some other OECD countries, the adjustment in labour input to the crisis in Portugal occurred primarily through job destruction; and ii) there is evidence that short-time work compensation schemes and working time accounts have helped preserve jobs in a number of OECD countries during the crisis (OECD, 2010b). More specifically, the reforms reduced the procedural requirements and time needed to implement short-time work arrangements, and individual working time accounts were introduced alongside the collective working time accounts already in place. Portugal also improved the design of short-time work compensation schemes to reduce their deadweight loss.
- These changes have increased the use of flexible time practices in Portugal. However, given that the reforms were introduced relatively late during the crisis (mid-2012), they are unlikely to have done much to prevent job losses during the recession. In addition, their use remains relatively low in comparison with other countries, and this is likely to remain so as long as there is a high share of temporary employment which makes it easier for firms to adjust labour inputs along the employment margin. Finally, the risk that short-time compensation schemes preserve inefficient job matches and prevent the reallocation of labour to more productive uses increases if they are not phased out as the recovery sets in.

#### OECD recommendations: Working time

20. Phase out (or reduce the generosity of) short-time work compensation schemes as the recovery takes hold to prevent such schemes from becoming an obstacle to the recovery.

### The road ahead

While the reforms outlined above were a step in the right direction in terms of building a more resilient and inclusive labour market and appear to have had the intended effect, assessing their joint impact on the labour market is much more difficult because of the large number of reforms that were undertaken (including many outside the labour market) over a relatively long period of time. In addition, little time has elapsed since the reforms were implemented and, in many cases, results will only become visible in the medium- to long-run. At the same time, the reforms coincided with a second dip in GDP growth and a gradual recovery. Disentangling the effects of the reforms from those of the economic cycle is notoriously difficult. That being said, the report finds that the fall in unemployment since Portugal started recovering from the recession

(Figure 2, Panel A) is much larger than one would have expected based on the past relationship between economic growth and unemployment (see Chapter 2 for more detail). While this cannot be interpreted as causal evidence, the finding is nevertheless consistent with the impact that would be expected from the reform package as well as the demonstrated effects that some individual measures have had so far on exits from unemployment, on-the-job search and hiring, amongst others.

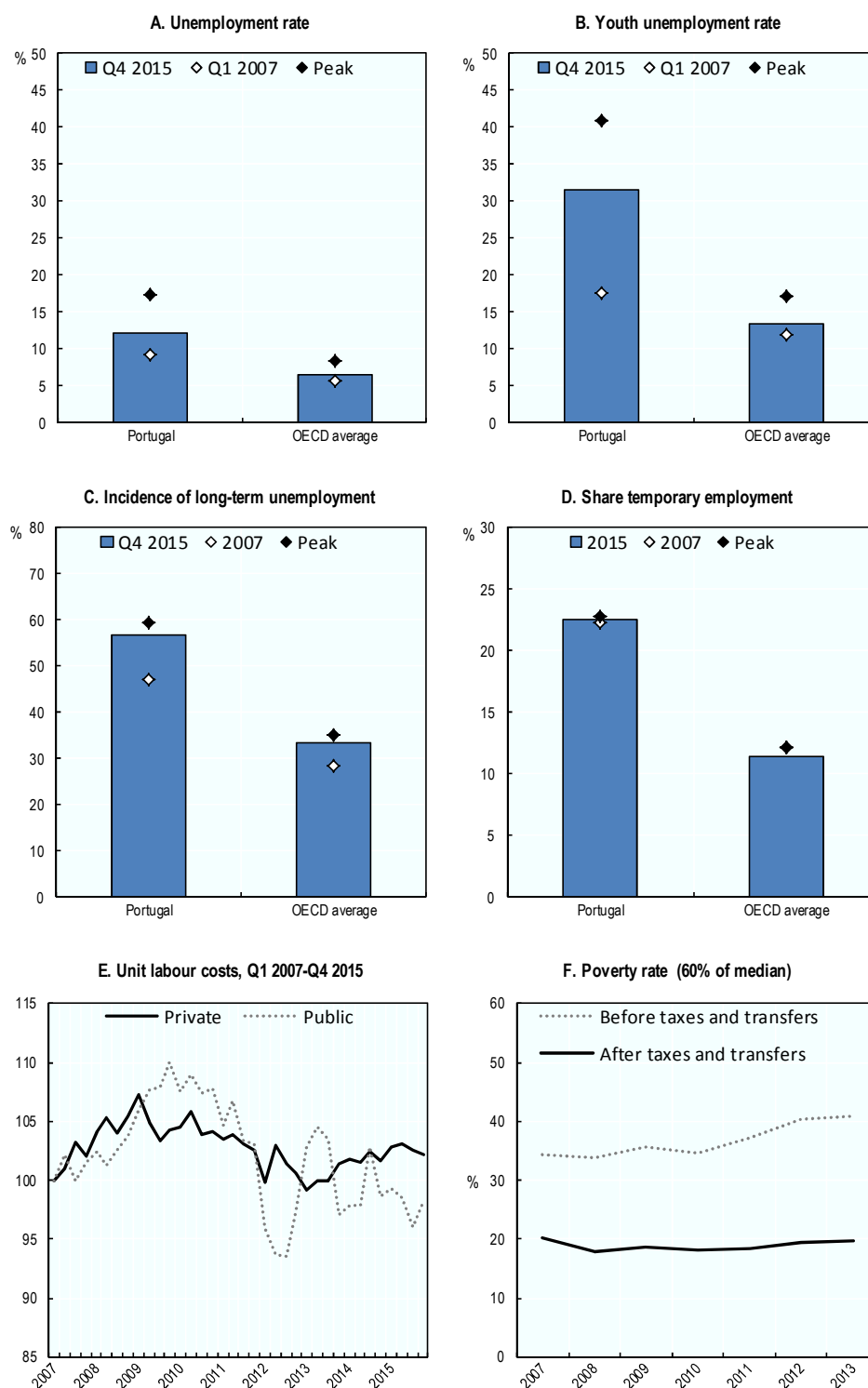
Despite the progress made, many challenges remain and there is a sense in which some reforms may not have gone far enough. The unemployment rate in Portugal remains high, particularly among youth (Figure 2, Panel B). The incidence of long-term unemployment has risen significantly, and has only recently started to fall again (Figure 2, Panel C). The labour market remains highly segmented (Figure 2, Panel D) and, unless further reforms of employment protection legislation are undertaken, this is likely to remain a defining feature of the Portuguese labour market for years to come. In addition, high rates of unemployment have resulted in rising poverty – at least before taxes and transfers are taken into account (Figure 2, Panel F).

Many of the measures undertaken during the crisis helped achieve wage moderation which, at the time of the deep recession, contributed to reduce job losses. They also helped to restore some of the competitiveness of the Portuguese economy lost in the period prior to the crisis, when wages were growing more rapidly than productivity (Figure 2, Panel E). However, the falls in unit labour costs were larger in the public sector (as a result of wage cuts) than in the private sector. In addition, the competitiveness gains in the private sector were driven primarily by improvements in productivity resulting from the exit of least productive firms from the market and the adoption of leaner production processes by surviving and new firms, rather than by falls in average compensation. In general, the evidence presented in this report suggests a high degree of nominal wage rigidity in the Portuguese economy, which could be particularly problematic at times of low inflation since it prevents real wage adjustments from taking place.

Improving employment outcomes in Portugal will hinge on further labour market reforms as outlined in this report. While some measures may require additional resources (e.g. reductions in social security contributions, increased coverage of unemployment benefits) others will provide savings (e.g. reductions in the maximum duration of unemployment benefits, better targeting of ALMPs). In addition, insofar as some of the measures will increase employment, they will also reduce expenditure on benefits while raising tax revenue. Finally, most of the measures proposed (e.g. EPL and collective bargaining reforms) will have an important impact on the labour market without additional cost to the tax payer.

Of course, labour market performance depends not only on employment policies, and there are many other challenges that need to be tackled in order to ensure more and better jobs in Portugal. The last chapter of this report outlines the main ones. First, a return to higher and more sustainable growth remains a critical condition for further improvements in the labour market. Unfortunately, based on current projections, the recovery in Portugal will only allow for some further reduction in the unemployment rate. A key obstacle to higher economic growth in Portugal is product market regulations. Despite significant improvements in this area in recent years, non-tradable sectors such as energy, transport and professional services continue to be characterised by low levels of competition and, given that intermediate inputs from these sectors are one of the most important cost inputs for firms in the tradable sector, the scope for further competitiveness gains and enhanced export performance depend crucially on further reforms in those areas. Growth and job creation in Portugal will also depend on the access that firms have to credit – the cost of which remains high compared to some other OECD countries, including Italy and Spain – as well as on reducing the tax wedge, which weighs heavily on Portuguese companies. Finally, achieving higher levels of productivity (but also inclusiveness) in Portugal will depend critically on the country's ability to upgrade the skills of its workforce, with a particular focus on the least-skilled.

Figure 2. Summary of key labour market developments



*Note:* The unemployment rate is harmonised and seasonally adjusted. Long-term unemployment covers those out unemployed for 12 months or more. The share of temporary employment is estimated as a proportion of all those in dependent employment. Unit labour costs for the private sector refer to the business economy (excluding real estate).

*Source:* OECD Labour Force Statistics Database, OECD Quarterly National Accounts Database, OECD Income Distribution and Poverty Database.



## **CHAPTER 1**

### **LABOUR MARKET REFORMS IN PORTUGAL 2011-2015**

Over the period 2011-2015, Portugal carried out a comprehensive package of reforms aimed at reducing labour market segmentation and (long-term) unemployment, on the one hand, while increasing flexibility, competitiveness and resilience, on the other. The reforms included changes to employment protection legislation (EPL), unemployment benefits, activation policies, collective bargaining and working time arrangements. This chapter offers a brief summary of these reforms, together with an analysis of their intended and (where possible) actual impact on the labour market.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.



### **Employment protection legislation on permanent contracts became less stringent, and the gap with temporary contracts was reduced**

Prior to the reforms, Portugal was an outlier on the OECD's employment protection legislation (EPL) indicator for regular contracts, which was driven primarily by: demanding procedural requirements for employers initiating a dismissal process; high severance payments; and the strong likelihood of reinstatement in cases of unfair dismissal. While it is not possible to capture all aspects of EPL in an internationally comparable summary indicator,<sup>5</sup> the OECD measure nonetheless gives a sense of how restrictive regulations for individual dismissal of regular workers were in Portugal compared to most other OECD countries. At the same time, the ease of hiring temporary workers in Portugal was more or less in line with that of the OECD average, meaning that there was a large regulatory gap between temporary and permanent contracts. While not the only determinant, this regulatory gap was an important factor behind the high level of labour market segmentation in Portugal. More generally, restrictive hiring and firing practices acted as a significant barrier to the efficient (re-)allocation of labour resources across the economy.

Between November 2011 and June 2014, Portugal implemented a number of changes to its EPL, including: reductions in severance pay (particularly for permanent contracts); introduction of a new reason for dismissal (inadaptability without change to the nature of the job); and the introduction of more objective (performance-related) criteria for dismissing workers in the case of extinction of a work position (which brought them more closely in line with those used in the case of collective dismissal). These reforms reduced the protection of workers on permanent contracts in Portugal, and narrowed the regulatory gap with workers on temporary contracts. From an international perspective, these reforms rank among the most significant ones implemented in recent years.

Despite these reforms, Portugal's EPL for permanent workers remains the most stringent in the OECD, along with that of the Czech Republic. This is because some of the key difficulties of dismissing permanent workers (discussed in Chapter 3 of this report) were not addressed. Further reforms are therefore highly recommended, especially since there is some early indication that the recent EPL reforms may have encouraged on-the-job search by individual workers, as well as hiring and the share of hiring that is on permanent contracts. The analysis also suggests that significant long-term effects on productivity and growth may be expected from the recent EPL reforms implemented in Portugal.

This section starts with a brief theoretical discussion on the impact of EPL on productivity, growth and labour market duality. It then describes the recent reforms implemented in Portugal, puts them in an international context, and provides some initial evidence on their impact. Long-run productivity and growth gains are also estimated.

### ***Rigid employment protection legislation can harm productivity and growth, and is a key determinant of labour market duality***

Adjusting the level and composition of the workforce to adapt to changing demand conditions and technology is vital for effective businesses operation, and therefore for productivity and economic growth. But job displacement entails significant costs for the workers concerned in terms of earning losses and the possible obsolescence of their job-specific skills and experience. In addition, social costs can also be important (e.g. benefit payments, and expenditure on job-search assistance and active labour market programmes).

Employment protection legislation (EPL), that is the rules governing the hiring and firing of workers, has typically been designed to protect jobs and increase job stability, with the aim of preserving the individual worker and society from some of the above-mentioned costs. A related objective of EPL is to make employers internalise the social cost of dismissing workers – without which the level of turnover

5. See Chapter 2 of OECD (2013c) for further detail on the limitations of the OECD EPL indicator.

would be inefficiently high. However, in some cases, constraints imposed on firms might be excessive, hindering the effectiveness of labour market flows and the allocation of labour to the most productive jobs, thereby harming productivity and growth.<sup>6</sup>

In addition, when there is a large gap in EPL between fixed-term and open-ended contracts, firms have a clear incentive to hire workers on temporary (instead of permanent) contracts, leading to labour market duality. For new entrants to the labour market, this reduces the probability of conversion to a permanent contract, turning fixed-term contracts into a trap rather than a stepping stone to more stable employment. For workers, this reduces incentives to invest in firm-specific skills, raises work-related stress, and lowers motivation. From the firm's perspective, it increases worker turnover and recruitment costs, and also lowers productivity. In addition, firms are less willing to invest in workers who are unlikely to keep their job, further contributing to lower productivity. Finally, large differences in regulations across contracts also tend to concentrate any required labour market adjustments on non-regular workers, thereby increasing labour market segmentation.

Evaluations of past labour market reforms in Portugal have produced evidence broadly consistent with the above theory. In particular, it has been shown that reducing the complexity of procedural requirements for individual dismissal in the case of regular contracts positively affects firm performance (through the indirect effect of employment protection on worker effort) as well as the share of temporary contracts (and therefore labour market segmentation). Box 1 provides further details.

#### Box 1. The impact of previous EPL reforms in Portugal

Martins (2009) assessed the impact of the complexity of procedural requirements in the case of just dismissal on job and worker flows, on wages, as well as on firm performance. He looks at the Portuguese labour law reform of 1989<sup>1</sup> which revised the regulations governing dismissal for disciplinary reasons, setting out a new set of procedural requirements to be followed by employers. A particular aspect of this reform is that it let small firms (employing 20 or fewer workers) follow a much simpler procedure: out of the 12 specific rules that larger firms needed to follow, only four needed to be considered by smaller firms. Comparing small and large employers, Martins (2009) finds no robust evidence that such procedural requirements impact on job or worker flows (although some estimates suggest an increase in hiring), however he does find evidence that stricter procedures reduced firm performance. The author argues that this is because higher protection for workers reduces their effort on the job (although a complementary explanation is that relaxing dismissal requirements allows for better managerial practices).

Along similar lines, Centeno and Novo (2012) look at what happened when a change to the Portuguese Labour Code in 2004 extended the procedural requirements to firms with 11 to 20 workers.<sup>2</sup> They find that stricter regulations for dismissal of workers with permanent contracts result in a higher share of workers on temporary contracts, as well as an increase in excess turnover for these type of contracts. These results therefore provide evidence that a larger gap in employment protection legislation between temporary and permanent contracts results in greater labour market segmentation. Centeno and Novo (2013) use the same natural experiment as Centeno and Novo (2012) and find that increases in protection for permanent workers also reduce the wages of new workers on permanent and temporary contracts, but do not affect the wages of existing workers on permanent contracts.

1. Decree-Law 64-A/1989 of 27 February.

2. Law 99/2003 of 27 August.

Source: Martins, P.S. (2009), "Dismissals for cause: The difference that just eight paragraphs can make", *Journal of Labor Economics*, Vol. 27/2, pp. 257-279; Centeno, M. and Á.A. Novo (2012), "Excess worker turnover and fixed-term contracts: Causal evidence in a two-tier system", *Labour Economics*, Vol. 19/3, pp 320-328; Centeno, M. and Á.A. Novo (2013), "Segmentar os Salários", *Boletim Económico*, Winter, Bank of Portugal, pp. 55-64.

6. While flexibility-enhancing EPL reforms can have a positive impact on the overall level of employment, this effect tends to be relatively small (OECD, 2006).

*Portugal implemented a range of measures to reduce employment protection on permanent contracts*

Between November 2011 and June 2014, Portugal implemented a number of EPL reforms, most of which targeted a reduction in the level of protection on permanent contracts. Central among those reforms was a significant reduction in severance pay on permanent contracts, which is now lower than that on temporary contracts (although severance pay on the latter was also reduced). Some preliminary OECD analysis suggests that these changes may have encouraged on-the-job<sup>7</sup> search as well as hiring and the share of hiring that is on permanent contracts. At the same time, because of grandfathering (i.e. the exemption of existing workers from many of the new regulations) – the effect on firing/job separations was limited. Portugal also tried to ease some of the reasons for dismissing individuals on permanent contracts. First, it introduced a new reason for dismissal (inadaptability without change to the nature of the job) – although it is not clear that it will make dismissal for inadaptability (a form rarely used in the past) any easier in practice. Second, Portugal tried to introduce more objective criteria for selecting individuals to dismiss in the case of extinction of a work position (bringing them more in line with those used for collective dismissal). Again, it remains to be seen whether this will make any difference in practice.

*Severance pay on permanent contracts was significantly reduced*

Before the reforms, Portugal had one of the highest levels of severance pay for the termination of open-ended employment contracts in the OECD. Regardless of tenure, every worker would be entitled to a minimum of three months' severance pay and there was no upper limit to the amount of severance pay that could be paid out. Severance payments were also higher for permanent than for temporary contracts. Taken together, this system created a significant disincentive for employers to hire workers on permanent contracts, and is likely to have harmed the efficient (re-)allocation of labour resources since firing was very costly for firms and, from the point of view of workers, entitlements to high severance pay (which are job-specific and therefore not portable) would have reduced the incentives to look for a job elsewhere, even if it could have led to a better match.

Over the period of the reforms, severance pay in the case of open-ended contracts was reduced from 30 days of base wage and tenure-based increments for every full year of tenure, to 12 days for every year of tenure. The minimum of three months' severance pay was removed, and ceilings were introduced to cap the maximum amount of severance pay that could be paid out. In the case of temporary contracts, severance pay was also reduced, although to a lesser extent (from three days per month of tenure on contracts lasting six months or less and two days per month of tenure for contracts lasting more than six months, to 18 days per year of tenure, and further to 12 days per year of tenure for contracts lasting more than three years).

Figure 3 illustrates how the pre- and post-reform rules for severance pay differ, both for temporary and permanent contracts, and over the first 72 months (six years) of tenure.<sup>8</sup> The two key points to take away from this graph are: i) the significant reduction in severance pay on permanent contracts; and ii) that severance pay for permanent contracts was higher than for fixed-term contracts prior to the reform, but is now lower. Both of these effects should encourage hiring on permanent contracts in the future. One caveat, however, is that while the reforms tackled the gap in severance pay between permanent and temporary contracts, they left untouched the difference in procedural costs which, according to some authors (e.g. Centeno and Novo, 2012), present the largest difference between the two types of contract. In addition,

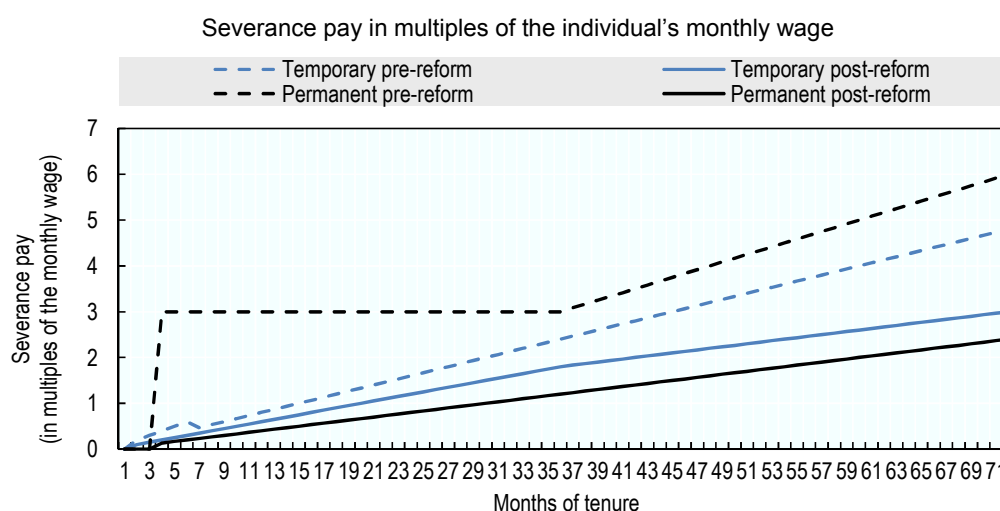
7. On-the-job search may be seen as a lead indicator that is likely to anticipate higher rates of job-to-job mobility (Orsini and Vila Núñez, 2014).

8. While the standard maximum cumulated duration of successive fixed-term contracts in Portugal is three years, temporary contracts of uncertain duration may last up to six years, which explains the choice of a six-year time period for the graph.

employers will have other incentives to keep on hiring on temporary contracts (see the discussion in Chapter 2 on labour market segmentation for further detail).

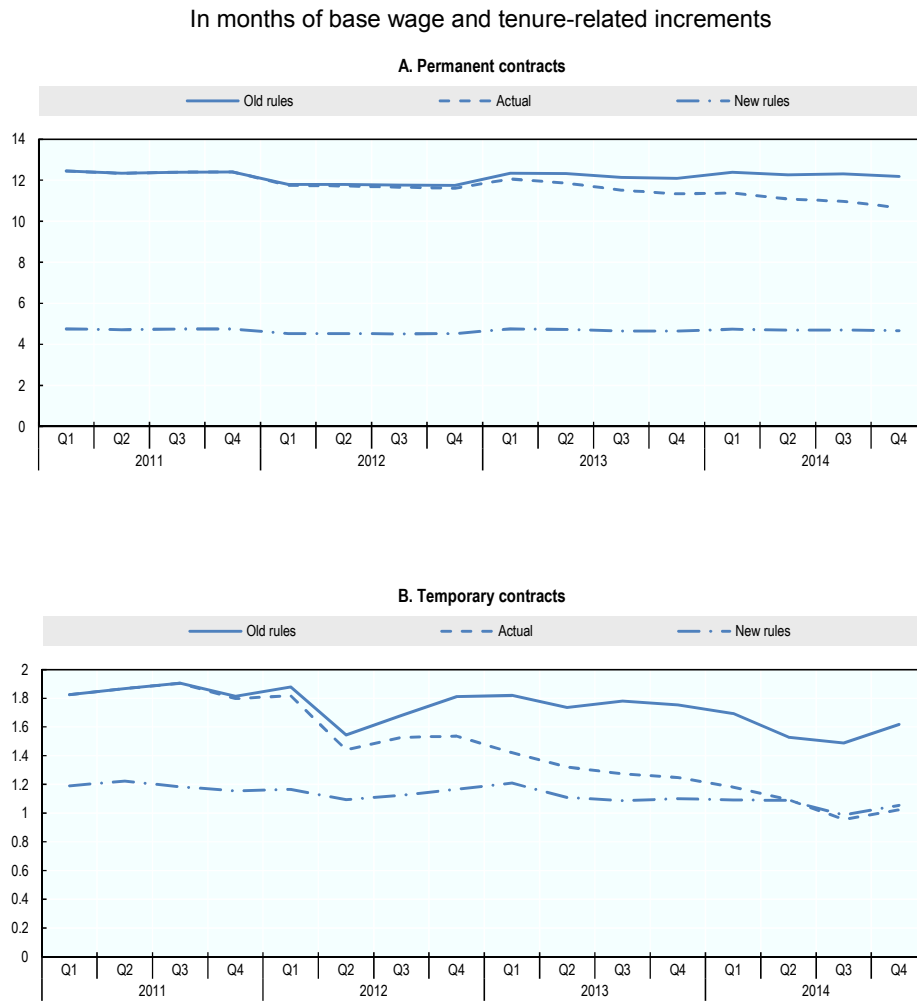
The new severance pay rules apply primarily to new contracts. For existing contracts, the rights accrued to date were largely preserved (called “grandfathering”). The reason for doing this was to avoid excessive job losses during the crisis. Indeed, there is growing evidence that EPL reforms engender short-run costs as their immediate impact tends to be greater on separations than on hiring, resulting (on average) in a small initial contraction of employment (e.g. Von Below and Thoursie, 2010). The preservation of severance pay entitlements will therefore have attenuated these short-term costs. On the downside, it also means that the positive effects of the reforms will take longer to manifest themselves. Figure 4 shows estimates of how fast (or rather slow) actual severance pay entitlements are converging with those intended by the new rules. If all workers on permanent contracts still had severance pay entitlements according to the old rules, then the average number of months of severance pay would be 12.2 in Q4 of 2014. If, on the other hand, all workers on permanent contracts had their severance pay entitlements calculated on the basis of the new rules, then they would receive 4.7 months on average. In practice, however, the actual level of severance pay will only slowly adjust downwards, since existing workers kept their built-up entitlements. This means that in Q4 of 2014, workers on permanent contracts were still entitled to 10.6 months of severance pay on average. Some simple linear projections based on the current trend suggest that the new rules will not apply fully until after 2021. In the case of temporary contracts, the adjustment will obviously be much faster since tenure is, by definition, much shorter on such contracts and turnover higher. As shown in Panel B of Figure 4, the new rules already apply entirely in the case of temporary contracts.

Figure 3. **Severance pay on temporary and permanent contracts before and after the reform**



Note: No severance pay is due if the worker is dismissed during the trial period, which is assumed to be 90 days for permanent contracts (although trial periods are longer for certain more demanding professions), 30 days for fixed-term contracts of six months or more, and 15 days for fixed-term contracts of less than six months. The graph does not illustrate the caps on severance pay introduced by the reform. Severance pay may not exceed 12 times the individual's monthly salary, which would be reached after 360 months (or 30 years) of tenure. In addition, the base wage (including tenure-based increments) for calculating the entitlement is capped at 20 times the national monthly minimum wage.

Source: OECD.

Figure 4. **Average severance pay entitlement under the old rules, new rules and actual**

*Note:* Quarterly EU-LFS data on start date, contract type and duration of temporary contracts are used to calculate the number of months of severance pay entitlement for each individual based on the information from Table A1. Given that the EU-LFS does not contain information on wages, the upper limits for severance pay are only applied in terms of the maximum number of months (i.e. 12) and not in terms of the maximum base wage (i.e. 20 times the minimum wage). Given that very few employees have wages higher than 20 times the minimum wage, the severance pay calculation will not be strongly affected by this simplification.

*Source:* OECD analysis based on the EU-LFS.

Despite the preservation of accrued severance pay rights, there is some early indication that the reforms of severance pay may have had a positive effect on on-the-job search, hiring and the share of hiring that is on permanent contracts (see Box 2). In addition, there is evidence that the grandfathering has mitigated the impact of the reform on job separations (although it introduced some inequalities between workers, depending on when they signed their contract).<sup>9</sup>

The reforms also introduced changes to the way severance payments are to be made. A dismissal fund (*Fundo de Compensação do Trabalho* – FCT) was set up which collects compulsory monthly contributions from employers into a savings account linked to each worker.<sup>10</sup> The purpose of the fund is to cover up to 50% of the severance pay in case of dismissal. Since October 2015, payments to the fund stop when this amount has been reached. When a worker is dismissed, the fund pays the part of severance pay that has been saved up, and the employer pays the remaining part. While the fund does not affect the overall cost of dismissal, it at least reduces the up-front cost as well as the liquidity risk of high severance payment obligations. If the worker leaves of his/her own accord, the employer can obtain a refund of the total amount saved up in that worker's account.

In addition, an insurance fund (*Fundo de Garantia de Compensação do Trabalho* – FGCT) was set up to protect workers in case the total amount of severance pay the employer can afford and the part paid by the FCT do not add up to 50% of what the worker is entitled to. The FGCT basically ensures that the worker receives at least 50% of the severance pay entitlement, and this is independent of the fund's performance (so the financial risk is borne entirely by the fund and the employers, and not by the workers).

While the new Portuguese system for severance payments reduces the up-front cost of dismissal to the employer and offers some insurance to the employee, it does not solve the problem that high accumulated severance pay rights act as a disincentive to mobility on the part of the worker. In this sense, the Portuguese system is very different from, for example, the Austrian severance pay system introduced in 2002, in which employers contribute to an individual worker's account which is transferrable from one employer to another. Upon retirement, employees can claim the remaining entitlements built up in their account as a cash payment or convert them into an annuity. By making accumulated severance payments entirely transferable from one employer to another, the Austrian solution eliminates obstacles to worker mobility. That being said, the Austrian system has the disadvantage that the financial risk in case the fund underperforms is borne entirely by the worker. In addition, the system is more expensive and therefore increases labour costs.

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9. The immediate positive effect on hiring combined with the delayed effect on firing is reminiscent of the transitional “honeymoon” job-creating effect described by Boeri and Garibaldi (2007) in the context of two-tier labour market reforms which liberalised the use of temporary contracts while leaving largely unchanged the legislation applying to the stock of workers employed under permanent (open-end) contracts. Their model predicts that there would be an immediate effect on hiring and therefore short-run employment gains, but that the latter would eventually be dissipated by the decline of insider workers.
  10. In practice, these contributions are waived for the first two years of the existence of the fund (or until the employment contract is terminated, whichever comes first) through the temporary Employment Incentive measure (*Incentivo Emprego*).

### Box 2. The impact of severance pay reforms in Portugal on on-the-job search and worker flows

The primary objective of the severance pay reforms carried out in Portugal over the period 2011-2013 was to encourage a more efficient re-allocation of labour resources. With lower severance pay entitlements, workers might be less reluctant to switch jobs, resulting in increased on-the-job search and job-to-job flows. For employers, lower severance pay could increase both hiring and firing rates. However, because accumulated severance pay entitlements were largely preserved by the reform, one would expect the largest (short-run) effects to be on hiring only (and possibly on the firing/job-to-job moves of new hires). In addition, because the reduction in severance pay was larger for permanent than for temporary contracts, one might expect to see an increase in the share of hiring that is on permanent contracts. At the same time, it is important to remember that severance pay was cut for both types of contract, and so the reform should have encouraged hiring on temporary as well as on permanent contracts.

New OECD analysis carried out in the context of this project uses the European Labour Force Survey and the Portuguese *Quadros de Pessoal* (a linked administrative employer-employee dataset) to shed some initial light on the impact of the reforms on on-the-job search and worker flows. The intuition behind the analysis is to assess whether workers and employers most deeply affected by the changes in severance pay have the greatest change in behaviour in line with what the theory would predict. For example, one would expect to observe a higher probability of on-the-job search for those individuals for whom the difference between actual/current severance pay and that which they would have received under the old rules is greatest. Similarly, employers might be more likely to fire workers for whom the reforms have meant the greatest reduction in severance pay (as measured by the difference between actual severance pay and what they would have been entitled to under the old rules). As far as hiring is concerned, employers will be more forward-looking and interested in the new rules (applying to new hires) rather than the actual rules (applying to existing workers). In this case, one would expect to see more hiring among employers where the difference in severance pay between the old and new rules is the greatest. Finally, one might expect to see an increase in the share of hiring that is on permanent contracts amongst those employers who saw a larger fall in severance pay for permanent workers than for temporary ones.

While a range of different models are run with different dependent variables and on different datasets (full details can be found in Annex C), the basic approach is to estimate an equation of the following type:

$$Y_{it} = \beta_0 + \beta_1 SP_{it} + \sum_{c>1} \beta_c X_{cit} + \gamma_t + \delta_g + \varepsilon_{it}$$

Where:  $Y_{it}$  is the outcome of interest (on-the-job search, job separations/employment outflows, hiring, share of permanent hiring) for individual, firm or occupation  $i$  at time  $t$ ;  $SP_{it}$  is a variable which measures the extent to which the individual/firm/occupation was affected by the severance pay reform;  $X_{cit}$  are a range of individual, firm or occupation characteristics. All specifications also include fixed effects for time ( $\gamma_t$ ) and, depending on the model run, occupation/firm fixed effects ( $\delta_g$ ). Because the models explore three separate reforms (1 November 2011, 1 November 2012, and 1 October 2013) which affect different groups in different ways, they may be thought of as a difference-in-differences set-up.

The results (presented and discussed in full in Annex C) largely confirm the predictions of the theory and indicate that the reforms: promoted on-the-job search; encouraged hiring (although these results are less robust); increased the share of hiring that is on permanent contracts; and had no noticeable effect on outflows from employment into unemployment and inactivity. The effects also appear to be larger for small firms than for large ones.

Some additional and different analysis (also presented in Annex C) indicates that job separations were more likely for individuals hired just after the reform than for those hired just before – and this effect appears to be driven primarily by separations which are at the employer's initiative (i.e. firing). These results indicate that the preservation of accumulated severance pay rights for existing workers successfully mitigated the short-run effect of the reforms on their likelihood of being fired. At the same time, however, this "grandfathering" introduced some inequalities in the labour market, depending on when workers signed their contract.

While these results are interesting and broadly consistent with what the theory would predict, they need to be interpreted with care because: i) the reforms were implemented very recently and their full impact on the labour market might not be observable yet; ii) the nature of the reforms means that it was not possible to identify clear treatment and control groups, and therefore the causality of the observed effects cannot be established with full certainty. On the other hand, the findings are surprisingly consistent across models and datasets, as well as robust to a falsification exercise. Either way, further research will be required to ascertain the findings obtained here.

*A new reason for dismissal was introduced: Inadaptability without change to the nature of the job*

Another characteristic of Portuguese labour law prior to the reforms was the relatively strict definition of fair dismissal in the case of regular contracts, which derives from the Constitution itself, and which made it very difficult, in practice, for employers to dismiss workers on open-ended contracts.

Prior to the reforms, a worker in Portugal could be dismissed for inadaptability if, following a change in the nature of the job (e.g. as a result of technological change or the adoption of new production/sales practices), s/he showed a continuous fall in productivity or in the quality of the work performed, which could not be remedied by additional training and a period of adaptation on the job. In addition, the employer needed to prove that there was no other, suitable position that the worker could be offered instead (*repêchage*). The difficulty of proving the existence of these conditions (and the ensuing legal uncertainty) meant that this form of dismissal was rarely used in practice (MTSS, 2007; Monteiro Fernandes, 2012; Pestana Nascimento, 2012; Phalempin, 2014).<sup>11</sup> Analysis of Social Security data especially provided for this report suggests that inadaptability accounted for less than 1% of job separations prior to reform (Figure 5).

To give employers more flexibility, the reforms introduced a second type of dismissal for inadaptability: that which does not require a change in the nature of the post and which, therefore, is more closely aligned with the concept of dismissal for “unsuitability”. This form of dismissal also no longer requires the employer to prove that there was no other position that the worker could have been moved to instead (*repêchage*).

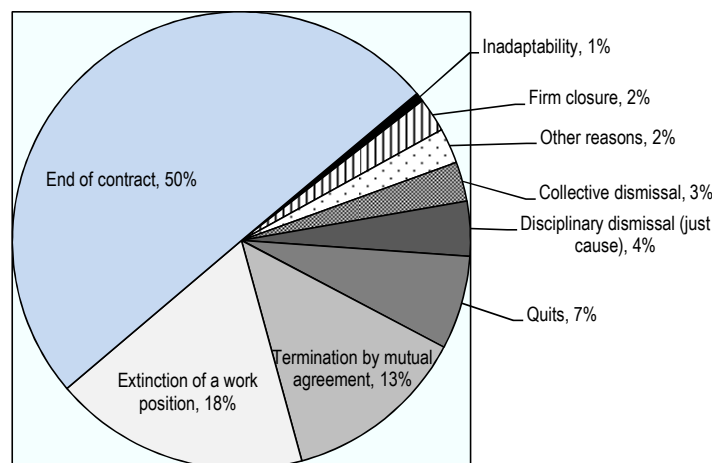
While it remains to be seen how these new regulations will be interpreted by the courts in practice, initial reactions by lawyers indicate that dismissing a worker for inadaptability (even without change in the nature of the post) will remain difficult in Portugal (Monteiro Fernandes, 2012; Phalempin, 2014). First, the procedure remains complicated (including notification and consultation procedures), and proving that a worker’s productivity or quality of work has significantly declined will remain difficult. Second, even though the new form of dismissal for inadaptability does not require the employer to prove that there was no other, suitable position available, this may make little difference in practice. This is because Article 53 of Portugal’s Constitution, which guarantees workers “security of employment” and prohibits “dismissals without just cause”, has traditionally been interpreted in a very strict sense as meaning that the employment relationship can only be terminated as a last resort, in situations where all other options have already been explored. That being said, the reform might at least send a signal to employees that the preservation of an employment relationship will, from now on, depend to a larger extent on their maintaining a satisfactory level of productivity.

11. According to Pestana Nascimento (2012) the conditions that needed to be fulfilled for dismissal on the grounds of inadaptability were so demanding that, until the change in the law in August 2012, only two judgments were pronounced on the matter.



Figure 5. **Reasons for job separations, first six months of 2012**

As a proportion of all flows from employment into unemployment



Note: Based on a 2% extract of all individuals registered with social security on 31 December 2012. Termination by mutual agreement can include termination of the employment contract as part of a recovery plan in the case of bankruptcy.

Source: OECD analysis based on social security data.

#### *Dismissal for extinction of a work position: Closer alignment with the rules for collective dismissals*

Prior to the reforms, employers in Portugal had to follow strict seniority-based (“last in, first out”) rules to select a worker to be dismissed in case of extinction of a work position. This made it difficult for employers to adjust their workforce in accordance with their business needs. In particular, it meant that dismissals were not necessarily based on worker productivity. These requirements for individual dismissal stood in stark contrast to those for collective dismissal, where employers could define their own criteria for selecting the workers to be dismissed. Anecdotally, this encouraged small firms (fewer than 50 employees) to opt for collective dismissal instead given that, in Portugal, such firms need to dismiss just two workers for the dismissal to be classified as collective.

The reform tried, but failed (as a result of a decision of the Constitutional Court) to allow employers to also select their own criteria for individual dismissal in case of extinction of a work position. The government then had another go at re-defining the criteria, and the end result is a new set of rules which moves away from seniority-based criteria, to ones based on performance and cost. In this sense, the criteria were at least more closely aligned with those that employers would tend to choose in the case of collective dismissal. Again, however, it remains to be seen how these will be applied in practice by the courts. In particular, there appears to be concern among some commentators that performance-related criteria remain too subjective and therefore difficult to assess by the courts.<sup>12</sup> That being said, the legal system does not appear to have had much trouble to date in assessing the criteria chosen by employers in the case of collective dismissal (Carvalho Martins, 2014) – so these concerns may be exaggerated.

12. Which may lead to another rejection by the Constitutional Court (Távora and González, 2015).

Dismissal for extinction of a work position is also subject to the *repêchage* condition – i.e. the need to prove that there was no other suitable position that the employee to be dismissed could have been moved to. While the reform tried to remove this condition, the Constitutional Court ruled it unconstitutional.

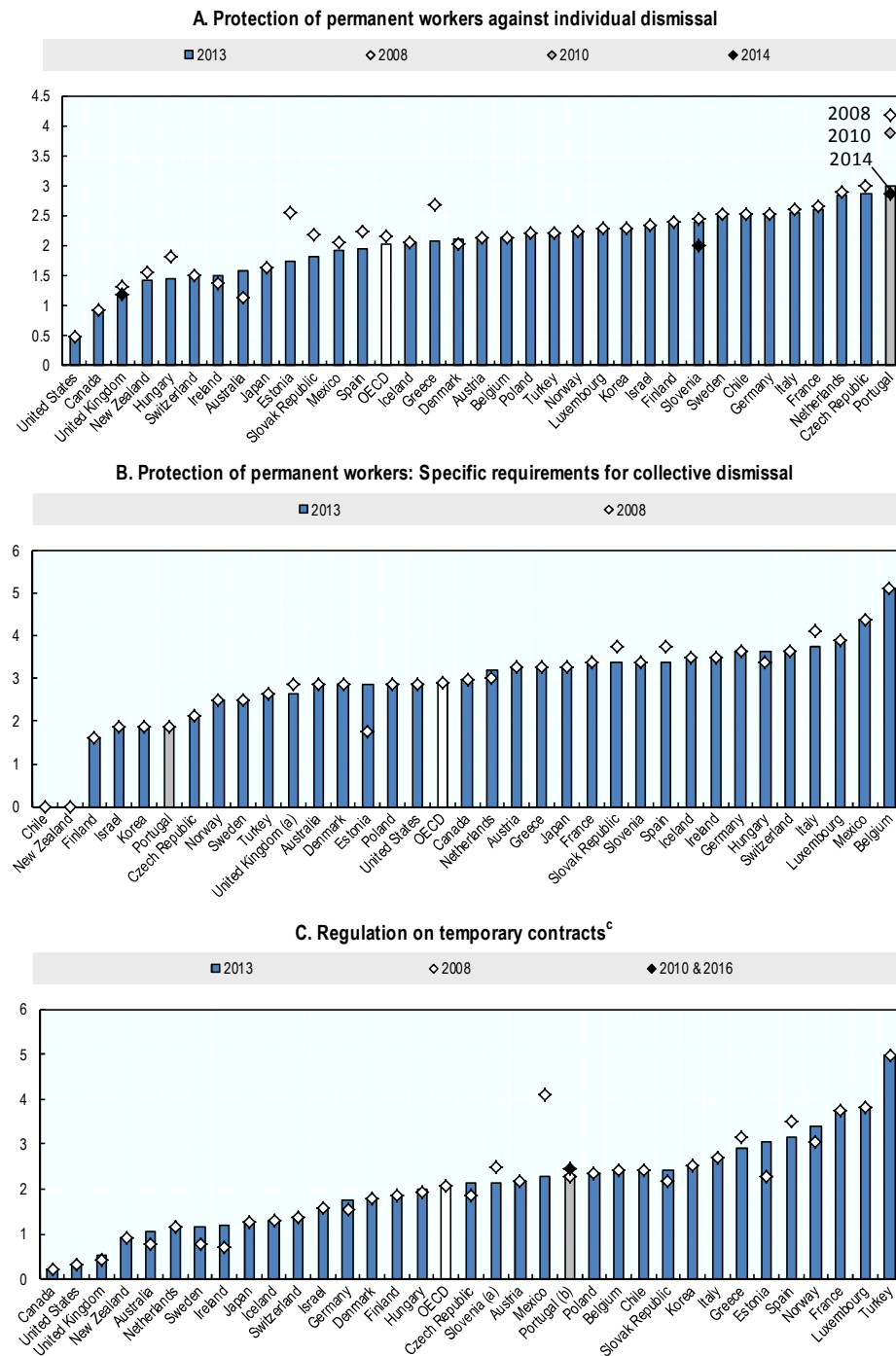
***These changes have significantly reduced Portugal's EPL – but much remains to be done***

The importance of the reforms described above can be analysed using the OECD indicators of employment protection legislation (EPL), which measure the procedures and costs involved in dismissing individuals or groups of workers and the procedures involved in hiring workers on fixed-term or temporary work agency contracts. Using this indicator, Figure 6 shows how the stringency of EPL evolved between 2008 and 2013 in OECD countries, and also provides provisional data for Portugal for the years 2014-2016 (where these are different from 2013). The stringency of EPL is shown separately for: i) individual dismissals of workers on permanent contracts (Panel A); ii) additional provisions for collective dismissals (Panel B); and iii) hiring on temporary contracts (Panel C). The comparative analysis shows that, following a trend common across many other OECD countries, the employment protection for permanent workers against individual dismissal has been significantly reduced in Portugal over the period 2008-2013. Despite this, the stringency of EPL for permanent workers remains the highest in the OECD, along with that of the Czech Republic. In the final chapter, some of the reasons behind this difference will be explored, along with further options for reform. Additional requirements for collective dismissal (e.g. notification requirements and additional delays) have always been relatively light in Portugal compared to other OECD countries, and this continues to be the case (Panel B).<sup>13</sup>

Finally, Panel C shows that hiring on temporary contracts in Portugal continues to be only marginally more difficult than in the OECD on average. During the crisis, regulation on temporary contracts in Portugal was reduced slightly, which reflects a measure which allowed exceptional renewals of temporary contracts. While the standard maximum cumulated duration of successive fixed-term contracts in Portugal is three years, two exceptional extensions of temporary contracts were permitted during the reforms. The first of these came into force on 11 January 2012 and allowed two additional extensions (not exceeding 18 months overall) of all fixed-term contracts that were set to reach the maximum duration limit by the end of June 2013. The second exceptional renewal came into force on 8 November 2013 and allowed all fixed-term contracts that would reach the maximum duration limit by 7 November 2015 to be extended twice (but not exceeding 12 months overall). As pointed out by Carvalho Martins (2014), this led to a situation where, in the most extreme case, fixed-term contracts of pre-defined duration could last for a total of five and a half years. While the purpose of these temporary extensions was to mitigate the impact of the crisis on unemployment, they may also have reduced the desired impact of the reforms on labour market duality in the short-run.

13. If anything, Figure 6 overestimates the difficulty of collective dismissals in Portugal. This is because the OECD EPL indicator is calculated as the sum of various components which measure the additional difficulty of collective dismissal over individual dismissal. The lowest score on each of these indicators is zero, and no negative values are allowed where collective dismissal is easier than individual dismissal (as is the case in Portugal).

Figure 6. Changes in the OECD indicators of employment protection, 2008-2013



- 2014 instead of 2013.
- The lower value for Portugal for 2013 reflects the temporary measures which allowed extraordinary renewals of temporary contracts.
- This captures the relative difficulty with which employers can hire workers on temporary contracts.

Source: OECD Employment Protection Database, 2013 update and preliminary OECD calculations for Portugal for 2014-2016.

### ***Expected effect on productivity and growth***

As shown in the previous section, the EPL reforms in Portugal were significant, implying a 0.93 point fall in the OECD EPL indicator. By way of comparison, the 2012 labour market reform in Spain resulted in just a 0.44 point fall in this indicator. One would expect reforms of this type to have an impact on labour productivity growth by improving the allocation of labour resources and reducing labour market duality. However, as argued above, the preservation of severance pay rights means that the impact on productivity will take time to materialise and so the immediate effect is likely to be small and therefore difficult to measure.

It is nonetheless possible to obtain an educated guess of what the potential long-term effects on productivity and growth of the Portuguese EPL reforms are likely to be, by using estimates previously obtained in the economic literature. For instance, Bassanini, Nunziata and Venn (2009) use industry-level data for 16 OECD countries over a period of more than 20 years and show that a reduction of half a point on the OECD EPL indicator for individual and collective dismissals raises multi-factor annual productivity growth in the business sector (excluding agriculture, mining, energy, real estate and professional services)<sup>14</sup> by 0.45 percentage points and labour productivity growth by 0.3 percentage points.

Using these estimates, one would therefore expect labour productivity growth in Portugal to increase by as much as 0.56 points once the reforms fully take effect. If in addition it is assumed that the share of the business sector (excluding agriculture, mining, energy, real estate and professional services) is 53% (i.e. equivalent to its 2010, pre-reform level), and that there is no impact of the EPL reforms on employment and productivity in other industries, one would expect a 0.30 point increase in annual GDP growth.

### ***Other reforms and measures in the area of employment protection legislation***

While these will not have impacted on the OECD's indicator for employment protection legislation, a few other changes and measures have been implemented in the past few years in the area of EPL, including: additional measures to tackle dependent self-employment and changes to contracts of very short duration.

#### ***Additional measures to tackle dependent self-employment have been taken***

One way in which increasing labour market duality manifested itself in Portugal was through a rise in dependent self-employment (so-called “false” self-employment or *falsos recibos verdes*<sup>15</sup>). These are situations in which the worker is formally self-employed, but the conditions of work are *de facto* similar to those of employees. For the employer, such a contractual relationship offers obvious advantages in terms of lower costs and risks.<sup>16</sup> For the worker there may be some advantages as well (e.g. the possibility of negotiating higher fees), but in practice this depends on the worker's bargaining power (which is often very low, given the lack of union representation) and frequently comes at the cost of significant reductions in social protection and job security. Because of the vulnerability that such employment relationships put workers in, many countries have legislation in place which aims to protect them, including conditions under which an employment contract would be presumed and the self-employed person considered a wage earner of the employer.

14. These industries were excluded by Bassanini, Nunziata and Venn (2009) due to the difficulty of accurately measuring multi-factor productivity growth in those industries.

15. The *Recibos Verdes* were introduced in Portugal in 1978 and were initially targeted at the liberal professions only. However, the great flexibility of the system meant that their use expanded considerably beyond their initial purpose (COE, 2015), and with it cases of abuse. Employers are not required to pay any social security contributions (which are paid by the employees), paid holidays or tenure-related salary increments.

16. Such types of working arrangements might also be used by employers to introduce additional competition for existing workers and thereby stymie wage demands and rises.

In 2012, it was estimated that nearly one in ten self-employed workers (with no employees) in Portugal was in a dependent self-employment relationship (ILO, 2014). While Portuguese labour law already defined the conditions under which an employment contract would be presumed, the reforms gave labour inspectors (*Autoridade para as Condições do Trabalho* – ACT) additional tools for enforcing the existing regulations and regularising contracts in cases of non-compliance. However, some may question what difference these new measures will make on the ground given that the ACT appears to struggle with a lack of resources to do its job effectively (Martins, 2015) and the recruitment of 80 new labour inspectors announced as part of the 2016 budget is certainly a move in the right direction.<sup>17</sup> That being said, the number of labour inspectors remains low in Portugal (307 in 2015), particularly given the fact that most firms in Portugal are SMEs.

#### *Contracts of very short duration*

The Portuguese Labour Code specifies a special form of temporary contract of very short duration (*muito curta duração*) which can be used for the purposes of seasonal agricultural activities or the organisation of touristic events. This contract is not subject to written form, although its celebration should be communicated electronically to social security. Prior to the reforms, these contracts could last no longer than a week, with a limit of 60 days over a period of 12 months. The length of these contracts was increased to 15 days, and the overall annual limit to 70 days.

#### **Access to unemployment benefits has been eased, but their generosity reduced to incentivise a more rapid return to work**

Unemployment benefits provide essential protection for workers against the loss of income from work, thus allowing them to smooth consumption as they engage in job search. In this sense, unemployment benefits have a welfare-enhancing role. In addition, by “buying time” for the unemployed, such benefits enable job searchers to find work that better matches their skills and experience. From a macroeconomic perspective, consumption smoothing acts as an automatic stabiliser. However, benefits, particularly where they are generous (in terms of replacement rates and duration), can also create disincentives for recipients to look for and take up work (OECD, 2006; Tatsiramos and van Ours, 2012; Venn, 2012) and therefore lengthen unemployment spells.

Prior to the reforms, Portugal had a relatively generous unemployment benefit system compared to other OECD countries, which is likely to have contributed to a high rate of long-term unemployment. To address this issue, Portugal lowered the cap on the maximum benefit amount and introduced a declining replacement rate to incentivise a more rapid return to work. In addition, the maximum duration of unemployment benefits was shortened – although this would only apply from the second unemployment spell onwards, so that an element of protection was kept in place during the recent episode of high unemployment. Unfortunately, this also means that the impact of the reform on long-term unemployment will take time to materialise. While it was possible to estimate the impact of the lowering of the cap and the introduction of the declining replacement rate, the early evidence appears inconclusive: the estimates indicate that these reforms have increased exits to employment, but they are all statistically insignificant. The reforms have nevertheless moved Portugal closer to the OECD average in terms of the generosity of unemployment benefits and, if past experience is anything to go by, they should eventually help shorten unemployment spells and reduce the level of long-term unemployment. That being said, the average maximum duration of unemployment benefits remains relatively high in Portugal compared to the OECD average.

17. Three years after Law No. 63/2013 came into force, ACT detected a total of 2 488 irregular workers. Many cases were voluntarily regularised by the employer (33.6% in 2014 and 60.9% in 2015) and the proportion of cases reported to the Public Prosecutor's Office reduced from 28.1% of the total cases detected in 2014 to 13.4% in 2015.

At the same time, with soaring unemployment rates and EPL reforms which made it easier for employers to dismiss workers, there was a need to widen the safety net provided by unemployment benefits, which Portugal achieved by relaxing the contribution/employment requirements for unemployment insurance. The evidence suggests that, despite a significant increase in unemployment between 2011 and 2013, the coverage rate of unemployment benefits held up well (and even increased slightly) over the same period. Since 2014, however, there has been a slight fall in the coverage rate, which is probably related to the increase in the number of long-term unemployed (and individuals running out of unemployment benefit).<sup>18</sup>

***Access to unemployment benefits was made easier, but their generosity declined***

In Portugal, unemployment insurance (*Subsídio Desemprego* – SD) is available to all individuals with sufficient contribution history, and the benefit amount is estimated as a proportion of previous earnings while duration increases with age and contributory history. Those who are not entitled to unemployment insurance may be entitled to unemployment assistance (*Subsídio Social de Desemprego Inicial* – SSDI) as long as they meet the necessary contribution conditions (which are less stringent than for unemployment insurance) and pass the means test. Unemployment assistance benefit amounts are linked to the social support index (*Indexante dos Apoios Sociais* – IAS) and depend on family type, while duration is calculated in the same way as for unemployment insurance. Unemployed individuals who exhausted the maximum duration of unemployment insurance may also be entitled to unemployment assistance (*Subsídio Social de Desemprego Subsequente* – SSDS) as long as they pass the means test. In the case of SSDS, the duration is equal to half the duration individuals were entitled to under unemployment insurance.<sup>19</sup> Finally, the *Rendimento Social de Inserção* (RSI) is a means-tested benefit of last resort.

In 2012, Portugal introduced reforms which facilitated access to unemployment benefits, while reducing their generosity (both in terms of duration and the replacement rate):

1. *Entitlement.* Access to unemployment insurance was made easier by lowering the necessary contributory history from 450 to 360 days over the past 24 months.
2. *Duration.* Maximum benefit duration was reduced from 900 to 540 days (depending on contributory history and age) – although additional increments based on contributory history were maintained, meaning that benefit duration for those with a long contribution history (and especially those aged over 50) could exceed this maximum. In the interest of protecting workers during the current crisis, the new rules would only start applying from the individual's second unemployment spell after the reform onwards. In the case of individuals aged 40 or over, the duration of unemployment assistance was increased (again, from the second unemployment spell onwards).
3. *Replacement rate.* The maximum amount of unemployment insurance that an individual could receive was reduced from three times the IAS to 2.5 times the IAS (but there was a temporary increase of 10% in unemployment insurance for individuals in workless households). In addition, Portugal introduced a declining replacement rate rule for unemployment insurance which meant that benefits would be reduced by 10% after six months to encourage greater job search effort.<sup>20</sup>

18. Note that an increase in long-term unemployment does not mean that the shortening of maximum benefit duration was not effective. Indeed, the rise in long-term unemployment may have been even steeper in the absence of the reforms.

19. Unemployment assistance may be renewed until the pensionable age is reached provided that: i) when unemployment begins, the insured person is aged 52 or over; and ii) by the time of its renewal, the insured person continues to meet the qualifying conditions.

20. In systems (like the Portuguese) where individuals are moved onto (less generous) unemployment assistance upon exhaustion of their regular unemployment insurance entitlement, there is, technically speaking, already

Another initiative the government took to encourage a return to work was to allow the unemployed to keep part of their benefits (50% during the first six months and 25% for the subsequent six months, within certain limits) if they accepted a full-time low-paid job.<sup>21</sup>

Finally, and in addition to the measures outlined above, the government introduced a contributory system of unemployment protection for self-employed workers who work mainly with only one contracting entity. Those who have exercised a dependent self-employment activity for at least 24 months out of the 48 preceding the termination of a service agreement, are now entitled to unemployment benefits. The generosity of these benefits depends on the individual's prior earnings, while the duration is linked to the individual's age and past labour market attachment. The system is financed through a 5% tax paid by employers. More details about the scheme can be found in Annex A. Of course, because entitlement would need to be built up to gain access to this benefit, its impact will only be noticeable in the medium- to long-term (Silva and Pereira, 2012).

***The reforms brought the generosity of Portuguese unemployment benefits closer to the OECD average, although maximum duration remains high***

As this section will show, Portugal had a relatively generous unemployment benefit system compared to other OECD countries prior to the crisis, both in terms of the replacement rate and the maximum duration of benefits. On both aspects, the reforms brought the generosity of the Portuguese unemployment benefit system more in line with that of other OECD countries, although maximum duration of unemployment insurance remains relatively long in Portugal compared with other OECD countries. At the same time, it was relatively more difficult in Portugal to gain access to unemployment insurance (due to longer contribution history requirements), and the reforms aligned the Portuguese system with standard practice across the OECD.

*Maximum duration of unemployment insurance*

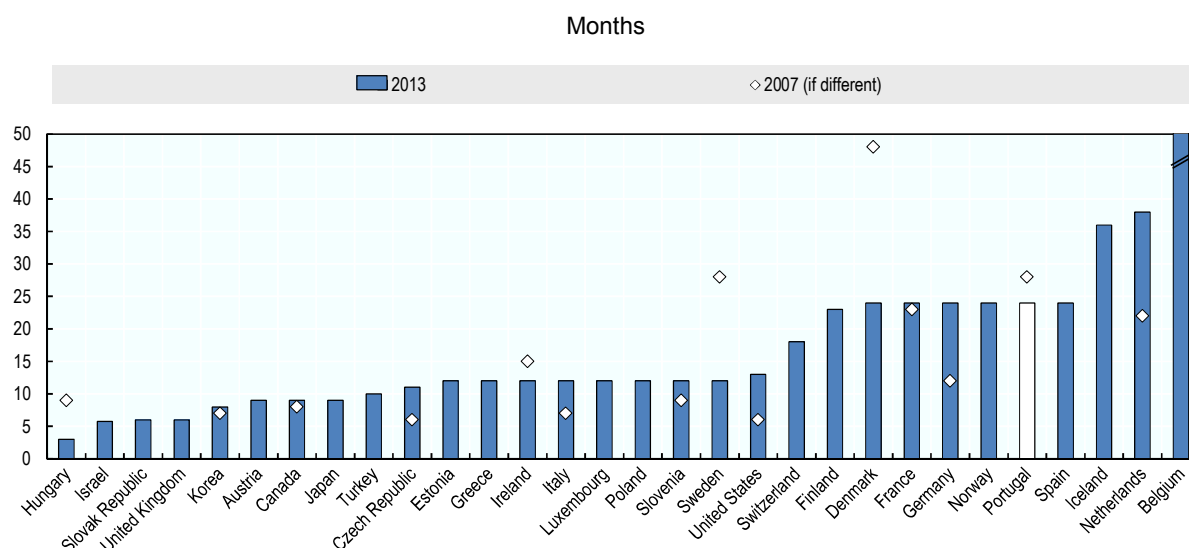
While Portugal reduced the maximum duration of unemployment insurance, it remains long compared to other OECD countries (Figure 7). In the median OECD country, the maximum duration of unemployment insurance is 12 months, compared to 24 months in Portugal. While Belgium is the only country where the duration of unemployment insurance is unlimited, it is important to point out that in many countries the duration of unemployment benefits is *de facto* unlimited because, once individuals run out of unemployment insurance, they are moved onto unemployment assistance which often can be claimed indefinitely (albeit with lower replacement rates and subject to a means test, so that coverage will be much lower). This is the case in Austria, Finland, Germany, Ireland, and the United Kingdom. In Australia and New Zealand, where no unemployment insurance exists, individuals are entitled to unemployment assistance for an unlimited period of time.

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a built-in declining benefit schedule (conditional on a means test, which often excludes those with a working spouse, for example).

21. It was already possible (since 2006) to keep part of one's unemployment benefit when working part-time. The new measure just extends this possibility (with different rules for the calculation of the benefit) to low-paid full-time jobs. Note that, in Portugal, the entitlement to continued UB payments is conditional on relatively restrictive rules around the type of work and the income from that work. By comparison, Japan's reemployment bonus allows people to keep part of their remaining benefit entitlement regardless of the type of job they move into.

Figure 7. Maximum duration of unemployment insurance, 2007-2013



*Note:* For Israel, maximum duration is shown for individuals with at least three dependents. In Denmark, the duration is 24 months in three years. In Belgium, the duration is unlimited. In Chile (not shown), the unemployed withdraw from an individual savings account for as long as their balance permits. For Portugal, the duration shown is estimated for a 40-year-old individual and includes additional increments based on contributory history (i.e. 720 days = 540 days + 4 x 45 days).

*Source:* OECD Social Policies and Data, Policy Overview Tables, Unemployment Benefits.

### *Replacement rate of unemployment benefits*

The generosity of unemployment benefits in Portugal, measured in terms of the replacement rate (i.e. the proportion of income in work that is maintained after job loss), has also moved closer to the OECD average (Figure 8, Panel A). Portugal lowered the maximum amount of unemployment insurance that an individual could receive and also introduced a reduction in benefits after six months of unemployment. Figure 8 shows the net replacement rate<sup>22</sup> (i.e. after taxes and benefits) in Portugal and other OECD countries, averaged across four different household types,<sup>23</sup> two different earnings levels,<sup>24</sup> and over 60 months of unemployment. Between 2007 and 2013, unemployment benefits across the OECD became, on average, less generous – although there are several exceptions (particularly countries where unemployment benefits were not very generous to start with). There was a significant reduction in the generosity of unemployment benefits in Portugal, which aligned them more closely with the OECD average.

22. Comparing the generosity of unemployment benefits across countries as measured by the “replacement rate” is complicated by the many different factors that countries consider when calculating an individual’s entitlement to unemployment benefit (e.g. length of unemployment spell; choice of reference earnings; floors and ceilings for unemployment benefits; number of dependents; age; interactions with the rest of the tax/benefit system; etc.) Besides differences across countries in how such benefits are calculated, these calculation rules also mean that there will be not just one, but many different replacement rates within each country. To circumvent some of these issues, the OECD computes replacement rates for “typical” worker and household cases, depending upon whether they are single or married, have children or not, for different levels of previous earnings (67%, 100% or 133% of average earnings), and for different phases of the unemployment spell.
23. Single person without children, one-earned married couple without children, lone parent with children, one earner-married couple with children. Most Portuguese households are composed of two earners with (36%) or without (24%) children.
24. For full-time earnings of 67% and 100% of average earnings.

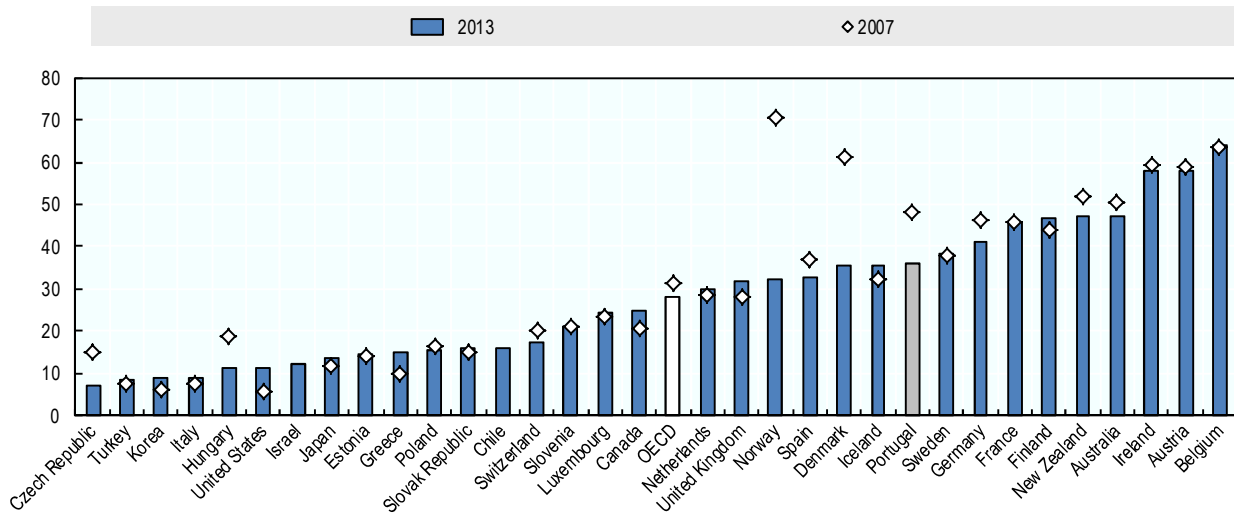


Panel A looks at the replacement rate of unemployment benefits only, which shows that they remain slightly more generous than in the OECD, on average. However, the unemployed are entitled to other benefits, including housing benefits and social assistance (like the RSI in Portugal). Once these benefits are taken into account as well, the replacement rate in Portugal is actually slightly below the OECD average (Figure 8, Panel B). One issue here is the generosity of the RSI, which was significantly reduced in recent years and led to a large decline in the number of beneficiaries. This is something which will be further discussed in Chapter 2 of this report.

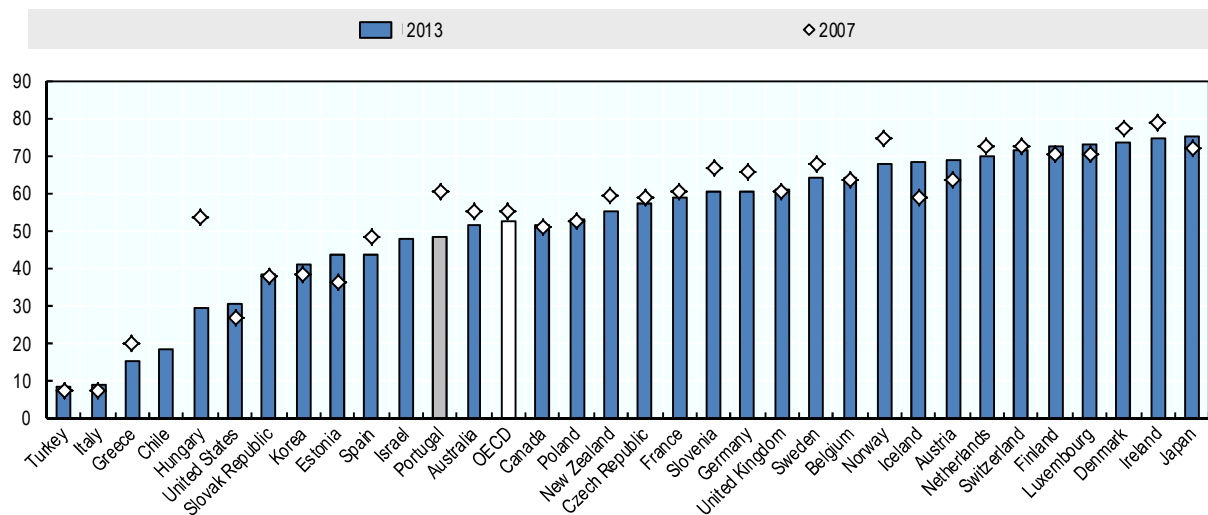
Figure 8. **Unweighted average of net replacement rates over 60 months of unemployment, 2007-2013**

Averaged over four family types and two earnings levels, in percent

**A. Family does not qualify for cash housing assistance or social assistance "top ups"**



**B. Family qualifies for cash housing assistance or social assistance "top ups"**

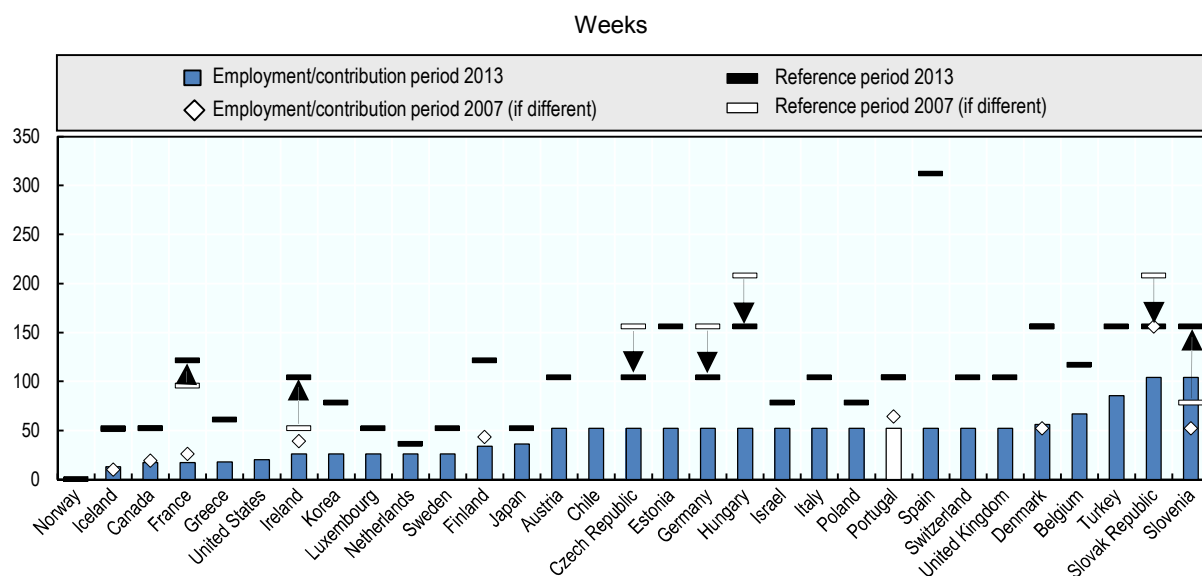


Source: OECD Tax-Benefit Models (revised 18/09/2015).

### *Employment/contribution requirements for unemployment insurance*

The ease of access to unemployment insurance is determined both by the employment/contribution requirements as well as by the reference period over which these contributions are calculated. Prior to the reforms, Portugal's contribution requirements were slightly higher than those generally observed across the OECD, but the reforms have brought these more in line with standard practice (i.e. around 12 months of contributions) – Figure 9. The reference period over which these contributions are estimated has not changed in Portugal but, at 24 months, is in line with OECD norms.

Figure 9. **Previous employment and contribution conditions for unemployment insurance, 2007-2013**



*Note:* In some countries, eligibility depends on employment only, in others it depends on contributions, while in others still it depends on both. Not all countries express previous employment/contribution conditions in weeks, and therefore the figures presented above are approximate only. Assumptions made for the conversion to weeks include: 1 year = 12 months = 52 weeks. For Canada, the conversion from hours to weeks is done on the assumption of 36.6 hours per week (<http://well-being.esdc.gc.ca/misme-iowb/3ndic.1t.4r@-eng.jsp?iid=19>). For Greece, the calculation is based assuming the condition of 125 days in the last 14 months. In the United States, another condition is the minimum earnings requirement. For Ireland, the calculation is based on 26 contributions paid in each of the two relevant tax years preceding the benefit year. For the Netherlands, the calculation is based on eligibility for the short-term benefit. In Sweden, the individual also needs to have been a member of an insurance fund in the last 12 months. In Finland, one week equals a minimum of 18 hours only. In Japan, the individual needs to have worked more than 11 days per month. For Austria, the calculation is based on the basis of the first spell of unemployment. For Chile, the calculation is for permanent contracts. In Denmark, an additional requirement is the payment of a membership fee and the work needs to have been full-time. In Turkey, the individual needs to have contributed continuously in the last 120 days. In Norway, prior work income needs to have been 24% of the average wage in the preceding calendar year, or 49% in the three preceding years.

*Source:* OECD Social Policies and Data, Policy Overview Tables, Unemployment Benefits.

Figure 9 also shows that a number of other countries eased access to unemployment insurance during the crisis, either by just shortening the contribution period (Canada and Finland) or by extending the reference period as well (France and Ireland). In a few countries, unemployment insurance became more difficult to access. Chile, Germany and Hungary all shortened the reference period over which contributions would be assessed (but all had relatively long reference periods to start with). The Slovak Republic and Slovenia were both countries where access to unemployment insurance was relatively stringent prior to the crisis, but they have moved in very different directions since. While the Slovak Republic shortened both the reference and the contribution periods, Slovenia did exactly the opposite.

***The reduction in unemployment benefit generosity should help reduce the rate of long-term unemployment***

Given the well-established link between unemployment benefit generosity and unemployment duration, one would expect the reforms in Portugal to reduce the incidence of long-term unemployment. Evidence from previous unemployment benefit reforms in Portugal has shown a clear relationship between benefit generosity and work incentives. In particular, evaluations have shown that the extension of the maximum duration of unemployment benefits in 1999 prolonged unemployment spells, and also that this reform was regressive (i.e. it benefited primarily those higher up the income distribution). Further details are presented in Box 3.

**Box 3. Unemployment benefit generosity and work incentives: Evidence from Portugal**

Júlio and Ramalho (2012) and Lopes (2015) show how exit rates from unemployment in Portugal are bunched around the time of benefit exhaustion, suggesting that unemployment benefits create disincentives for job search. A number of earlier studies had produced causal evidence of the impact of maximum benefit duration on the length of unemployment spells by exploiting a reform of unemployment benefits that occurred in 1999. These findings are discussed below.

In 1999, the maximum duration of unemployment insurance benefits in Portugal depended exclusively on an individual's age at the beginning of the unemployment spell. It ranged from ten months for individuals aged under 25, to 30 months for those aged 55 or over. In July 1999, the maximum duration of unemployment insurance benefits increased for certain age groups, with a new minimum of 12 months and a new maximum of 38 months for those aged 45 and over. Table A provides more detail on the maximum benefit durations by age group, before and after the reform.

**Table A. Maximum duration of unemployment insurance benefits in Portugal before and after the July 1999 reform**

Months

Before the reform		After the reform	
Age group	Maximum benefit duration	Age group	Maximum benefit duration
15-24	10	15-29	12
25-29	12	30-39	18
30-34	15	40-44	24
35-39	18	45-64	30 (+8) <sup>a</sup>
40-44	21		
45-49	24		
50-54	27		
55-64	30		

a. Individuals aged 45 or over receive two additional months for every five years of contributions over the past 20.

Source: Centeno and Novo (2007).

Using a difference-in-differences methodology, Pereira (2006) assesses the impact of this reform on the length of unemployment spells. In line with the international evidence which shows that exit rates from unemployment benefits are higher in systems that are less generous, she finds that extending the duration of unemployment benefits in Portugal in 1999 prolonged unemployment spells. She finds that for those aged under 25 and aged 30-35 on the assistance benefit (*Subsídio Social de Desemprego Inicial* – SSDI), the increase in duration of entitlements increased the average days of benefit paid (up to the end of the original entitlement period) by 17.5 days. It is important to point out that this is only the “anticipation” effect of the benefit extension, and that administrative data (as used by Pereira, 2006) do not allow estimation of the impact during the extension period or beyond, which is likely to be significantly greater.

**Box 3. Unemployment benefit generosity and work incentives: Evidence from Portugal (cont.)**

Centeno and Novo (2007) exploit the same reform and find that the effect on the length of unemployment spells was smaller the greater the liquidity constraints – i.e. extending the duration of unemployment benefits was regressive as it benefited primarily those higher up the income distribution. In their policy recommendations, the authors suggest that unemployment benefit duration in Portugal should be set as a decreasing function of wages prior to the unemployment spell.

Finally, Addison and Portugal (2008) exploit the differences in maximum benefit duration before the 1999 reform and compare individuals who differed by just one year of age but who were in different age groups and, therefore, had a three-month difference in their maximum benefit duration entitlement. Over the three-month periods of the unemployment spell following unemployment insurance, the transition rates into employment were 61% to 82% higher for the groups without unemployment insurance coverage.

As a concluding remark, it is worth remembering that, in addition to unemployment insurance, unemployment assistance is available in Portugal. The relevance of this to the results presented in this box is that, when individuals can move from unemployment insurance to unemployment assistance, the impact of extending the maximum duration of unemployment insurance benefits are likely to be muted.

*Source:* Addison, J.T. and P. Portugal (2008), “How do different entitlements to unemployment benefits affect the transitions from unemployment into employment?” *Economics Letters*, Vol. 101/3, pp. 206-209. Centeno, M. and Á.A. Novo (2007), “A regressividade do subsídio de desemprego: Identificação através do efeito de rendimento da alteração legislativa de Julho de 1999”, *Boletim Económico*, Bank of Portugal, Autumn, pp. 139-156. Júlio, P. and T. Ramalho (2012), “Subsídio de desemprego e transição para o Emprego”, *Boletim Mensal de Economia Portuguesa*, No. 12, Gabinete de Estratégia e de Estudos, Ministério da Economia e do Emprego, and Gabinete de Planeamento, Estratégia, Avaliação e Relações Internacionais, Ministério das Finanças. Lopes, M.C. (2015), “O impacto do tempo de atribuição do subsídio de desemprego na duração do desemprego”, unpublished working paper. Pereira, A. (2006), “Avaliação do impacto das alterações do sistema social de apoio do desemprego”, *Boletim Económico*, Spring, Bank of Portugal.

The impact of the recent reforms is more difficult to assess. The main reason is that the most important reform (i.e. the reduction in maximum benefit duration) cannot yet be evaluated because it does not apply to individuals’ first unemployment spell after the reform. It was nevertheless possible to produce some initial evidence on the reduction in benefit levels (i.e. the reduction in the cap and the declining replacement rate) (Box 4). Both the reduction in the cap and the 10% reduction in unemployment insurance after six months of unemployment appear to have increased exits from unemployment into employment for those affected – but the estimates are not statistically significant (except for the 10% reduction for individuals with low benefit levels, but then only marginally so). The evidence presented here should be seen as preliminary only, and future research should seek to replicate the analysis on larger samples and covering a longer time period after the reform.

**Box 4. Evaluating the impact of the unemployment benefit reforms****Reduction in maximum benefit duration**

The reform which will probably have the greatest effect on the behavior of the unemployed is the reduction in maximum benefit duration. However, because workers will still be entitled to unemployment insurance under the old rules for their first unemployment spell after the reforms, it is impossible at this stage to assess the impact of this reform on unemployment duration.

**Reduction in benefit levels**

By contrast, the reductions in benefit levels (reduction in the cap and declining replacement rate after six months) have been applied to all new unemployment spells starting after April 1<sup>st</sup> 2012 and can, therefore, be evaluated. Using a 2% sample of social security records which matches individuals’ contribution history to information on their benefit levels and duration, new OECD analysis presents initial evidence on the impact that these reforms have had on the probability of moving from unemployment to employment. The detailed analysis can be found in Annex D to this report. Below follows a short summary of the main results.

#### Box 4. Evaluating the impact of the unemployment benefit reforms

##### *Reduction in the cap*

To assess the impact of the new cap, a difference-in-differences model is used to compare changes in the probability of exit to employment for individuals whose benefit levels are in the range affected by the change (i.e. unemployment insurance between EUR 1 048.05 and EUR 1 257.66) to individuals whose benefit level is just below the new cap (i.e. between EUR 943.25 and EUR 1 048.05). The results indicate that the probability of exiting to employment has increased more for individuals affected by the reduction in the cap than for those who were not. However, the difference is not statistically significant. This result is confirmed in a second model where the treatment and control groups are made more similar through propensity score matching.

##### *Declining replacement rate*

To assess the impact of the declining replacement rate, a difference-in-differences model is used which compares changes in the probability of exit to employment for individuals who became unemployed in the two months prior to the introduction of the new rule (and therefore were not affected) to individuals who became unemployed in the two months after (and were affected). Once again, the treatment and control groups are made as comparable as possible through the use of propensity score matching. The results indicate that the individuals affected by the 10% reduction in unemployment insurance after six months had a greater increase in the probability of moving to employment than the individuals who were not. Again, however, the difference is not statistically significant. The only exception is for individuals on low benefits, although the coefficient is only marginally significant at the 10% level.

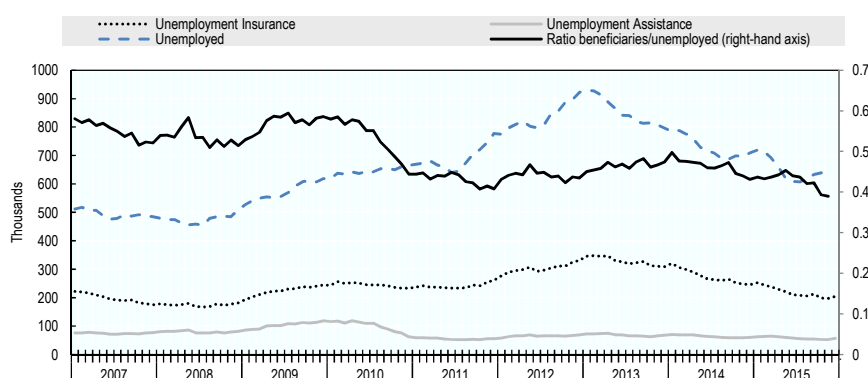
##### *Estimated savings from the reforms*

While the preliminary assessment could not detect any significant effect of the unemployment benefit level reforms on unemployment outflows, the benefit reductions will still have had an impact on the government budget. Over the period April 2012 to September 2015, it is estimated that the reduction in the cap resulted in a total saving of around EUR 70 million, while the declining replacement rate resulted in an estimated saving of around EUR 200 million. These represent an estimated 1.9% and 5.5% savings over the total amount of UI that would have been spent over this period.

#### *Despite significant increases in unemployment between 2011 and 2013, coverage held up well*

While the number of unemployed increased by 200 000 between June 2011 and June 2013, the coverage rate (calculated as the ratio of unemployment insurance/assistance beneficiaries to the number of unemployed) rose slightly from 0.45 to 0.47 over the same period (Figure 10). This will partly reflect the easing of access to unemployment insurance in 2012. From 2014 onwards, a slight fall in the coverage rate can be observed (despite a fall in unemployment), which is likely to be related to the increase in long-term unemployment (see Chapter 2) and individuals running out of unemployment benefit (young people in particular – see Box 5). This is unlikely to reflect the new rules around unemployment benefit duration, because the grandfathering rules ensured that those would only start applying from individuals' second spell of unemployment onwards.

Figure 10. Unemployment insurance and assistance recipients and number of unemployed, January 2011 to December 2015



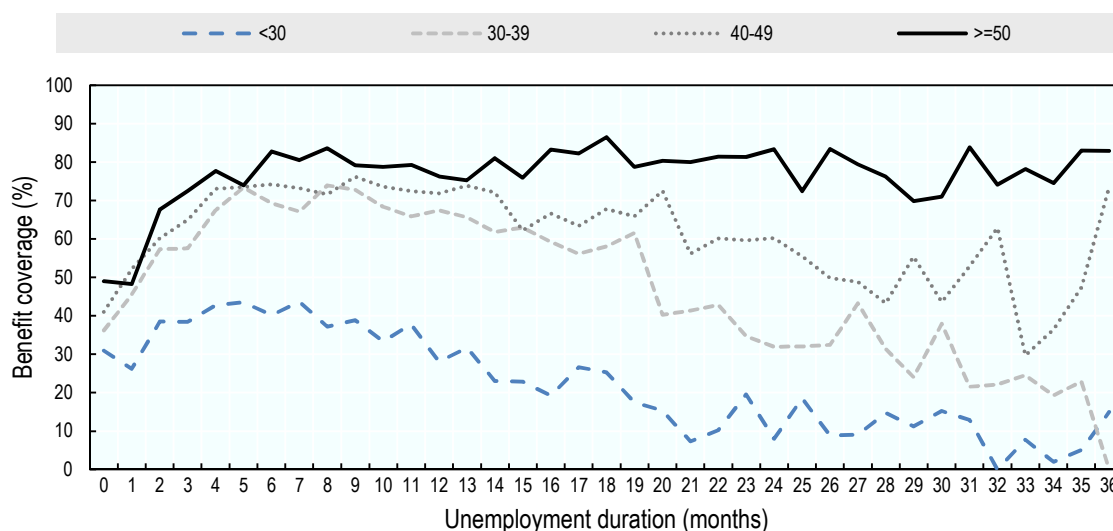
Note: Number of unemployed refers to monthly harmonised unemployment levels. Ratio of beneficiaries/unemployed is calculated as (unemployment insurance + unemployment assistance)/unemployed.

Source: Portuguese official Social Security statistics on unemployment benefits (20/01/2016 release) and OECD Short-Term Labour Market Statistics Database

**Box 5. Unemployment benefit coverage by age and unemployment duration:  
Evidence from the Portuguese Labour Force Survey**

The Portuguese Labour Force Survey (*Inquérito ao Emprego*) contains information on whether the unemployed are in receipt of unemployment benefits (insurance or assistance). This information is less reliable than that obtained from administrative sources (and which was used for Figure 10) because it is self-reported and in particular because individuals may not be able to make a distinction between unemployment benefits and social assistance. The information is nonetheless interesting because it allows one to analyse how benefit coverage varies by age and benefit duration. This analysis, presented in the figure below, shows: i) that coverage rates are lower for youth to start with; ii) that coverage declines with benefit duration; and iii) that the decline in benefit duration is steeper the younger the age group. After three years of unemployment, for example, virtually no youth are still in receipt of unemployment benefits, while the proportion of unemployed aged 50 and over is still very high (80%) and has not declined. This graph clearly illustrates that unemployment benefits in Portugal are particularly generous (in terms of duration) for older individuals. Again, it is worth remembering that the recent reforms of maximum benefit duration will not have had much effect on these coverage rates, since they only apply from the second unemployment spell after the reforms onwards.

**Figure A. Unemployment benefit coverage by age and unemployment duration**



Note: Averages calculated over the period Q1 2011-Q3 2015. Large fluctuations are due to small sample sizes.

Source: OECD analysis based on the *Inquérito ao Emprego*.

### Activation policies have been strengthened

Moving individuals from unemployment into jobs requires an effective activation framework, which includes the incentives contained in the unemployment benefit system discussed above, but goes beyond that to cover: other determinants of motivation, measures to promote employability, as well as policies to increase the number of opportunities available to jobseekers.

This section starts by presenting the key elements of the OECD's activation framework, and discusses Portugal's recent reforms in each of the areas defined by this framework. Portugal's eligibility criteria for unemployment benefits (i.e. the criteria determining ongoing eligibility for unemployment benefits which require recipients to actively look for work, take up suitable job offers or take part in active labour market programmes) have always been strict on paper. However, recent measures have strengthened the way these criteria are implemented in practice, with proven success in terms of exits from unemployment. Portugal has also significantly ramped up its offer of short-term training programmes and hiring subsidies for the unemployed, which international evidence has shown are particularly effective for the long-term

unemployed at times of crisis. Given that the coverage of these measures has been widened in recent years, there may now be a need to re-focus some of them (particularly the more costly ones) on those who need them most (e.g. youth and the long-term unemployed)<sup>25</sup> in order to reduce deadweight losses. Finally, a comprehensive strategy has been put in place to strengthen the Public Employment Service, which is a critical driver of the success of any activation programme. Going forward, it will be absolutely essential that this strategy is fully implemented.

### ***The OECD Activation Framework***

The core objective of activation policies is to help, support and encourage people to move into rewarding and productive jobs – with the ultimate aim of fostering more inclusive and resilient labour markets. The OECD has recently published a new framework for guiding the development of activation strategies to connect people with jobs (OECD, 2015a). This framework consists of three building blocks – motivation, employability and opportunities – which need to build on a solid foundation of well-functioning labour market institutions:

- *Motivation.* People need to be motivated to work. This involves making sure that work pays and tackling disincentives to work that may arise in unemployment and related benefits by making these benefits, where feasible, conditional on availability for work.
- *Employability.* For some individuals, a rapid return to work is unlikely, and so additional support may be required to strengthen their employability. Intensive counselling interviews can help detect opportunities to increase or update jobseekers' skills, review CVs, provide advice on job-search strategies or interview techniques, discuss referrals to active labour market policies (ALMPs) and modify individual action plans. ALMPs (like work experience or training) can, if well-designed and targeted, increase the employability of jobseekers in a cost-effective manner.
- *Opportunities.* Bringing people into employment also means expanding the set of available employment opportunities. This involves matching jobseekers with employers who are seeking to fill vacancies, and addressing demand-side barriers through actively engaging and assisting employers in hiring and retaining workers.
- *Institutions.* The successful delivery of the above three elements depends critically on the existence of strong PES institutions. The role that the PES plays in matching jobseekers and employers can be enhanced through: good performance management; partnership approaches between organisations and agencies to improve the co-ordination of service delivery; and seizing opportunities offered by digitisation and new technologies.

Over the course of the reform period, Portugal introduced changes to each of the building blocks outlined above. All these reforms are discussed in detail in the Annex A, and a short summary follows below.

### ***Motivation: Eligibility criteria for unemployment benefits (which were strict on paper) were applied more strictly in practice***

The reforms discussed in the previous section were largely intended to increase the incentives to return to work by reducing the generosity of unemployment benefits. However, another way of offsetting

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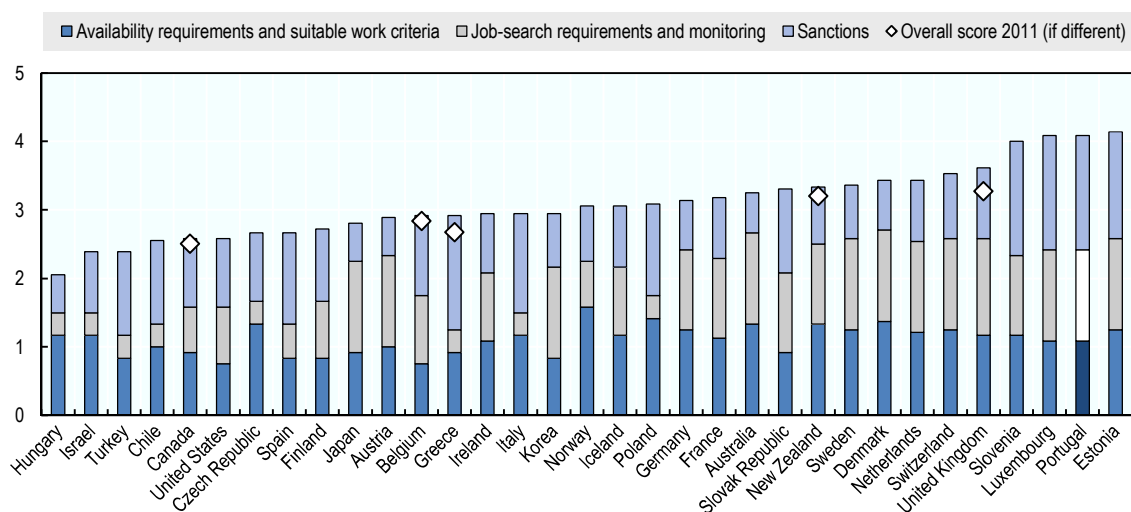
25. The evaluation literature has generally found that interventions targeted at youth tend to have smaller effects, but they are still positive, particularly in the short-run (Card, Kluve and Weber, 2015).

the negative effects of unemployment benefits on work incentives is to put in place criteria which determine the continued eligibility to receive such benefits, such as requirements that recipients actively look for work, take up suitable job offers or take part in ALMPs – with non-compliance resulting in benefit sanctions (Venn, 2012; Langenbucher, 2015). Indeed, there is growing evidence that job search monitoring and benefit sanctions can reduce the duration of unemployment and increase the rate of job entry (McVicar, 2014).<sup>26</sup>

Portugal's eligibility criteria for unemployment benefits were already among the strictest in the OECD in 2011 and its score on this indicator did not change after the recent reforms (Figure 11). Some reasons for this high score include: the requirement of fortnightly job-search interviews (which only Australia and the United Kingdom have as well) and the termination of unemployment benefits (and loss of remaining benefit entitlement) if the jobseeker refuses a suitable job offer or fails to participate in counselling interviews or ALMPs organised by the PES. A few areas where Portugal is perhaps a little less stringent than some other OECD countries include: the fact that there is no requirement to be available for work during participation in ALMPs, as well as the fact that the recipient's previous occupation, skills and/or education are considered when placing demands on occupational mobility (while in many other countries, recipients are required to accept any job that they are capable of doing, regardless of their previous occupation and the wage offered).

Figure 11. **Overall strictness of eligibility criteria for unemployment insurance, 2014**

Scored from 1 (least strict) to 5 (most strict)



*Note:* The indicator refers to the situation in mid-2014s for all countries. Availability criteria cover: availability during ALMP participation, demands on occupational mobility, demands on geographical mobility, and other valid reasons for refusing job offers. Job-searching requirements and monitoring cover: frequency of job-searching monitoring, and documentation of job-search monitoring. Sanctions cover those for: voluntary unemployment, refusing job offers, repeated refusal of job offers, refusing PES activities or ALMP placements, and refusal of PES activities or ALMP placements. For the detailed coding framework and weights applied, see Langenbucher (2015).

*Source:* Langenbucher (2015).

26. However, there is also some evidence that by compelling benefit recipients to take up lower paid or poorer quality jobs or jobs that do not suit their personal circumstances, strict eligibility criteria could increase the likelihood of labour force exit and reduce the quality of job matches (Venn, 2012; McVicar, 2014).



The fact that Portugal's score on the strictness of eligibility criteria has not changed does not mean, however, that nothing has improved. Indeed, one of the limitations of the OECD indicator is that it mainly reflects the strictness of rules as they are outlined in legislation or regulations, not how they operate on the ground. In the case of Portugal, for example, while jobseekers were already required to confirm their availability for work each fortnight, in practice these checks were often nothing more than an administrative requirement with very little content (Martins and Pessoa e Costa, 2014). As part of an overarching programme to modernise the Public Employment Service (*Programa de Relançamento do Serviço Público de Emprego*) new life was breathed into these job availability tests. More specifically, jobseekers aged 45 and over, as well as those who had been unemployed for six months or more, were summoned for mandatory interviews with PES case workers and referred to active labour market measures if deemed necessary. This initiative has been evaluated by Martins and Pessoa e Costa (2014) and has been found to double the monthly reemployment probability of those who had been unemployed for at least six months (see Box 6). This compulsory, bi-monthly monitoring mechanism has recently been replaced by a more personalised monitoring model, which includes quarterly action planning and ensures that different types of follow-up actions are carried out each semester (Law 34/2016 of 24 August).

**Box 6. Reemployment and substitution effects from increased activation: Evidence from times of crisis**

The *convocatórias* introduced as part of the 2012 labour market reform in Portugal required specific unemployment benefit recipients to meet jobcentre caseworkers and then participate in active labour market programmes. This initiative has recently been evaluated by Martins and Pessoa e Costa (2014) who focus on the group of unemployed who had been out of work for six months or more (and who were younger than 45). More specifically, the authors compare the outcomes of this group to those of the group of individuals with unemployment spells shorter than six months. They find that the probability of exiting from unemployment and into employment was doubled for individuals subject to the programme. As the authors point out, their results are all the more important given that the programme was implemented during a period of high unemployment. Indeed, in a situation where job vacancies are rare, one might expect the scope for displacement effects to be greater. Yet, using a different dataset in a comparative analysis across 86 job centres, they find no evidence of substitution effects such as decreased transitions to employment amongst non-eligible individuals.

Source: Martins, P.S. and S. Pessoa e Costa (2014), "Reemployment and substitution effects from increased activation: Evidence from times of crisis", *IZA Discussion Paper Series*, No. 8600.

***Employability: New training measures were introduced and participation increased significantly***

The programme to modernise the Public Employment Service also contained a host of measures to strengthen the employability of jobseekers, including: the referral of the unemployed to job search assistance or short-term training programmes within two weeks of registration; the introduction of career managers who accompany certain jobseekers on an individual and continuous basis; and more detailed and regularly updated individual action plans. Two short-duration training programmes were introduced in 2013: *formação transversal* (a 25-hours training programme aimed at improving personal, communication, and job search skills); and *Vida Ativa* (short, modular training courses, or validation of existing skills within three months of registration at the Public Employment Service). The number of participants in training measures increased significantly, from 339 824 in 2010 to 535 534 in 2014 (more than a 50% increase).<sup>27</sup> Such programmes have been associated with positive employment outcomes both in Portugal and in other countries (and particularly for the long-term unemployed and during recessions) – see Box 7 for further details.

27. These figures are taken from the IEFP's *Relatório de Execução Física e Financeira* of December of each of each year and refer to *formação profissional*.

**Box 7. The effectiveness of active labour market programmes: Existing evidence from Portugal and abroad**

Reviewing over 200 econometric evaluations of active labour market programmes (ALMPs) published since 2007, Card, Kluve and Weber (2015) reach four important conclusions about such measures: i) while they tend to have a negligible impact in the short-run, they positively affect employment outcomes after about 2-3 years; ii) programmes that focus on human capital accumulation tend to have the greatest impact; iii) ALMPs are particularly effective for the long-term unemployed; and iv) they are more likely to be effective in a recession. A key policy recommendation made by the authors is to provide “countercyclical job training programs and private employment subsidies” at times of crisis to prevent the long-term unemployed from “leaving the labor force, risking permanent losses in the productive capacity of the economy.” This is exactly what Portugal has done during the recent recession.

Evidence on the effectiveness of active labour market programmes in Portugal is much rarer, and the methodology used by most of the existing studies does not always stand up to scrutiny. It is therefore critical, going forwards, that more resources are poured into the careful monitoring and evaluation of ALMPs in Portugal.

Costa Dias and Varejão (2012) estimate that ALMPs increase the probability of employment by between 10 to 25 percentage points although – given that the authors cannot fully control for unobservable characteristics which simultaneously determine selection into the programmes and labour market success – these estimated impacts may be biased depending on the quality of the control variable data, the impact of motivational factors (particularly when participation is voluntary), and other factors. Consistent with the evidence of Card, Kluve and Weber (2015), they also find that such measures (training programmes in particular) tend to show effects only several years after participation. Nunes (2007) finds positive employment effects of subsidised internships that took place between 1998 and 2003, while Centeno, Centeno and Novo (2009) find a small reduction in unemployment duration of participation in job-search assistance programmes. The authors argue that this modest effect may be due to a lack of wage subsidies at the time when the programmes were implemented – a shortcoming which has since been addressed by the Portuguese Government.

*Source:* Card, D., J. Kluve and A. Weber (2015), “What works? A meta analysis of recent active labor market program evaluations”, *RUHR Economic Papers*, No. 572. Costa Dias, M., and J. Varejão (2012), *Estudo de Avaliação das Políticas Ativas de Emprego: Relatório Final*, Faculdade de Economia da Universidade do Porto, Porto, Portugal. Nunes, A. (2007), *Microeconomic Studies on Programme Causal Effects – Empirical Evidence from Portuguese Active Labour Market Policy*, PhD Thesis, Department of Economics, University of Coimbra, Coimbra, Portugal. Centeno, L., M. Centeno and Á. Novo (2009), “Evaluating job-search programs for old and young individuals: Heterogeneous impact on unemployment duration”, *Labour Economics*, Vol. 16/1, pp. 12-25.

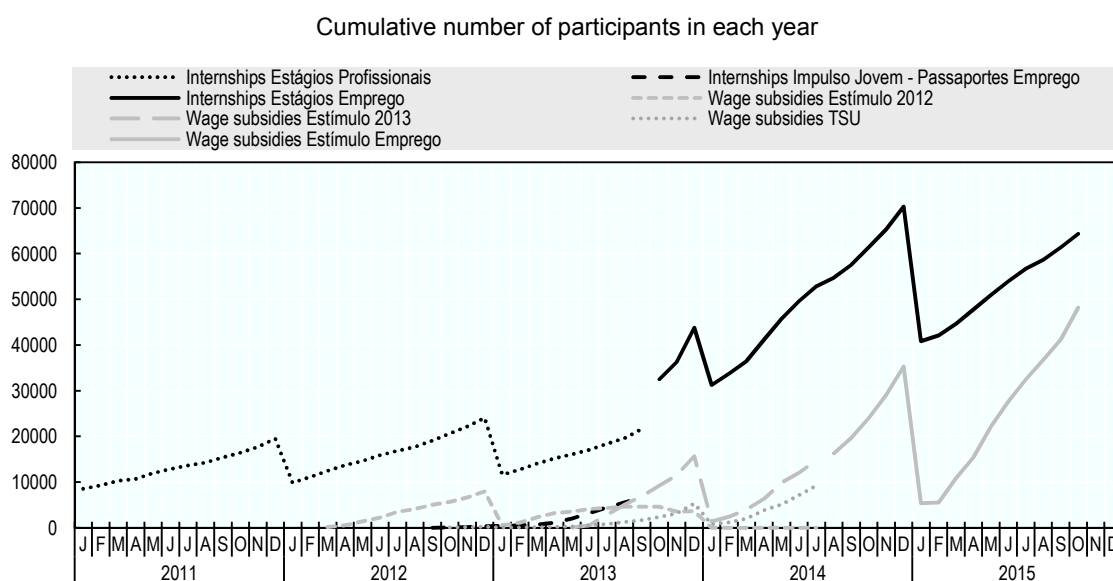
***Opportunities: Job broking activities have been strengthened and new hiring subsidies have been introduced***

The successful activation of jobseekers depends not only on their motivation and employability, but also on the existence of sufficient demand. A key factor here is, of course, economic growth. While there is little the PES can do to promote growth, it nevertheless has a crucial role in ensuring that jobseekers have access to as wide a range of employment opportunities as possible, independently of the state of the business cycle. In particular, the PES plays a critical role in job broking – i.e. in matching jobseekers with employers who are seeking to fill vacancies. The Portuguese PES is undertaking a number of steps to strengthen its activity in this area. One of these is to set up a vacancy-registration tool, disseminated via social media, and integrated with an online vacancy database (*Portal NetEmprego*). On the employee side, the PES is trying to improve the electronic registration of the unemployed, including the possibility to upload individual action plans. There are also plans to co-operate more closely with other stakeholders (temporary work agencies, private employment agencies, employer associations, Offices for Professional Insertion – *Gabinetes de Inserção Profissional*) to better capture existing job vacancies.

While job broking is crucial for matching jobseekers and employers, some groups of jobseekers may need additional support to ensure that job opportunities are available to them. This may be the case in particular for low-skilled and/or young workers whose (expected) productivity may not exceed the minimum wage employers are required to pay for them (OECD, 2010c). For these types of workers, targeted hiring subsidies might incentivise employers to take them on, and this is an area in which Portugal has been particularly active in recent years. Two different hiring subsidies (*Estímulo 2012* and *Apoio à*

*Contratação via Reembolso da TSU*) were introduced in 2012, both revised in 2013, and eventually merged into one programme (*Estímulo Emprego*) in 2014. While these programmes have been focused primarily on youth, the low-skilled and the long-term unemployed, their coverage has changed and broadened over time (see Annex A for details). Incentives were also built in to encourage employers to offer participants permanent employment contracts (either to start off with, or as a conversion at the end of the subsidy). The subsidies awarded were relatively important in size. For example, *Estímulo 2013* covered 50-60% of the beneficiary's wage for a period of six months, and up to a maximum total value of six times the IAS (i.e.  $6 \times \text{EUR } 419.22 = \text{EUR } 2\,515$ ). As shown in Figure 12, the hiring subsidies went from no participants in 2011 to nearly 50 000 over the first ten months of 2015. While such programmes have been shown to have positive employment effects (see Box 7), they can also have significant deadweight losses (i.e. the subsidisation of workers who would have been hired anyway, even in the absence of the programme). One estimate suggests that, in the case of *Estímulo 2012*, around 60% of employers said they would have created the job even in the absence of the subsidy. Still, deadweight losses are never entirely avoidable and the loss estimated in the case of *Estímulo 2012* is actually relatively low in comparison with estimates for some other programmes from abroad (which have frequently been put at around 90%<sup>28</sup>). That being said, as the overall unemployment rate in Portugal continues on a downward trend (see Chapter 2), it may be necessary to increasingly focus the resources dedicated to such programmes on the unemployed who need them most (i.e. youth and the long-term unemployed). International evidence shows that hiring subsidies can be a very cost-effective and efficient means of reducing unemployment if they are sensibly targeted, especially on the long-term unemployed (Brown, 2015).

Figure 12. Participation in hiring subsidies and subsidised internships, 2011-2015



Note: The graph shows the cumulative number of participants in each year, by month. Participants who have not completed the programme in December of year T are carried over to year T+1.

Source: OECD analysis based on IEFP Statistics, *Síntese da Execução dos Programas e Medidas de Emprego e Formação Profissional*.

28. See Martin (2000) and Bartik (2001).

Some related measures are the subsidised internships like the *Estágios Profissionais* and the *Passaportes Emprego*, later merged under the name of *Estágios Emprego*, or also the *Contratos Emprego-Inserção* (which are work experience programmes for the long-term unemployed and RSI beneficiaries). These programmes help groups at the margins of the labour market (particularly youth and the low-skilled) gain valuable work experience, and often contain a training element. During the reform period, several changes were introduced to these programmes, often with the intention of broadening their coverage. Figure 12 shows how the number of participants in these programmes (excluding the *Contratos Emprego-Inserção*, which remained relatively stable) increased significantly from less than 20 000 in 2011 to more than 70 000 in 2014. The *Estágios Emprego* also seem to have very positive employment outcomes, with 67% of participants in work nine months after conclusion of the programme (Government of Portugal, 2014). Again, there might be a need to re-focus those programmes on those who need them most as the recovery takes hold.

New analysis carried out in the context of the present report and based on administrative data from the Public Employment Service confirms that subsidised internship programmes appear to have a positive impact on the employment outcomes of participants compared to non-participants (Box 8). The analysis further suggests that, amongst the programmes analysed, hiring subsidies have the greatest effect on the probability of employment of participants, while the effect of *Vida Ativa* and socially useful work is much more limited. However, it is important to stress that the analysis presented in Box 8 cannot control for selection into programmes based on unobservable variables which, in turn, might co-determine the outcome of interest. An important lesson to take away from this is that more research and evaluation is needed in Portugal on the effectiveness of active labour market programmes. Evidence produced by such research could help, in turn, to fine-tune the programmes concerned and to develop an ALMP portfolio which is more effective at helping the unemployed back into work. While it may be more difficult to properly evaluate existing programmes, new ALMPs should be trialled on a random, pilot basis.

**Box 8. The effectiveness of active labour market programmes in Portugal:  
New evidence based on administrative PES data**

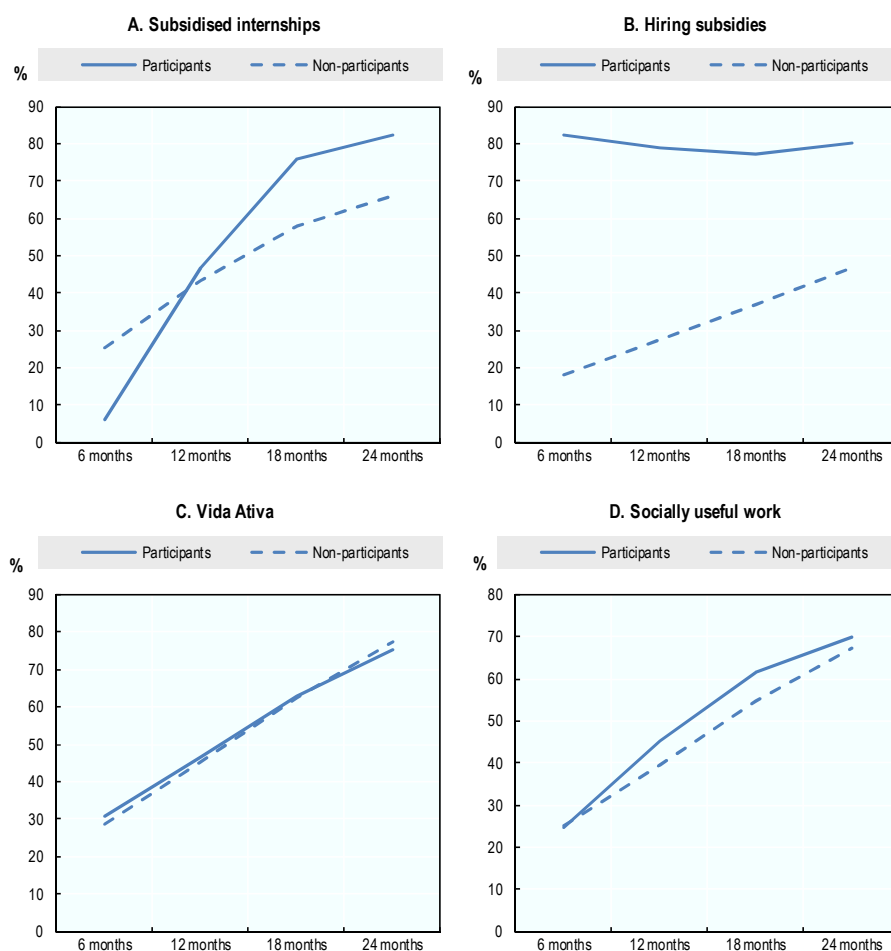
This box summarises new evidence for Portugal on the employment outcomes of participants in active labour market programmes over the period 2012-2014, based on administrative data provided by the Public Employment Service. The full analysis as well as a description of the data can be found in Annex E to this report. The analysis covers four programmes: i) subsidised internships (*Passaportes Emprego*, *Estágios Profissionais*, *Estágios Emprego*); ii) hiring subsidies (*Estímulo 2012*, *Incentivo à contratação*); iii) *Vida Ativa*; and iv) socially useful work (*Contrato Emprego-Inserção*, *Contrato Emprego-Inserção+*).

Individuals who enrolled in one of these programmes at time  $t$  are compared to a set of “control” or similar individuals who did not enroll in that programme at time  $t$ . The control group is formed using propensity score matching (PSM) techniques. More specifically, individuals are matched on the basis of age, gender, marital status, number of children, years of schooling, date of registration with the PES and previous employment history. It is important to point out that, while PSM presents a number of advantages over other techniques (like ordinary least squares), it does not allow researchers to retrieve the causal impact of a programme on employment outcomes if selection into the programme occurs on the basis of unobservable characteristics. So the findings obtained here should be interpreted in this light. Once the matching is complete, the employment outcomes of the treatment and control groups are compared at six months’ intervals:  $t+6$ ,  $t+12$ ,  $t+18$  and  $t+24$ . Because time is measured from the start of participation in a programme, it is possible that individuals may still be participating in the programme at time  $t+6$  (depending on the length of the programme). The results of this analysis are summarised in Figure A.

After six months, individuals participating in subsidised internship programmes are clearly still enrolled in the programme, however after that their employment outcomes improve significantly faster than those of non-participants (Panel A). Those who benefit from a hiring subsidy have a very high probability of being employed throughout the period – an effect which persists even after 24 months (Panel B). By contrast, *Vida Ativa* appears to have very little impact on employment outcomes (Panel C) – which may be because of the modular nature of the programme and/or the short duration of many interventions included under this programme. Finally, the employment impact of socially useful work is small and seems to disappear in the long-run (Panel D).

**Box 8. The effectiveness of active labour market programmes in Portugal:  
New evidence based on administrative PES data (cont.)**

**Figure A. Probability of being in employment at various time intervals for participants versus non-participants in a selection of ALMPs**



Source: OECD analysis based on administrative data from the Portuguese PES.

***Institutions: A comprehensive programme to modernise the Public Employment Service was launched***

As mentioned at the beginning of this section, the success of any activation strategy will depend critically on the strength of the institutions that are expected to implement it. In line with this, Portugal set out to improve its PES, and how it interacts with other stakeholders. A key element in this was the merging of Job Centres with Professional Training Centres to achieve a closer alignment between employment and training services offered to jobseekers. The reform also announced the introduction of stronger performance management and evaluation mechanisms: an efficiency rating system of local PES offices; customer satisfaction surveys; and regular monitoring and evaluation of placement efforts and job search activity. Efforts are also underway to modernise the PES' information systems, including: a re-design of the website; a new system for arranging interviews through e-mail and/or text messages; and breathing new life into the SAI – an interactive customer service. However, not all of these measures have been fully implemented and, going forward, it will be critical to make sure that they are.

PES performance can also be improved by introducing a greater degree of contestability and, with this in mind, Portugal relaxed the rules around the setting up of private and temporary work agencies (see Annex A for details). While the government has also announced plans to allow the PES to contract out some of its activities to private employment agencies, in practice this has still not materialised (although there are plans for two pilot projects – European Commission, 2015). It is important to point out, however, that contracting out public employment services is difficult to get right in practice, and that the evaluation literature shows mixed results. That being said, under the right contractual arrangements, private providers can improve outcomes for certain groups, bring innovation to service delivery, and introduce competitive pressure which may improve PES performance (Finn, 2011). It is particularly important to place enough weight on the quality of service provision and to have strong information systems in place which allow performance to be monitored accurately.

### **The reforms aimed to make collective bargaining more decentralised, dynamic and representative**

While collective bargaining can play an essential role in making labour markets operate more efficiently, it can also introduce important distortions when wages are pushed significantly above those that would prevail in a perfectly competitive market. This balance is difficult to get right in practice and also depends on economic and political circumstances, other labour market institutions, as well as the degree of trust between social partners – all of which help explain why the collective bargaining systems of most countries are in a constant state of flux.

Despite earlier reforms, the Portuguese collective bargaining system continued to struggle with issues of representativeness at the onset of the crisis. In particular, the combination of unrepresentative employer organisations and trade unions, on the one hand, and the practice of quasi-automatic extensions of collective agreements, on the other, led to the imposition of a large number of wage floors across the economy which, because they did not represent the circumstances of many non-signatory firms, harmed competitiveness and employment. Such wage floors can be particularly harmful during times of crisis, when a lack of wage flexibility is more likely to translate into job losses (Villanueva, 2015). In addition, extension agreements were often applied retrospectively so that firms covered by such extensions incurred large and sudden costs.<sup>29</sup>

A significant number of reforms were implemented during the crisis, all aimed at making the Portuguese collective bargaining system more representative, decentralised and dynamic. Extensions of collective agreements were temporarily frozen after Portugal received financial assistance from the Troika in May 2011 and, from November 2012 onwards, extensions were only granted if the collective agreement met certain criteria in terms of the representativeness of the employers that signed up to it. However, the initial representativeness rule (requiring the employer organisation to represent 50% of workers in the relevant sector) may have set the bar too high, ruling out extensions in the majority of cases. While the rule was later relaxed by also allowing extensions in cases where 30% of the signatory employers are small and medium enterprises, it remains to be seen what impact this will have on the share of agreements that are extended. However, given the very large share of SMEs in the Portuguese economy, it seems likely that the bar has now been set too low and that most agreements will again meet the conditions for extension without the need for significant additional effort in terms of employer organisation. As part of the package of reforms, Portugal also allowed firm-level agreements to be negotiated by works councils in firms with at least 150 employees (previously this threshold was set at 500 employees) – but the lack of worker representation in smaller firms raises questions about how much difference this will make in practice. Portugal also shortened the survival period of collective agreements that have expired and not been

29. Currently, the retroactive effects of such clauses are limited to the first day of the month in which the extension order is published, which largely solves the problem – although it may be desirable to enshrine this practice into legislation.

renewed, which should help increase the frequency with which such agreements are renegotiated. Finally, a possibility was introduced for employers to temporarily suspend a collective agreement (or certain terms contained in it) at times of crisis. While it makes sense that such action cannot be taken unilaterally by employers, the uncertainty about how cases of disagreement with worker representatives are resolved mean that this measure is unlikely to be much used in practice. It would also help if the conditions under which such clauses can be used by employers can be clarified.

Since the reforms, there has been a significant drop in the number of collective bargaining agreements and in the number of workers covered by them. While the freezing of and new rules around extensions will have played some part in this, the crisis itself will have made employers more reluctant to negotiate new wage terms. In addition, there is evidence that the decline in sector-level bargaining already started in the mid-1990s, and was accelerated by provisions contained in the 2003 Labour Code which weakened the bargaining power of unions. While the most recent data show that the number of collective agreements is rising again, it remains to be seen whether it will recover to pre-crisis levels, and also whether there will be a permanent shift towards more firm-level bargaining or not. Compared to other OECD countries, Portugal's wage bargaining system remains highly centralised and, so far, there has not yet been a strong shift towards firm-level agreements (in contrast to what has happened in Greece and Ireland, for example).

The remainder of this section discusses pre-crisis weaknesses in the Portuguese collective bargaining system, explains the reforms, and assesses their impact on the number and type of collective agreements, as well as on the bargaining coverage rate. The final part discusses the Portuguese reforms from an international perspective.

### ***Collective bargaining can make the labour market operate more efficiently***

Collective bargaining can fulfil an essential role in the efficient operation of labour markets by correcting two important market failures: i) the asymmetry of information between workers and employers; and ii) the asymmetry in bargaining power between these two groups. By addressing these market failures, collective bargaining can ensure that workers' voice is heard and that they are paid in line with their productivity – leading to a more efficient allocation of resources across firms and industries. Other efficiency gains might result from the fact that transaction costs will be lower than if bargaining was done at the individual level, and also, if markets are imperfect, from a reduction in monopsony power of the firm. In addition, collective bargaining can result in more compressed wage distributions (Addison, 2015). In particular, a combination of high union density and bargaining coverage with the centralisation/co-ordination of wage bargaining have been shown to go hand-in-hand with lower overall wage inequality (OECD, 2004). Lower wage inequality, in turn, could be beneficial for economic growth (OECD, 2015b).

However collective bargaining can also introduce distortions in the labour market. This can occur when rent-seeking behaviour pushes wages significantly above those that would prevail in a perfectly competitive market, resulting in lower employment (and possibly higher income inequality) than would otherwise be the case. In the presence of extension mechanisms, collective bargaining can also become an anticompetitive tool if a limited number of incumbent firms agree on higher wages to prevent new firms from entering the market or eliminate existing competition. The extent to which collective bargaining is distortionary rather than efficiency-enhancing will depend on number of factors, including: the flexibility of the collective bargaining system in responding to changes in economic conditions and/or the needs of individual firms, as well as the representativeness of the agreements reached. These, in turn, will depend critically on the institutional characteristics of a country's collective bargaining system.

### ***The Portuguese collective bargaining system prior to the reforms***

Prior to the reforms, it had been argued that collective bargaining in Portugal resulted in some important distortions of the labour market, introducing wage rigidity, higher unemployment, as well as lower resilience of the economy to fluctuations in the business cycle. The distortionary effect of collective

bargaining was largely blamed on a combination of unrepresentative employer organisations and trade unions, on the one hand, and the quasi-automatic extension of collective agreements, on the other.

Trade union density in Portugal is only slightly above the OECD average (20.5% versus 17.1% in 2012) and significantly below the rates observed in the Nordic countries (67.2% in Denmark, 68.6% in Finland, 82.6% in Iceland, 53.3% in Norway and 67.5% in Sweden).<sup>30</sup> At the same time employer representation is weak. Estimates based on administrative data (*Quadros de Pessoal*) suggest that, on average, employer organisations in Portugal represent just 38% of workers.<sup>31</sup> Moreover, as Table 1 makes clear, such representation varies significantly by industry, from as little as 9% in the water sector to over three quarters in the financial and insurance sector.<sup>32</sup>

Despite low trade union and employer representation, collective agreements in Portugal covered around 90% of workers prior to the crisis (Addison, Portugal and Vilares, 2015), which can be explained by the fact that collective agreements were extended almost automatically by the government to the entire sector, upon simple request of one of the parties to the agreement.<sup>33,34</sup> This led to a situation where wage agreements reached between a minority of firms and workers (often men with permanent contracts and high job tenure, working for large employers or firms shielded from competition – Portugal and Vilares, 2013; Vilares, 2015) would be extended to all other firms and workers in the sector.

Because these agreements set wages at a very detailed level (both by industry and by occupation), the collective bargaining system in Portugal effectively imposed as many as 30 000 wage floors across the country each year (Martins, 2014) – which are believed to have had negative consequences in terms of firms' competitiveness, employment as well as labour market segmentation (see Box 9). To make matters worse, when collective agreements were extended, the corresponding wage clauses often applied retrospectively, forcing employers affected to pay the resulting wage arrears. This exacerbated the potential negative effects of administrative extensions on competitiveness and employment (Cardoso and Portugal, 2005; Martins, 2014).

30. These figures are taken from OECD and J. Visser, ICTWSS database, version 3.0. Note that this rate includes the public sector where density is believed to be much higher than in the private sector. Estimates by Addison, Portugal and Vilares (2015) based on the *Relatório Único* put the union density rate in Portugal at a much lower figure: 11% on average over the period 2010-2012. This estimate is based on a question which asks the employer to "Indicate the number of workers for whom you have knowledge of their membership in a union (because they are union officials, because you deduct membership dues from their salary, or because the worker informed you about his/her membership so as to determine which particular collective regulation is applicable to their case)." However, given that there is no legal obligation in Portugal to disclose union membership, the figures reported by employers in the *Relatório Único* are likely to be an underestimate.

31. These estimates are consistent with those obtained elsewhere. The 2006 *Livro Verde sobre as Relações Laborais* (MTSS, 2006) already pointed out that a large proportion of employers are not affiliated to any employer organisation, and the 2007 *Livro Branco das Relações Laborais* (MTSS, 2007) found that there was no worker representation of any kind in two thirds of Portuguese workplaces.

32. It is important to point out that some important groups will never be represented by collective agreements: the unemployed and potential start-ups.

33. Voluntary extensions by the employers to non-unionised members are also very common because there is no legal requirement for trade unions to reveal their constituency. Employers are therefore faced with the practical impossibility of distinguishing between workers who are union members (and for whom the agreement is binding) and those who are not.

34. Another reason for the high level of coverage is that agreements tended to remain valid for a relatively long period of time.



Combined with the facts that: i) firms are legally prohibited from reducing base wages (unless this is permitted by collective agreement)<sup>35</sup> and ii) collective bargaining agreements in Portugal can sometimes be difficult to re-negotiate, this system resulted in a high level of downward wage rigidity in the Portuguese labour market, which is particularly harmful at times of crisis with low inflation: if firms cannot adapt to worsening economic conditions by lowering (real) wages, the only other adjustment channel left is employment.<sup>36</sup> During the recent crisis, this is indeed what has been observed: large numbers of workers had their wages frozen (see Box 14 in Chapter 2), but low inflation meant real wages moved little and large employment losses ensued (Carneiro, Portugal and Varejão, 2014).

**Box 9. There is evidence that quasi-automatic administrative extensions of collective bargaining agreements in Portugal have harmed competitiveness and employment**

Research has shown that the quasi-automatic extension of collective agreements in Portugal has had negative effects in terms of employment (including the quality of employment), as well as firm survival.

Guimarães, Martins and Portugal (2014) tentatively use the term “upward nominal wage rigidity” to refer to the consequences of the Portuguese collective bargaining system which obliges firms to increase the wages of their workforce in order to comply with the administrative extensions of collective agreements. Using the potential increase in a firm’s wage bill (measured as the difference between workers’ current wages and those implied by the new wage floors), the authors find that, over the period 1986-2009, firms more heavily affected by changes in wage floors decreased their hiring rates and, more importantly, significantly increased their separation rates: a 10% increase in the wage bill led to a fall in employment of 2.1%, which is largely driven by an increase in separation rates (which increased by 2.3 percentage points in response to a 10% increase in the wage bill). The authors also find that a 10% increase in the (real) wage bill increased the probability of firm closure by 7.8 percentage points.

Looking at what happens following an extension of a collective bargaining agreement in a particular sector, Martins (2014) finds that employment decreases by 2% four months after the extension is issued, resulting from both a fall in hiring and an increase in firm closures (but no significant change in separations or firm start-ups is observed). In addition, Martins finds that such administrative extensions (which also entail the payment of substantial wage arrears) tend to increase the share of dependent self-employment (and therefore labour market segmentation) as firms seek to reduce their costs. The author also finds that small firms are more negatively affected by such extensions.

Building on this work, Hijzen and Martins (2016) analyse what happened when Portugal suspended the extensions of collective bargaining agreements in mid-2011. Their work suggests that extensions had a negative impact on employment growth, concentrated amongst non-affiliated firms. The authors further argue that the lack of representativeness and the retro-activity of extensions are key drivers behind this negative employment effect – particularly in the context of a recession.

The evidence found for Portugal is consistent with the international evidence on extensions of collective wage agreements (Villanueva, 2015): while extensions can be useful tools to reduce wage inequality and gender gaps, there is a risk that they come at the cost of employment losses, particularly during recessions. Any income gains made by workers covered by extensions therefore need to be weighed against the income losses incurred by those who lose their job.

*Source:* Guimarães, P., F. Martins and P. Portugal (2014), “Upward nominal wage rigidity”, paper presented at the Deutsche Bundesbank/Institute for Employment Research conference on “(European) Labour markets and the economic crisis” held on 12/13 June 2014 in Eltville, Germany; Martins, P.S. (2014), “30,000 minimum wages: The economic benefits of collective bargaining extensions”, *IZA Discussion Paper Series*, No. 8540. Villanueva, E. (2015), “Employment and wage effects of extending collective bargaining agreements”, *IZA World of Labor*, No. 136.

35. See Article 129 of the Labour Code: “É proibido ao empregador diminuir a retribuição, salvo nos casos previstos neste Código ou em instrumento de regulamentação colectiva de trabalho.”

36. Cardoso and Portugal (2005) had shown that the contractual wages set by collective agreements set a floor to remuneration and that actual wages frequently exceed those minima, giving rise to a “wage cushion”. This wage cushion gives firms some flexibility to adjust real wages downwards at times of crisis – however this mechanism only really works if inflation is positive.

Table 1. **Employer organisations' membership and density, 2010-2014**

Percentage of companies member of employer organisations, and percentage of workers employed by member companies of employer organisations (average 2010-2014)

Industry	% employers member of employer organisation	% members that are SMEs	% of workers covered by employers that are member of an employer organisation
A Agriculture, forestry and fishing	8.8	99.9	13.9
B Mining and quarrying	21.0	99.0	34.0
C Manufacturing	20.2	97.6	49.2
D Electricity, gas, steam and air conditioning supply	6.9	92.4	10.7
E Water supply; sewerage, waste management and remediation activities	9.7	99.7	9.9
F Construction	16.7	99.4	33.2
G Wholesale and retail trade; repair of motor vehicles and motorcycles	19.5	99.6	42.8
H Transportation and storage	32.0	99.2	35.2
I Accommodation and food service activities	22.2	99.6	45.3
J Information and communication	9.0	98.9	11.4
K Financial and insurance activities	17.2	95.9	76.7
L Real estate activities	11.9	100.0	14.5
M Professional, scientific and technical activities	12.6	99.8	19.2
N Administrative and support service activities	12.4	94.5	42.0
O Public administration and defence; compulsory social security	4.7	100.0	6.0
P Education	17.7	99.4	31.4
Q Human health and social work activities	10.5	99.3	14.3
R Arts, entertainment and recreation	8.9	98.7	24.4
S Other service activities	13.7	99.8	15.8
U Activities of extraterritorial organisations and bodies	6.5	100.0	1.0
Average	17.6	99.1	37.7

Source: OECD analysis based on the *Quadros de Pessoal*.

### ***Reforms of the Portuguese collective bargaining system***

The recent labour market reforms introduced a number of changes to collective bargaining in Portugal in an attempt to make it more:

1. *Representative*. After a freezing of administrative extensions from May 2011 onwards, criteria were introduced towards the end of 2012 for approving future extensions of collective agreements. The reasoning behind such representativeness criteria is to limit the potential negative effects of extensions on the competitive position of non-affiliated firms. Ideally, such criteria should be challenging enough (so that they work as an incentive for employers to organise), but not too challenging (so as to make extensions virtually impossible). The first representativeness rule introduced in Portugal stated that extensions would only be granted if the employers who signed the agreement employed at least 50% of the workers in the sector, geographical area or occupation to which the agreement was to be extended. However, given the low employer organisation density rate in Portugal (see Table 1), this condition more or less ruled out most extensions and was probably too demanding. Part of the problem is that a very large proportion of employers in Portugal are SME's (with fewer than 250 employees) and that these are difficult to organise. Acknowledging this economic reality, the government subsequently introduced an additional rule

allowing extensions in cases where the signatories to the agreement consist of at least 30% of micro-, small- and medium-sized enterprises. While it remains to be seen what effect this new rule has, one would largely expect a return to the pre-crisis situation given that 99.7% of firms in Portugal are SMEs. Indeed, data on employer organisation membership in 2012 suggests that, on average, 60% of the members of employer organisations in Portugal were SMEs, and that only 23 out of 410 employer organisations had fewer than 30% SME members.

2. *Decentralised.* The second change to the collective bargaining process was to allow works councils in firms with at least 150 employees to negotiate agreements at plant level (previously, as part of the 2009 revision of the Labour Code, the threshold had been set at 500 employees). In theory, this would allow negotiated wages and working time arrangements to more closely reflect a firm's economic reality.<sup>37</sup> Some commentators have argued that this will not make much difference in practice, given that the Portuguese Constitution grants trade unions exclusive rights to negotiate on behalf of workers (Article 56) and that works councils will therefore only be allowed to conduct such negotiations if the necessary powers are delegated to them by unions.<sup>38</sup> However, such rules are common throughout the OECD (except in Greece and Romania) and exist because company-based worker representation is never truly independent of the employer. For example, under existing laws, works councils cannot call a strike, which significantly reduces their bargaining power. Even in Germany, where there has been a clear shift towards company-level bargaining, legislation formally prohibits works councils from concluding firm-level agreements on issues covered by collective bargaining unless they are expressly authorised to do so by the relevant sector agreement (Addison et al., 2014). A more important problem in the case of Portugal is that worker representation in small firms is very poor (Visser, 2016).<sup>39</sup> Estimates based on the European Company Survey suggest that only around 8% of establishments in Portugal with 10-249 employees had some form of workplace representation in 2013, compared to 40% on average in the other countries that participated in the survey (Figure 13).<sup>40</sup>
3. *Dynamic.* The third change aimed to encourage more frequent and swifter re-negotiations of collective agreements by placing additional constraints on the time for which they remain valid. On the one hand, the reforms targeted cessation clauses contained within certain older collective agreements which stipulated that the agreement would remain in force until it was replaced by a

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37. The reforms also further encouraged the inclusion of articulation clauses between different levels of bargaining, particularly on matters of functional and geographical mobility, the organisation of working time, and compensation.

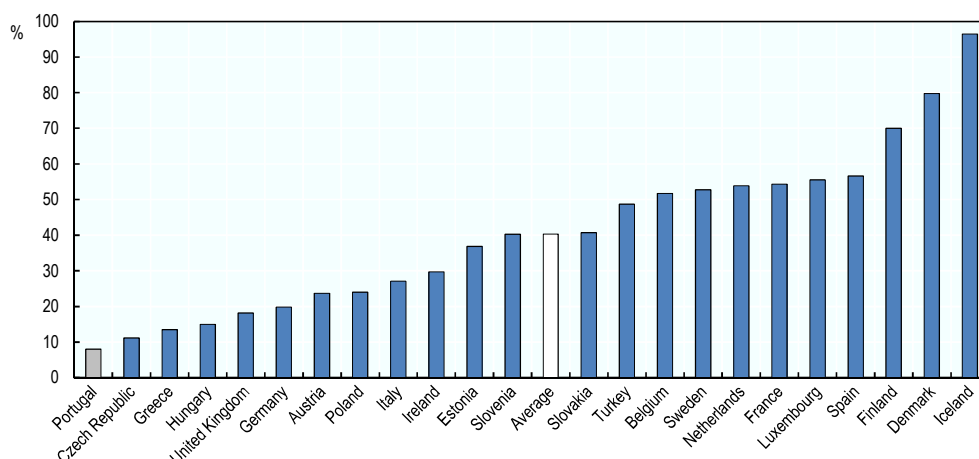
38. Reform proposals favouring agreements that can be signed independently of the trade union had to be abandoned in the face of strong union opposition (Addison, Portugal and Vilares, 2015). That being said, even before the reforms, there were some atypical collective agreements signed at plant level between employers and their works councils that have proved successful over the years (Palma Ramalho, 2013). However, such agreements, where they were signed without the mandate of the relevant union, would not be legally enforceable (Távora and González, 2015).

39. Because smaller firms have no (or little) union representation in Portugal, the lowering of the threshold in 2012 to allow agreements in smaller firms to derogate from higher-level agreements could be argued to have increased the level of disarticulation of the system. As pointed out by Visser (2013), however, "Articulated bargaining is rare. Most countries are either stuck with a more centralised solution, usually because there is no enterprise-level representation that has the trust of the unions and capability to confront management in bargaining, or local bargaining proceeds without strong checks and balances."

40. Visser (2013) mentions the interesting case of Hungary where the exclusive right of unions to negotiate collective agreements was removed at the turn of the millennium and a legal provision was introduced to allow works councils to sign collective agreements in the absence of union organisation in the workplace. However, this measure was not effective because, despite being mandatory, effective works councils existed only where unions were present. The provision was repealed again in 2002.

new one. The validity of such cessation clauses was reduced from five to three years.<sup>41</sup> In addition, a cap of 18 months was placed on the grace period (*sobrevigência*) which kicks in when one of the parties withdraws from an agreement and which allows for negotiations to take place (there was no cap prior to the reforms). Finally, the additional grace period (*ultra sobrevivência*) for which the agreement remains valid if negotiations turn out to be unsuccessful was reduced from 60 to 45 days.

Figure 13. **Proportion of establishments with 10-249 employees that have some sort of worker representation, 2013**



Source: OECD analysis based on the European Company Survey.

In addition to the reforms outlined above, employers can (since September 2014) temporarily suspend a collective agreement at times of crisis (i.e. for reasons of “hardship” or “inability-to-pay”) as long as: i) this can be shown to be necessary for the preservation of jobs; and ii) the necessary agreement has been obtained from the relevant trade union(s). While such a safeguard makes sense to protect workers from potential abuse by employers, it is not clear what would happen in the case of disagreement between unions and employers – which makes the measure difficult to implement in practice and, therefore, reduces its potential effectiveness.<sup>42</sup> It would also help if the conditions under which employers can suspend a collective agreement could be clarified. In Spain, for example, sectoral agreements have to include objective conditions (such as a fall in sales or productivity over a specified period of time) that specify when firms may opt out of what was agreed.

41. There was also a suggestion to further reduce the validity of such cessation clauses to two years, but it is not clear that this would make much difference in practice. Based on an analysis of agreements that have already been denounced, Naumann (2014) concluded that the length of the survival period of agreements with cessation clauses would be of little practical relevance because: i) very few of these had a cessation clause; and ii) the last revision of these agreements dated back to more than 15 years, making the survival period irrelevant.

42. It has been argued that a major stumbling block to the use of such opt-out clauses is that works councils need explicit agreement from the union to negotiate agreements at the firm level. While this is probably true, there is a strong argument for maintaining such union consent, which is that works councils are never truly independent from their employers and therefore have much weaker bargaining power (especially since they are usually not legally entitled to call a strike).

### Impact of the collective bargaining reforms

*The number of sector agreements has dropped, but not only because of the reforms*

Since the reforms, there has been a significant drop in the number of sector agreements as well as in the number of extensions of these agreements – although the latest data show some recovery. The number of sector agreements fell from 142 in 2010 to just 27 in 2013, but was back up again to 65 in 2015 (Table 2). Similarly, the number of extensions fell from 128 in 2010 to 9 in 2013, but stood at 44 in 2015. More significantly, the ratio of extensions to sector agreements had fallen markedly (from around 100% prior to the reform to just over a quarter in 2011) but, in 2015, increased again to 68%.

Table 2. Evolution of collective agreements and extensions, 2008-2015

Year	Number of agreements <sup>a</sup>				Workers covered				Extensions (of sector agreements)	
	Total	Sector	Groups of firms	Firm level	Total	Sector agreements	Agreements between groups of firms	Firm-level agreements	Number	% <sup>b</sup>
2007	251	160	27	64	1 430 660	1 430 660	58 233	32 384		
2008	296	172	27	97	1 894 846	1 778 216	47 232	69 398	178	103%
2009	251	142	22	87	1 487 193	1 299 371	59 902	37 952	128	90%
2010	230	141	25	64	1 485 950	1 309 267	64 455	33 344	149	106%
2011	170	93	22	55	1 242 181	1 160 080	52 737	24 102	24	26%
2012	85	36	10	39	404 756	291 068	26 645	9 909	13	36%
2013	94	27	18	49	241 539	197 017	27 104	17 418	9	33%
2014	152	49	23	80	246 643	214 603	19 596	12 444	16	33%
2015	138	65	20	53	568 875	446 025	21 728	22 624	44	68%

a. Sector agreements (*Contratos Coletivos de Trabalho*, CCT) are agreements negotiated between one or more employer organisations and one or more trade unions. Agreements between groups of firms (*Acordos Coletivos de Trabalho* – ACT) are signed by several employers that are not part of an employer organisation and one or more trade unions. Firm-level agreements (*Acordos de Empresa*) involve just a single employer.

b. The percentage of agreements that are extended may exceed 100% because the numerator measures the number of extensions that were granted in a specific year, while the denominator measures the number of agreements signed in that year.

Source: MESS/DGERT.

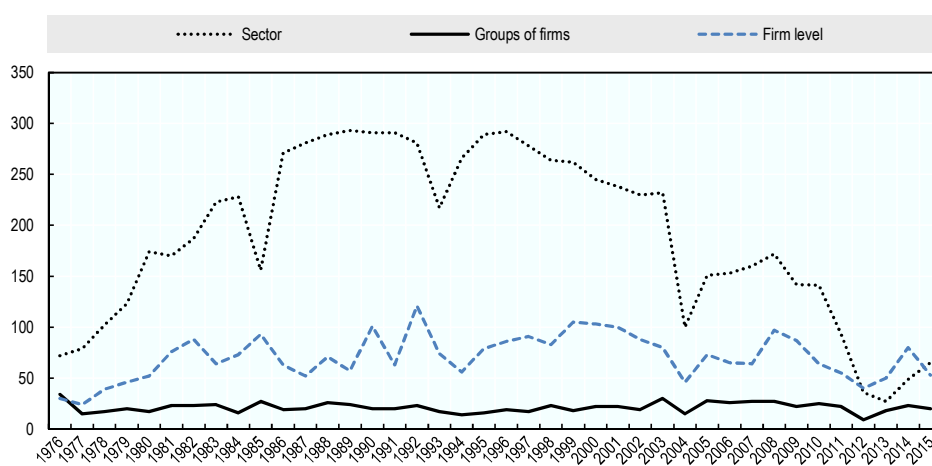
There is some disagreement as to why the number of sector agreements has fallen so drastically, although the reasons advanced are not mutually exclusive. Some commentators contend that, as a result of the reforms, employers have been reluctant to sign agreements which are unlikely to be extended to other firms in the sector because this would put them at a competitive disadvantage (Campos Lima, 2013; ILO, 2014). This would also help explain why there has been an increase in agreements in 2014, following the softening of the rules around the extension of agreements towards the middle of that year. An alternative interpretation is that these trends are simply a consequence of the crisis and the attempt by employers to reduce costs by freezing nominal wages (Addison, Portugal and Vilarés, 2015). Indeed, the number of sector agreements also fell in a number of other countries as a result of the crisis (e.g. Belgium, the Czech Republic, France, Germany, Italy, the Netherlands, Slovenia, Spain – Visser, 2016). Yet another explanation traces the origins of the decline in sector bargaining back to the 2003 Labour Code, which introduced the possibility of expiry of collective agreements and also eliminated the principle that collective agreements could only establish more favourable conditions than those set by the general law (Távora and González, 2015).<sup>43</sup> According to this line of argument, the 2003 Labour Code significantly weakened the bargaining power of unions<sup>44</sup> which

43. The 2009 Labour Code subsequently specified a number of areas that could not be object of less favourable dispositions in collective agreements (Távora and González, 2015).

44. The 2003 Labour Code allowed employers to withdraw unilaterally from existing agreements (whereas previously, existing agreements could only be cancelled if all signatories agreed). More specifically, the 2003

translated into a low level of renewals of collective bargaining agreements during the crisis. Indeed, as Alves, Poças and Tomé (2013) show, there was a drastic fall in the number of sector agreements in 2003 (Figure 14). That being said, the same figure also shows that the number of sector agreements was already on a longer-term (albeit gradual) path of decline that started in the mid-1990s – well before the recent labour market reforms as well as the economic and financial crisis.

Figure 14. **Evolution in collective bargaining, by type of agreement, 1976-2015, Portugal**



Source: MSES/DGERT and Alves, Poças and Tomé (2013).

Going back to Table 2, the data also show that there has been a fall in agreements between groups of firms (*Acordos Coletivos de Trabalho*)<sup>45</sup> from 27 in 2007 to 10 in 2012, but that their number has been increasing again in recent years (23 in 2014 and 20 in 2015). Perhaps more interesting given the reforms that have taken place, the number of firm-level agreements has also fallen, from 97 in 2008 to 39 in 2012. However, their number increased to 80 in 2014 and their share of the overall number of agreements has risen from one third in 2008 to over half in 2014. However, it would be too soon to conclude that collective bargaining in Portugal is now more decentralised than it was before the crisis – especially since there was a fall again in the number of such agreements to 53 in 2015 (with their share down to 38%). Indeed, as the next section will show, collective bargaining in Portugal generally remains very centralised.<sup>46</sup>

Labour Code specified that, following a period of unsuccessful negotiations, any party could denounce the agreement, thereby initiating a process which would culminate in its expiry (*caducidade*) if a new agreement could not be reached. One loophole left by this legislation was that agreements with a “cessation” clause (i.e. a clause which stipulates that the agreement remains in force until replaced) could still not expire. These cessation clauses were targeted by the 2009 Labour Code, which prohibited them in new agreements and put a limit on their validity in existing agreements.

45. These are agreements signed between several employers that are not part of an employers’ organisation and one or more trade unions. Such agreements are common in the financial and utilities sectors (Addison, Portugal and Vilares, 2015).
46. An alternative firm-level union strategy outside formal bargaining (the *caderno reivindicativo*) has gained importance during the crisis as collective bargaining blockages appeared at the sector level (Távora and González, 2015): “The *caderno reivindicativo* simply consists of local trade unions meeting with the workers of a firm and on their behalf approaching their employer without any formalities with the purpose of negotiating wage increases (and in some cases other terms of employment).”

*Collective bargaining coverage has fallen, but there is disagreement about how much*

There is also some disagreement as to how important the fall in collective bargaining coverage has been.<sup>47</sup> According to Addison, Portugal and Vilares (2015), the stock of workers covered by collective agreements has fallen only marginally in recent years, and still stood at 89% in 2012, primarily because many remain covered by old agreements that are still valid. Similarly, the 2014 *Quadros de Pessoal* data registers a coverage rate of 89%. However, Visser (2015) estimates that the coverage rate has fallen more drastically, from 84.9% in 2007 to 72.2% in 2013.<sup>48</sup> Visser argues that even these estimates may not be very meaningful because the wage floors fixed in older agreements may mean very little in practice as they are likely to have been overtaken by the national minimum wage. In addition, if there is no uptake in the number of new agreements very soon, then rules around the expiry of collective agreements mean that the coverage rate may fall sharply in years to come. To put things into context, however, the fall in collective bargaining coverage in Portugal is not unique and follows a more general trend observed across the OECD (Box 10).

**Box 10. The impact of the crisis on collective bargaining coverage in OECD countries**

According to the estimates by Visser (2015), the average collective bargaining coverage rate across OECD countries has declined from 53.5% prior to the crisis to 49.4% in 2013 (Figure A). While in most countries the fall in the coverage rate was relatively minor and part of a longer-term trend, a few countries have seen significant reductions in the collective bargaining coverage rate over the last few years, including: Greece (a fall of nearly 50%), Hungary and the Slovak Republic (-38%), Slovenia (-29%) and Portugal (-14%). All of these countries have pushed through significant reforms of their collective bargaining system during this period. At the same time, the figure shows that very large differences persist across OECD countries in the collective bargaining coverage rate – with nearly universal coverage in countries like Finland, Belgium, Austria and France, and rates below 20% in many of the non-European OECD countries. Despite the falls in recent years, bargaining coverage in Portugal remains significantly above the OECD average.

In many countries (including Portugal) low unionisation co-exists with high bargaining coverage because collective agreements are extended to the entire sector, occupation or geographical area. However, Visser (2013) argues that extending collective bargaining agreements is not the only way of obtaining high levels of bargaining coverage. In some countries (like in Scandinavia) a high bargaining coverage rate is achieved through a high level of unionisation – although this may depend on some unique features, such as union involvement in the running of unemployment insurance benefits, and/or the right to organise solidarity strikes. For example, in Denmark and Sweden, unorganised firms frequently sign “adhesion agreements” under strike pressure from unions (Visser, 2016).

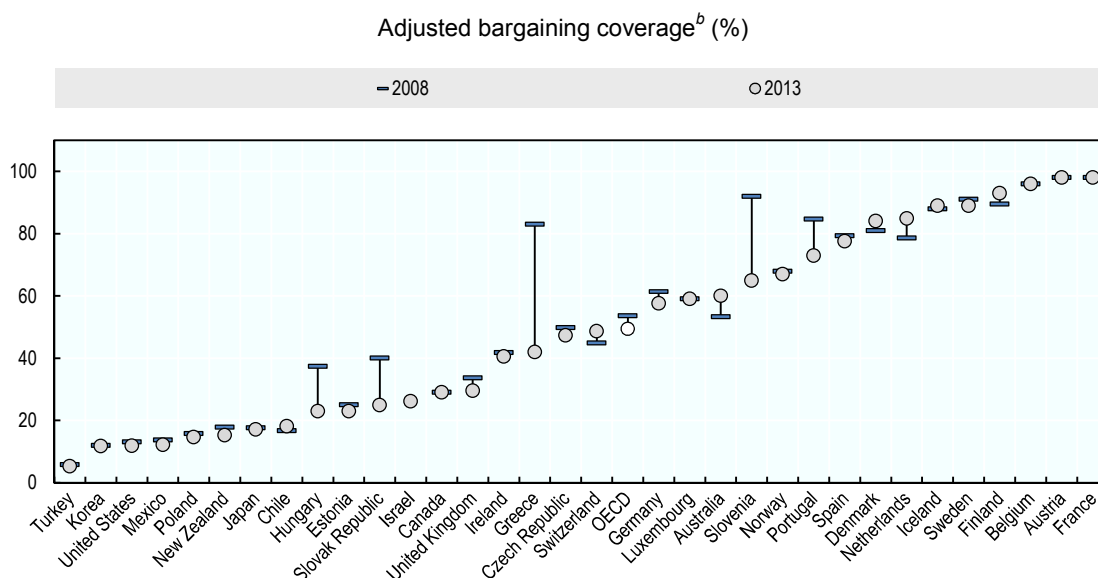
Visser (2013) also argues that the key to a high bargaining coverage rate is multi-employer bargaining: for 25 European countries over the period 2000-2009 there is a strong correlation ( $r=0.8$ ) between the level of employer organisation and the bargaining coverage rate. Visser (2013) provides convincing evidence that, wherever multi-employer bargaining has been replaced by single-employer bargaining, the coverage rate has fallen significantly (e.g. Britain in the 1980s; New Zealand and Australia in the 1990s). Similarly, Visser (2016) points out that some of the greatest losses in bargaining coverage in recent years occurred in countries where important regulatory changes happened that led to a reduction in multi-employer bargaining.

*Source:* Visser, J. (2016), “What happened to collective bargaining during the Great Recession?”, *IZA Journal of Labor Policy*, Vol. 5/9.; Visser, J. (2015), ICTWSS Database, Version 5.0, Amsterdam Institute for Advanced Labour Studies AIAS; Visser, J. (2013), “Wage bargaining institutions – From crisis to crisis”, *Economic Papers*, No. 488, European Commission Directorate-General for Economic and Financial Affairs.

47. Bargaining coverage gives an indication of the extent to which workers’ wages are set by collective agreement rather than by market forces (Pedersini, 2015).

48. The level difference in Visser’s (2015) coverage rates is due mainly because of his choice of denominator, which also includes public sector workers (who are not covered by collective agreements).

## Box 10. The impact of the crisis on collective bargaining coverage in OECD countries (cont.)

Figure A. Changes in collective bargaining coverage, 2008-2013<sup>a</sup>

- a. 2005 instead of 2008 for Ireland. 2007 instead of 2008 for Denmark, Estonia, Hungary, New Zealand, Sweden and Switzerland. 2009 instead of 2008 for Chile and Norway. 2011 instead of 2008 for Mexico. 2009 instead of 2013 for Ireland. 2011 instead of 2013 for New Zealand. 2012 instead of 2013 for Australia, Estonia, France, Israel, Korea, Luxembourg, Poland and the United States.
- b. Adjusted bargaining coverage = employees covered by collective (wage) bargaining agreements as a proportion of all wage and salary earners in employment with the right to bargaining, expressed as percentage, adjusted for the possibility that some sectors or occupations are excluded from the right to bargain (removing such groups from the employment count before dividing the number of covered employees over the total number of dependent workers in employment).

Source: Visser, J. (2015), ICTWSS Database, Version 5.0, Amsterdam Institute for Advanced Labour Studies (AIAS).

*There has been an important fall in the number of workers receiving contractual wage increases*

The fall in collective agreements and extensions led to a significant fall in the number of workers receiving pay rises as a result of such agreements: from 1.7 million in 2008 to less than 200 000 in 2013 (Table 3). Even among the workers benefiting from pay rises, however, those were often small and, in 2011 and 2012, not sufficient to beat inflation (i.e. wages declined in real terms). In Chapter 2 of this report, these wage developments (and their impact on Portugal's competitiveness) will be analysed in further detail.

Table 3. Annual changes in contractual wages, 2008-2015

	2008	2009	2010	2011	2012	2013	2014	2015
Number of workers affected	1 704 107	1 303 457	1 294 570	1 202 908	306 187	186 581	213 738	495 059
Nominal change from previous period (%)	3.1	2.9	2.4	1.5	1.4	1.0	1.0	0.7
CPI change from previous period (%)	2.6	-0.8	1.4	3.7	2.8	0.3	-0.3	0.5
Real change (%)	0.5	3.7	1.0	-2.2	-1.4	0.7	1.3	0.2

Note: Contractual wages are those wages set by collective agreement.

Source: MSES/DGERT and OECD Employment Outlook database (for CPI data).



### *The Portuguese collective bargaining reforms from an international perspective*

Reforms of collective bargaining institutions of the type implemented in Portugal over the past few years are not unique, and similar changes have been introduced in other countries at the same time (e.g. in Greece, Spain, Ireland). While many of the reforms in those countries were quite substantial and often carried out under pressure from international finance institutions, they frequently resulted in a mere catch-up process with other countries where similar changes had already occurred, albeit more gradually and over a longer period of time (Eurofound, 2015). In particular, one can observe a general, longer-term trend across OECD countries in terms of: the decentralisation of collective bargaining; a reduction in the use of administrative extensions; and limits placed on the time validity of agreements. The need for such changes has been attributed to globalisation and increased competition from abroad, which mean that individual firms need more flexibility to adjust labour costs and productivity in order to respond to changes in market conditions.<sup>49</sup> Moreover, many commentators agree that such trends are likely to continue for the foreseeable future (Visser, 2013; Eurofound, 2015). While this sub-section argues that the recent reforms in Portugal followed a more general trend across OECD countries, the analysis will also show that, compared to many other countries, Portugal's wage bargaining system remains highly centralised and that there has not yet been a strong shift towards firm-level agreements (in contrast to what happened in Greece and Ireland, for example).

#### *Decentralisation*

Visser (2015) constructs a summary measure of the extent of decentralisation of collective bargaining which considers simultaneously: the predominant level at which bargaining takes place;<sup>50</sup> the frequency or scope of additional enterprise bargaining; the possibility of opening clauses in collective agreements; the extent of articulation of enterprise bargaining; and the possibility of derogation.<sup>51</sup> The evolution of this indicator over time is shown in Figure 15, which shows that there has been a clear trend across the OECD towards decentralisation.<sup>52</sup> In most countries, this had been happening well before the recent economic and financial crisis, but in Greece, Portugal and Spain the changes are more recent.

While the indicator suggests that Portugal's collective bargaining system has become more decentralised, the main driver of this change is the 2009 change to the Labour Code which introduced the possibility of firm-level agreements. However, as argued above, there has not (yet) been a strong shift towards firm-level agreements in Portugal – a finding which is confirmed in Figures 16 and 17, which show that the dominant level of bargaining in Portugal remains the sectoral level, while additional enterprise bargaining on wages is still rare, even in large firms. The experience in Portugal during the recent crisis stands in stark contrast to what happened in Greece and Ireland, where multi-employer bargaining “all but disappeared” during the recession (Figure 16 and Visser, 2016). Even amongst

49. One argument for multi-employer bargaining has been that, by establishing a wage floor across all employers in the same sector, it takes wages out of the equation as far as competition is concerned. However, with increasing competition from abroad, this argument loses a lot of its strength.

50. A particular level is dominant if it accounts for at least two-thirds of bargaining in terms of employees covered.

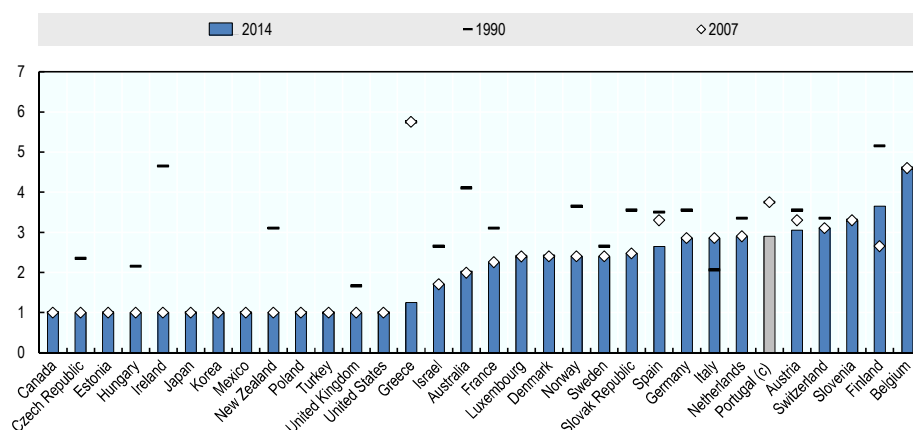
51. Visser (2015) defines derogation as “the possibility of setting aside the favourability principle in higher-order (usually sector) agreements, allowing deviation from norms established in the higher-order agreement that in some aspects are less favourable, possibly in exchange for some other guarantees or benefits.”

52. The trend towards increased decentralisation has often been based on the argument that decentralised collective bargaining systems achieve better macroeconomic outcomes that are closer aligned to those that would have been achieved through market forces. However, it has also been argued that similar macroeconomic outcomes can be achieved by highly centralised bargaining systems, as long as there is a high level of co-ordination and a responsible attitude on the part of unions (Pedersini, 2015). In particular, highly centralised wage bargaining institutions need to concentrate on objectives that are in the interest of as many of their members as possible and can, therefore, “promote low structural unemployment and mitigate the direct impact of shocks on employment” (OECD, 2014a).

countries where sector bargaining remained the dominant level, there has been a move to more frequent bargaining at the firm level. In Austria, for example, employers in the metal-engineering industry left the joint bargaining platform in 2012 and signed separate agreements (Visser, 2016).

Figure 15. **Centralisation of wage bargaining, 1990-2014<sup>a</sup>**

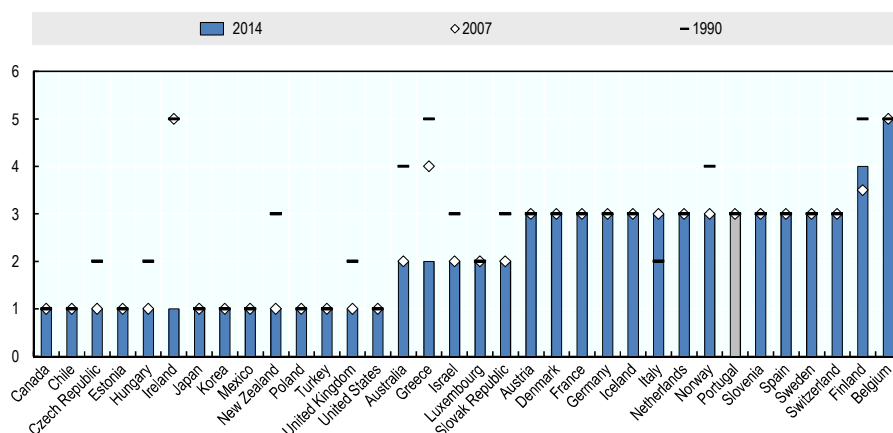
Index of centralisation of wage bargaining<sup>b</sup>



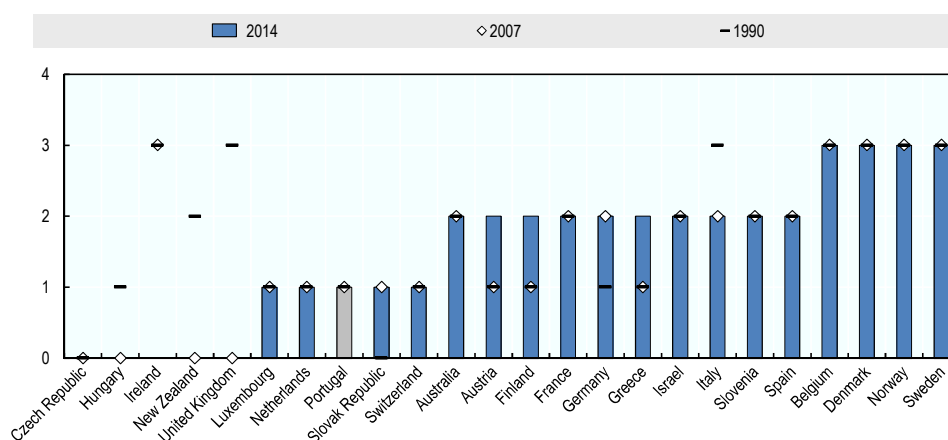
- 1991 instead of 1990 for the Czech Republic, Estonia and Portugal. 1993 instead of 1990 for the Slovak Republic.
- The index is calculated as:  $LEVEL - (fAEB + OCG)/4 (= \text{max value}) + (Art + DR - 1)/5 (= \text{max value})$ . Where: LEVEL = the predominant level at which wage bargaining takes place; fAEB = frequency or scope of additional enterprise bargaining; OCG = general opening clauses in collective agreements; Art = articulation of enterprise bargaining; DR = derogation. For further detail on how these variables are defined, see Visser (2015).
- The 2014 estimate for Portugal differs slightly from that in Visser (2015) because, following discussions with the author, "derogation" has been coded as 2 (i.e. favourability principle is anchored in law, derogation possible under conditions) instead of 0 (i.e. favourability is inversed, enterprise agreements favoured over higher-order agreements).

Source: Visser, J. (2015), ICTWSS Database, Version 5.0, Amsterdam Institute for Advanced Labour Studies AIAS.

Figure 16. **The predominant level<sup>a</sup> at which wage bargaining takes place, 1990-2014<sup>b</sup>**



- 5 = bargaining predominantly takes place at central or cross-industry level and there are centrally determined binding norms or ceilings to be respected by agreements negotiated at lower levels;  
4 = intermediate or alternating between central and industry bargaining;  
3 = bargaining predominantly takes place at the sector or industry level;  
2 = intermediate or alternating between sector and company bargaining;  
1 = bargaining predominantly takes place at the local or company level.
  - 1991 instead of 1990 for the Czech Republic, Estonia and Portugal. 1993 instead of 1990 for the Slovak Republic.
- Source: Visser, J. (2015), ICTWSS Database, Version 5.0, Amsterdam Institute for Advanced Labour Studies AIAS.

Figure 17. Frequency or scope of additional enterprise bargaining<sup>a</sup>, 1990-2014<sup>b</sup>

- a. 3 = additional enterprise bargaining on wages is common;  
 2 = additional enterprise bargaining on wages occurs only in large firms;  
 1 = additional enterprise bargaining on wages is rare even in large firms;  
 0 = no additional enterprise-level bargaining on wages (or does not apply, if “level”=1).
- b. Canada, Estonia, Japan, Korea, Mexico, Poland and United States are not included because bargaining in those countries predominantly takes place at the local or company level over the entire period under consideration.

Source: Visser, J. (2015), ICTWSS Database, Version 5.0, Amsterdam Institute for Advanced Labour Studies AIAS.

The move towards decentralisation in many OECD countries is closely connected to the increased possibility of opening clauses – i.e. the ability to set aside the legal favourability principle which dictates that collective agreements can only deviate from the law (and that lower-level agreements can only deviate from higher-level agreements) in ways that are favourable for workers (Visser, 2013). In Portugal, collective agreements have been able to establish less favourable conditions than those prescribed by the law since the introduction of the Labour Code in 2003 (although, in 2009, the revised Labour Code then specified a number of areas that could not be object of less favourable dispositions in collective agreements), while firm-level agreements (in firms with 500 or more employees) have been able to deviate from higher-level agreements in a less favourable way since 2009. As discussed above, this possibility was extended to firms with 150 or more employees in 2012. In most other OECD countries where the predominant level of bargaining is at the sector/industry/national level, the widespread use of opening clauses in collective agreements only began at the beginning of this century (Visser, 2013) – although in a few countries, this is a far more recent phenomenon (e.g. Finland, Greece, Italy and Spain).

Opening clauses as discussed in the previous paragraph need to be distinguished from “inability-to-pay” (or “hardship”) clauses, which have also been on the rise across the OECD, and which allow temporary deviations from higher-level agreements for firms facing economic difficulties. As discussed above, Portugal introduced this possibility in 2014. Similarly, such clauses have been used by many other OECD countries during the recent crisis (e.g. Austria, Finland, Greece, Norway, Poland, Sweden, Slovenia and Spain). In a handful of countries, they were possible even before the crisis, though sometimes only informally (at least to start with). In Germany, for example, informal arrangements between works councils and employers which allowed deviations from collective agreements in order to save jobs started emerging in the 1990s, and were later institutionalised.

### *Extensions*

The extension of collective bargaining agreements is legally possible in around two thirds of OECD countries. The exceptions are: Canada,<sup>53</sup> Denmark, Greece (since 2011), Italy,<sup>54</sup> Mexico, New Zealand, Sweden, Turkey,<sup>55</sup> the United Kingdom and the United States. In the United Kingdom and New Zealand, extensions used to be possible, but were removed in the early 1980s and 1990s, respectively. While the advantages of extensions for non-unionised employees are obvious, employers may also have an interest in having collective agreements extended because it tends to remove competition on the basis of working conditions (including wages). In addition, extension practices may be particularly useful in countries where there are a large number of small firms (for whom the transaction costs of bargaining are too high) and may even act as an incentive for employers to join an employer organisation in order to get their voice heard.<sup>56</sup> However, as argued above, extensions may also have important negative consequences in terms of competitiveness and employment.

Amongst the countries where extensions are possible, important differences exist in terms of: i) how common such extensions are; ii) whether extensions apply to the whole (or only a part) of the agreements; and iii) what specific requirements need to be fulfilled for an extension to be granted. In some countries (including Portugal before the crisis), extensions are quasi-automatic and apply to virtually all agreements. These countries are: Austria, Belgium, Finland, France, Greece (before 2011), Slovenia and Spain. In other countries, there is a much more selective use of extensions. In Ireland, for example, extensions are only applied to wages and working conditions, and similar restrictions exist in Germany and in Norway also. Finally, in many countries specific requirements need to be met (often relating to the representativeness of the employers signatory to the agreement – i.e. the percentage of workers they represent) before an extension will be granted. Most commonly, the representativeness threshold is set at around 50%: e.g. Finland, Germany (until recently), Greece and Spain (for some procedures). In other countries, the thresholds can be lower (e.g. 30% in Switzerland in some sectors) or higher (60% in the Netherlands, or lower under certain conditions). Clearly, the right rule and threshold need to be adapted to the economic realities of each country.

The crisis brought about important changes to the practice of extensions in many countries, not just in Portugal. In some, extensions were temporarily suspended – sometimes deliberately (like in Greece), sometimes as a result of legal uncertainty (e.g. Ireland and the Slovak Republic). Estonia made a deliberate choice to drop automatic extensions, while the Czech Republic introduced the possibility of exemption for SME's and firms facing financial difficulties.

Interestingly, not all OECD countries decided to weaken the practice of extensions. In the Netherlands, for example, the government made it more difficult for firms to obtain an exemption from extensions, while in Germany the representativeness threshold for extensions to be granted was lowered. That being said, there are few countries where the number of extensions has increased over time – Germany, Norway and Switzerland being the only three exceptions (but these are countries where extensions were relatively rare or non-existent in the past – Eurofound, 2015). Overall, therefore, the practice of extending collective agreements has become less common during the crisis in OECD countries.

53. With the exception of Quebec.

54. In Italy, the courts tend to uphold minimum wage claims based on sectoral agreements for uncovered workers performing similar work, which serves as a functional equivalent to the practice of extension.

55. While there is an instrument for extension of collective agreements in Turkey, it is rarely used in practice (Uçkan, 2012).

56. On the other hand, extensions may reduce union membership as non-unionised workers are able to free-ride on the outcomes of bargaining rounds without having to pay a union membership fee (Blanchard, Jaumotte and Loungani, 2013).

Sometimes, this was as a result of temporary measures, but some countries have introduced permanent restrictions on the use of extensions. While there are obvious reasons for refraining from quasi-automatic extensions during times of crisis, it remains to be seen how the practice will evolve once countries return to higher rates of growth.

#### *Termination and continuation beyond expiry*

Until recently, collective agreements in a handful of countries (primarily in Southern Europe) would not expire unless they were replaced by new ones. The reasoning behind such rules is that they protect workers in cases where employers are unwilling to negotiate new terms. However, because they significantly strengthen the bargaining power of unions, such rules also make it much more difficult for employers who, during times of crisis, may need to negotiate less favourable terms in order to survive and/or avoid employment losses.

While Portugal already introduced the possibility of expiry of agreements without replacement in 2003<sup>57</sup> (and further reduced the length of time for which agreements with cessation clauses could remain valid during the recent reform period), Greece, Spain and Estonia only followed suit during the crisis. In Greece, the indefinite duration of collective agreements (*metenergeia*) was scrapped and replaced by a period of validity of between one to three years, while the after-effect period of agreements was reduced from six to three months. Upon expiry, all clauses of the agreement will cease to apply, except those on basic salary and allowances for maternity, children, education, and hazardous work. Similarly, the Spanish Government put an end to the practice of *ultra-actividad* in 2012, and the after-effect of collective agreements is now limited to one year. In the same year, Estonia removed the possibility of automatic continuation after expiry, and agreements can now only remain valid beyond expiry upon agreement between the signatory parties. Another practice which has emerged in some countries is to allow collective agreements to be terminated unilaterally by one of the signatory parties, like in Poland in 2002 (Eurofound, 2015; Visser, 2016). Overall, and despite the recent reforms, the legal requirements for the expiry of collective agreements remain more demanding and the minimum periods longer in Portugal than in other European countries (Naumann, 2014).

#### **Additional wage moderation was achieved by freezing the minimum wage and reducing overtime pay**

In a bid to restore competitiveness and save jobs, the government froze the minimum wage between 2011 and 2014, and cut the pay (and other compensation) for overtime work. In addition, attempts were made at cutting public sector wages, although the Constitutional Court blocked many of these cuts. These measures came on top of the reduction in collective agreements and extensions discussed above. As the next chapter will make clear, all these measures helped achieve some wage moderation during the crisis.

#### ***The minimum wage was frozen***

Traditionally uprated in January of each year, the Portuguese minimum wage (*Retribuição Mínima Mensal Garantida*) was frozen at its January 2011 level of EUR 485 until October 2014, when it was increased to EUR 505. While the real minimum wage had been relatively stable prior to the crisis, it increased rapidly in the early stages of the recession (2008-2010). The freezing of the minimum wage in 2011 led to a slow erosion of its real value, but the 2014 increase brought the minimum wage back to a real level comparable to that observed at its peak in 2010 (Figure 18).

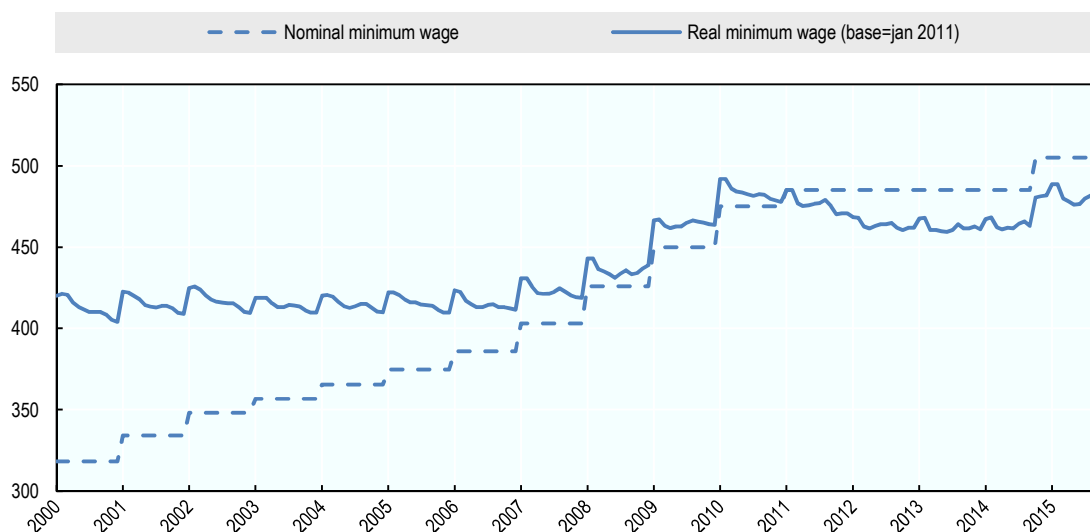
On average across the OECD, minimum wages rose as a proportion of median wages during the crisis – from 47.3% in 2007 to 50.2% in 2014. In Portugal, this increase was even greater (from 51.4% to 57.5%) and, in 2014, Portugal had the sixth highest minimum wage relative to median wages among all OECD

57. The 2006 revision of the Labour Code added an important rule which was that, if the signatories did not specify which conditions of the agreement was to transfer to the individual work contract upon expiry, then provisions related to pay, category and function would automatically be transferred (Naumann, 2014).

countries. Only Turkey, Chile, France, Slovenia and New Zealand had a higher minimum-to-median-wage ratio (Figure 19). While the cost to employers of the 2014 increase in the minimum wage was somewhat offset by a temporary<sup>58</sup> decrease of 0.75 percentage points in employer social security contributions on minimum-wage workers who were hired prior to June 2014, it is important to highlight that, in general, Portugal imposes relatively high employer social security contributions on minimum-wage workers compared to other countries in the OECD (OECD, 2015c). This will exacerbate the possible negative effect of a high minimum-to-median-wage ratio on employment.<sup>59</sup>

From the point of view of employees, however, Portugal imposes relatively low income taxes and social contributions, so that households pocket a large share of any increase in the minimum wage (much larger than in most other OECD countries; OECD, 2015c). At the same time, the freezing of the minimum wage has hurt workers and, in 2013, OECD analysis shows that minimum-wage workers needed to work a relatively high number of hours to be able to move above the relative poverty line: a lone parent with two children needed to work 50 hours per week at the minimum wage before earning 50% of median net household income, while one-earner couples with two children needed to work 62 hours to achieve the same (OECD, 2015c).

Figure 18. **Nominal and real levels of the Portuguese minimum wage, January 2000 to September 2015**



Note: Real minimum wage obtained using the monthly Consumer Price Index; base= January 2010.

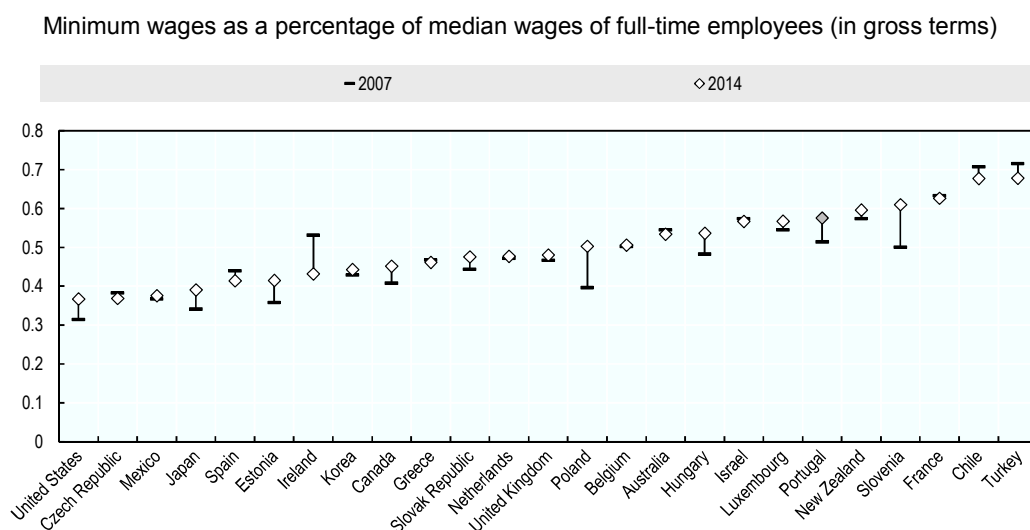
Source: OECD Minimum Wage Database and OECD Economic Outlook Database.

In conclusion: while recent increases in the minimum wage are to be welcomed from a worker perspective, they should raise some concern for employers, particularly because employer taxes and social security contributions on minimum-wage workers are relatively high in Portugal.

58. This measure was set to expire in January 2016.

59. Two studies have shown that minimum wages have (small) negative effects on employment in Portugal (Centeno, Duarte and Novo, 2011; Carneiro et al., 2011). These findings are consistent with the wider, international evidence which has shown that moderate increases in a moderate minimum wage are unlikely to have significant negative employment effects – although more vulnerable groups might be slightly more adversely affected (OECD, 2015c).

Figure 19. Minimum wage levels pre- and post-crisis, 2007-2014



Note: Countries are ranked in ascending order of the MW/Median ratio in 2013. 2009 instead of 2007 data for Mexico. 2013 instead of 2014 data for Japan and Korea.

Source: OECD Minimum Wages Database.

### *Compensation for overtime work was reduced*

Most countries across the OECD regulate standard workweek hours and have laws in place that dictate additional compensation for overtime work. The primary motivation for such legislation is to protect workers' safety and well-being. In addition, some analysts believe that restrictions on overtime work could promote employment: by reducing the number of hours worked by each individual worker, regulations on overtime force employers to hire new workers instead. However, the evidence does not support this claim. If anything, it has been found that greater restrictions on overtime work (including higher overtime premia) raise labour costs and result in a reduction in overall employment (Oaxaca, 2014).<sup>60</sup> While seemingly counterintuitive, there are various reasons why reductions in the number of overtime hours will not create additional employment. One of these is that overtime tends to be carried out primarily by skilled workers, and such work cannot easily be done by unskilled workers. Another reason is that restricting overtime work induces workers affected by such measures to look for second jobs, which creates additional competition for existing jobs. Finally, if jobs consist of a given package of compensation and working conditions, then reductions in overtime pay could simply be compensated for by increases in other types of pay (base wages or other pay) (Trejo, 1991).

In a bid to reduce wage costs, Portugal cut compensation for overtime work by half and revoked the right to paid compensatory time off. In addition, the government suspended until the end of 2014 all clauses regarding overtime pay and compensatory time off contained in collective agreements and employment contracts. Finally, by promoting the use of working time accounts (see next section), employers were offered a cheaper alternative to using overtime work.

60. Similarly, experiments with work-sharing in a number of European countries during the 1980s and 1990s – based on the belief that reducing the average number of hours worked by each employee would result in the creation of new jobs – have not resulted in any employment effects. If anything, the employment effects of such schemes have been negative (Kramarz et al., 2008; Andrews et al., 2015).

Cuts to overtime pay were controversial, especially since they resulted in reductions in earnings for some workers highly dependent on overtime hours. Távora and González (2015) show how some employers kept paying overtime at the pre-reform rates, in return for other concessions from workers. Indeed, new evidence produced by the OECD suggests that there may have been some compensation for cuts in overtime pay through greater increases in base wages and/or in hours worked (see Box 11). At the same time, there is little evidence that the reduction in overtime pay may have reduced employment growth. If anything, there might have been more employment growth in firms that increased their use of overtime.<sup>61</sup> This is because, as argued in Box 11, the main driver of overtime use (and employment growth) is firm performance, and not the rate at which overtime is paid. In a way this is not surprising given that overtime pay actually represents a very small portion of firms' overall wage bill (see Box 14 in Chapter 2).

#### **Box 11. Overtime pay rates, overtime use, and employment growth following the reform of overtime**

This box uses data from the *Quadros de Pessoal* to analyse the effects of the change to overtime compensation on overtime pay rates, the use of overtime, employment growth, hours worked, and other wages. All results are for the private (non-agricultural) sector.

##### **Hourly overtime compensation fell**

The reforms of overtime compensation had a significant impact on hourly overtime pay rates in Portugal which, between 2011 and 2012, fell by 16.7% (13.4%) among workers working (firms using) overtime. While 79.4% (74.4%) of employees (firms) who worked (used) overtime in both 2011 and 2012, saw a reduction in their hourly overtime compensation, only 13.7% (21.8%) experienced an increase. The decision to reduce overtime pay rates appears to have been influenced by firm performance: among firms that did not reduce overtime pay rates, turnover increased by 5.6% on average (compared to just 2.3% among firms that reduced overtime pay rates).

##### **The use of overtime decreased as well**

Despite the strong reductions in hourly overtime compensation, the use of overtime did not increase. Before the reform, 7.6% (3.6%) of employees (firms) worked (used) overtime, while after the reform the incidence of overtime was 6.3% (3.4%) among employees (firms). Similarly, the average monthly number of overtime hours per employee was 1.20 prior to the reform, and 1.07 after.

The reduction in the use of overtime is not surprising, given that the reform was introduced at the trough of the recession, when demand was low and employers were shedding workers rather than needing more of their time. In addition, the reform coincided with the introduction of the individual working time accounts, which may have reduced the use of classic overtime work. While some firms did increase their use of overtime, this was generally because they were performing well: 41.5% of firms that increased their use of overtime experienced an increase in turnover, compared to 28.3% of firms reducing their use of overtime. It is also not the case that firms that started using more overtime were more likely to cut overtime pay rates: regardless of whether they increased or reduced overtime use, 75% of firms on average lowered the hourly overtime rate.

##### **There is no indication that the reform harmed employment growth**

A key concern is that, by reducing the cost of overtime, the reform may have hampered the creation of new jobs. This might be particularly true in a recovery, when demand is picking up but firms are still uncertain about future growth and prefer to use existing employees more, rather than risking to take on new ones. That being said, if the overtime wage rate is reduced and firms do not increase hours worked in response, then the savings obtained might be reinvested by firms into hiring new employees – and so the employment effect of the cut in overtime compensation could in fact be positive.

The data do not indicate that there was any substantial substitution of overtime use for employment growth. In fact, firms that both cut their overtime pay rate and increased the use of overtime also had larger employment growth than average (6.1% versus 0.2%). Just as with the use of overtime, the primary determinant of employment growth is firm performance: employment grew 10.5% in firms where turnover increased, while it fell by 4.3% in the other firms.

61. Martins (2016a) also finds that firms that cut overtime premiums experienced greater increases in employment.



**Box 11. Overtime pay rates, overtime use, and employment growth following the reform of overtime (cont.)****Cuts in overtime pay rates were compensated for by increases in hours worked and/or other wages**

Another interesting (and related) question is whether any reductions in hourly overtime pay were compensated for by increases either in other types of pay, or in the number of hours worked. Indeed, the reform was controversial as it reduced the incomes of certain employees who heavily relied on overtime work, and there is anecdotal evidence that some firms compensated the reduction in overtime pay for those workers by increasing their base wage. The Portuguese *Quadros de Pessoal* data show that the hourly wages (excluding overtime) grew slightly more for employees who experienced a drop in their overtime wage rate (0.48% versus 0.36%). Similarly, the probability of an increase in total hours worked (including overtime) was significantly greater for employees who had their overtime pay rate cut (41.8% compared to 11.6% on average). These figures indicate that the impact of the reduction in the overtime pay rate on total pay was mitigated through increases in both other wages and hours worked.

The above results (i.e. that the reduction in overtime pay rates was not associated with an obvious increase in the use of overtime or decrease in employment growth – and that there was some compensation for the losses in overtime pay by increases in other wages and hours worked) are not entirely surprising, given that total overtime pay only represents a very small fraction of firms' average wage bill per employee (see Box 14 in Chapter 2 for further detail).

***Public sector wages were cut***

In addition to freezing the minimum wage, the government cut the wages of civil servants earning more than EUR 1 500 in 2011 (by 3.5% to 10%). It also attempted to further cut public sector wages by: i) suspending the 13<sup>th</sup> and 14<sup>th</sup> monthly salary payments for those workers earning EUR 1 100 or more per month; ii) suspending the equivalent of one of those payments for workers with monthly salaries between EUR 600 and EUR 1 100. However, Portugal's Constitutional Court ruled that these cuts were unconstitutional and that the payment of bonuses should be resumed in 2013. These cuts were nevertheless implemented in 2012. In addition, in 2013, the government increased the working hours of public sector workers from 35 to 40 hours per week, without any increase in pay.

The government reintroduced similar public sector wage cuts, albeit more significant and also for civil servants earning below EUR 1 500 per month, as part of its 2014 Budget Law. Once more, these cuts were ruled unconstitutional (in May 2014) and were only implemented in the first five months of 2014. Other provisions contained in the 2014 Budget Law with an impact on public sector wages (such as overtime pay reductions and uncompensated longer work weeks) were not challenged. Given that the ruling of the Constitutional Court had severe implications for public finances, the government launched a new austerity package in 2014, which again cut public sector wages over the period 2014-2018 at rates comparable to those applied in 2011. These measures were immediately brought before the Constitutional Court (August 2014), which ruled that the cuts for 2014 and 2015 were constitutional, but that it was not acceptable to implement wage cuts for a more extended period than the one fixed for the implementation of the Memorandum of Understanding on Specific Economic Policy Conditionality, which lasted until May 2015.<sup>62</sup>

62. The XXI Constitutional Government reversed previous cuts in public sector wages by the end of 2016, and returned from the 40-hour week introduced in 2013 to the old 35-hour week in July 2016.

***Working time has become more flexible to contain employment fluctuations over the cycle***

Adjustments in labour input in response to adverse conditions can happen either along the extensive margin (i.e. reducing the number of people in work) or along the intensive margin (i.e. reducing the hours of people in work). Avoiding unnecessary redundancies is obviously preferable from the employees' point of view, but also for employers because it allows them to hold on to employees (and firm-specific human capital) and avoid costly hiring and firing procedures. From society's perspective, it mitigates the costs of higher unemployment, including expenditure on unemployment benefits.

In contrast to some other OECD countries, the adjustment in labour input to the crisis in Portugal occurred primarily through job destruction. There are many factors which determine the choice of adjustment mechanism (hours versus jobs), but making sure that employers have the flexibility to adjust working time is one of them. In particular, there is evidence that short-time work compensation schemes helped preserve jobs in a number of OECD countries during the crisis (OECD, 2010b). In addition, working time accounts played an important role in countries such as Germany.

Such schemes existed in Portugal prior to the crisis, but the evidence suggests that they were used very little. To encourage employers to use such measures in the future, Portugal reduced the procedural requirements and time needed to implement short-time work compensation schemes (*redução temporária do período normal de trabalho ou suspensão do contrato de trabalho*), and also introduced additional safeguards to reduce the deadweight loss incurred by them. In addition, individual working time accounts (*banco de horas*) were introduced alongside the collective working time accounts already in place, and it was made easier to extend the latter to workers not covered by collective agreements.<sup>63</sup>

While there appears to have been a slight uptake of short-time work and working time accounts following the reforms, this probably came too late to make a significant difference to job destruction during the recent recession. In addition, and despite the reform, the take-up of flexible working time arrangements may remain low in Portugal as long as there is a high share of temporary employment, which makes it easy for firms to adjust labour inputs along the employment margin.

***In Portugal, the adjustment in labour input to the crisis occurred primarily through job destruction***

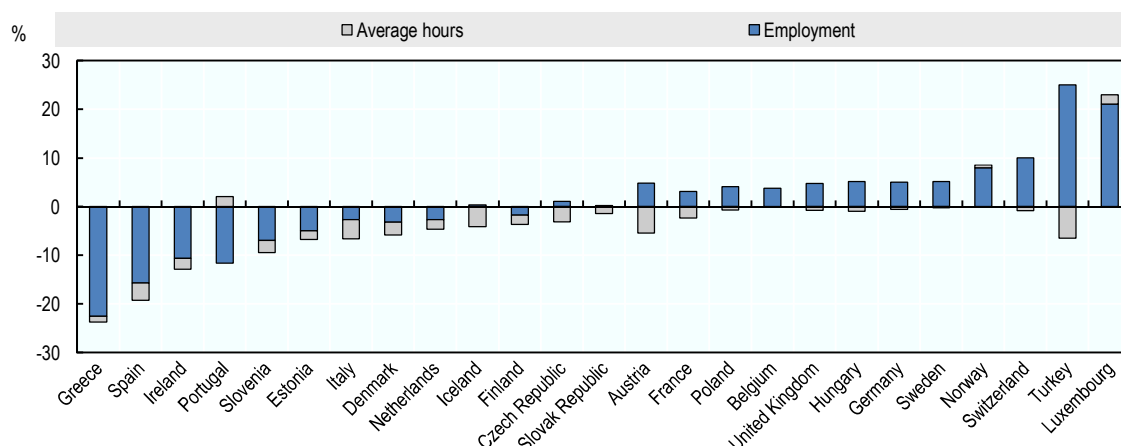
A decomposition of the reduction in total hours worked during the crisis shows that, in Portugal, this fall can be attributed entirely to employment losses,<sup>64</sup> while in other countries a reduction in average hours worked played a more important role (Figure 20). OECD (2010b) showed that, in some countries, the decline in employment during the crisis was small compared to what would have been expected given the size of the decline in output, and that this was due in large part to reductions in average hours worked.

63. The XXI Constitutional Government has announced plans to abolish the possibility of individual working time accounts established upon agreement between the employer and employee. Instead, there would be a return to the pre-reform situation where such working time accounts could be established only by collective agreement (Government of Portugal, 2015).

64. One of the contributing factors to these employment losses is the fact that a very large share of Portugal's businesses is made up of micro/small enterprises, with low survival rates during times of crisis. Indeed, Carneiro, Portugal and Varejão (2014) show that the closing of existing firms contributed significantly to overall employment losses.

Figure 20. **Decomposition of the change in total hours worked, 2007-2014**

Change in total hours worked that can be attributed to changes in employment and average hours worked, respectively



*Note:* Countries are ranked in ascending order of the percentage change in total hours worked. Covers all ages 15+. Because of a methodological change in the Portuguese Labour Force Survey, data prior to 2011 are not fully comparable with the more recent data. The new methodology results in higher levels of unemployment and inactivity compared to the methodology used prior to 2011. For detailed information, see Statistics Portugal (2011).

*Source:* Eurostat.

***In some countries, short-time work compensation and working time accounts played an important role in preserving jobs during the crisis***

There are many factors that determine the extent to which labour input adjustments are made along the intensive margin (hours worked) as opposed to the extensive margin (employment) – including differences in the nature of the shock and the structure of the economy. However, making sure that employers have the flexibility to adjust working time in response to changing demand conditions is one of those reasons.

For example, there is evidence that short-time work compensation played an important role in preserving jobs during the crisis in a number of OECD countries, including in Germany, Japan, Belgium and Finland (OECD, 2010b). Convincing employees to reduce working time during a crisis may be difficult for employers since it implies a significant loss in earnings. If, however, the government compensates some of that loss and ensures that employees still earn more than they would receive in unemployment benefits, they might be more easily persuaded. While such publicly sponsored schemes to support temporary reductions in working time or lay-offs were possible in Portugal even prior to the crisis (*redução temporária do período normal de trabalho ou suspensão do contrato de trabalho*), they appear to have been rarely used (MTSS 2006). In comparison, countries which experienced a fall in GDP in 2009 similar to that of Portugal (e.g. Austria, the Netherlands, Switzerland and the United States) had much greater incidence of short-time workers in the labour force (see Figure 21).

Similarly, there is evidence that working time accounts (or banks) have helped preserve jobs during the crisis in countries like Germany (Zapf and Brehmer, 2010). These schemes allow employers to increase hours worked (within certain limits) when demand is high, and then to run down the accumulated time when demand is low. Again, while such flexibility has been available to employers in Portugal since 2009, it has been used relatively little in practice (Monteiro Fernandes, 2012).

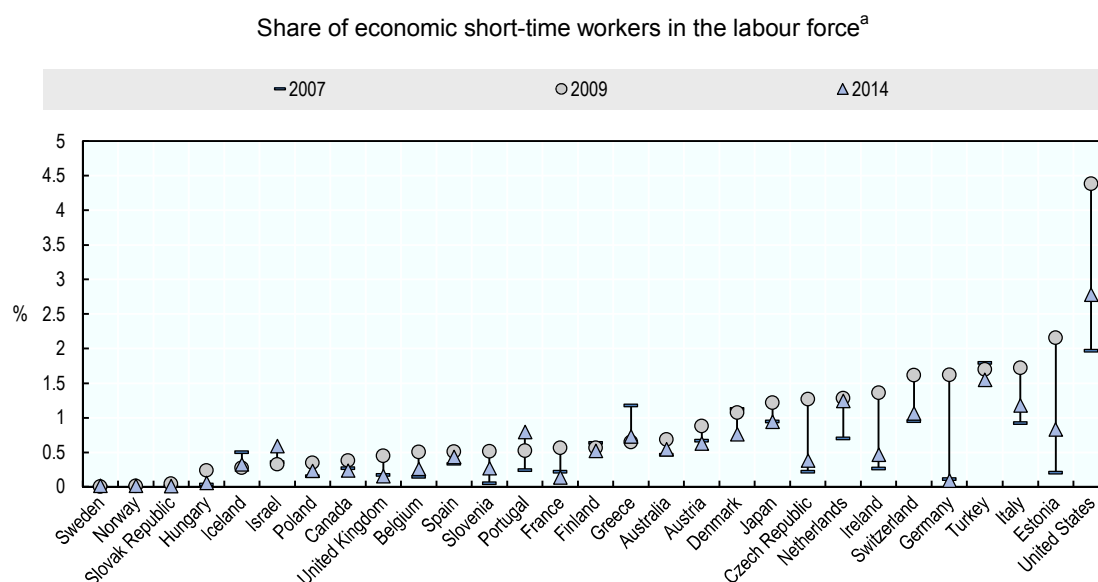
### *Portugal introduced a number of reforms to facilitate the use of flexible working time arrangements*

Towards the middle of 2012, Portugal introduced a number of changes that would make it easier for employers to use short-time work compensation as well as working time accounts. The procedural requirements and time needed to implement short-time work arrangements were reduced. In particular, the notice period employers need to respect to inform workers of the measure to be applied was shortened (with a possibility to implement immediately if the works council agrees), and the workers' representative body can no longer oppose an extension of the short-time working arrangement as long as the employer follows the necessary communication procedures.

A second reform involved the introduction of individual working time accounts alongside the collective working time accounts already in place, and it was made easier to extend the latter to workers not covered by collective agreements. Under the previous rules, working time accounts had to be regulated by collective agreement. As pointed out by Távora and González (2015), the new rules therefore decentralised decisions around internal flexibility to the firm.

Figure 21 suggests that the share of economic short-time workers in Portugal has increased over time. Interestingly, Portugal is one of the only countries where the use of short-time work has risen between 2009 and 2014, which could reflect the fact that such measures are now easier to implement. In most other countries, the peak was reached in 2009, and there was a substantial reduction in the use of short-time work by 2014. While international comparative data is not available, Table 4 shows that the number of workers covered (firms using) working time accounts in Portugal was 2.5 (1.3) times higher in 2014 than it was in 2010. That being said, the proportion using working time accounts remains relatively low (2% of workers and less than 1% of firms). In addition, because these reforms came so late in the crisis, is it is highly unlikely that they will have had a significant impact on stemming job losses. As Chapter 2 will show, Portugal started emerging from the crisis in early 2013.

Figure 21. **The incidence of short-time workers, 2007-2014**



- a. Persons working less than usual during the survey reference week due to slack work for technical or economic reasons or to change of job during reference week – i.e. start or end of job without taking up a new one.

Source: OECD Employment Database.

Table 4. Use of working time accounts, 2010-2014

		Number					Percentage (%)				
		2010	2011	2012	2013	2014	2010	2011	2012	2013	2014
Workers	<b>Total</b>	<b>14 015</b>	<b>15 581</b>	<b>30 817</b>	<b>42 481</b>	<b>49 132</b>	<b>0.53</b>	<b>0.60</b>	<b>1.26</b>	<b>1.75</b>	<b>1.96</b>
	Working-time account (collective)	14 015	15 581	17 710	25 274	28 975	0.53	0.60	0.73	1.04	1.16
	Working-time account (individual)			11 307	15 103	17 951			0.46	0.62	0.72
	Working-time account (group)			1 800	2 104	2 206			0.07	0.09	0.09
Firms	<b>Total</b>	<b>1 032</b>	<b>1 087</b>	<b>1 534</b>	<b>1 956</b>	<b>2 362</b>	<b>0.36</b>	<b>0.38</b>	<b>0.56</b>	<b>0.72</b>	<b>0.86</b>
	Working-time account (collective)	1 032	1 087	1 189	1 426	1 542	0.36	0.38	0.43	0.52	0.56
	Working-time account (individual)			339	524	700			0.12	0.19	0.25
	Working-time account (group)			61	105	120			0.02	0.04	0.04

Source: Gabinete de Estratégia e Estudos, Ministry of Economy (based on the *Quadros de Pessoal*).

***Portugal also improved the design of short-time work compensation schemes to reduce their deadweight loss***

While the majority of OECD countries operated a short-time work compensation scheme during the crisis, OECD (2010b) showed that there are important differences in the design of such schemes across countries which may affect their relative success at stemming job losses. In particular, such design features can influence: i) the amount of deadweight loss such schemes incur (i.e. the subsidisation of jobs which would have been kept even in the absence of the subsidy) as well as ii) their displacement effects (i.e. the preservation of jobs that are not viable without the subsidy, even after business conditions improve). Among the main characteristics of short-time work schemes OECD (2010b) distinguishes:

- *Work-sharing requirements* which specify how working time reductions are to be distributed across the workforce of participating firms, including by setting a minimum number or share of employees who must participate, or limits on the minimum or maximum hours reductions.
- *Eligibility requirements* which set conditions that employers or employees must meet in order to participate in the programme (e.g. minimum reduction in production and/or sales; or an explicit agreement between the social partners).
- *Conditionality requirements* which set behavioural requirements for employers and employees participating in short-time work schemes (e.g. prohibitions of dismissals during or, in some cases, for a short period after participation in short-time work schemes; the development of recovery plans).
- The *generosity* of a short-time work programme which determines the cost of participation for both firms and employees, as well as the maximum duration for which income support is available.

As part of the reform of short-time work compensation, Portugal attempted to reduce the deadweight losses of such schemes by: imposing a 30% contribution of the employer to the financial compensation paid to the worker; providing financial incentives to encourage workers to take up training while not working; and banning firing in the period immediately after the end of the scheme. While these requirements and the generosity of short-time work schemes can be tightened so as to reduce deadweight losses and displacement effects, it is important to bear in mind that there is also an important trade-off in terms of the uptake of such schemes: the higher the administrative burden placed on firms, the higher the probability that the latter will be deterred from participating in them.

***Short-time work compensation also has its limitations***

While short-time work compensation schemes can help avoid unnecessary job losses during a crisis, there are also some risks attached to their use. For instance, they tend to benefit permanent employees primarily, and may therefore exacerbate the labour market divide between permanent employees and those on temporary and part-time contracts.<sup>65</sup> In addition, and particularly where they are overly generous, such schemes may result in the preservation of inefficient job matches and prevent the reallocation of labour to more productive uses. This may also hinder hiring during the recovery and, for this reason, the OECD has previously suggested that the use of short-time work schemes be discouraged as the economy enters into recovery (OECD, 2010b). These limitations highlight the fact that short-time work compensation should be seen as just one of many ways of reducing working hours during periods of slack. Other methods include working time accounts, reductions in overtime, as well as reductions in working time on the initiative of employers. Under certain circumstances, such alternative schemes may even achieve a more tailored and efficient outcome than a government-led scheme (Cahuc, 2014).

Finally, it is not clear that, even after the reforms, employers in Portugal will make much use of reductions in working time to respond to changing market conditions. In fact, one possible reason for the low take-up of such measures in some countries (e.g. France) is that they have a high share of temporary employees, which makes it easier to make adjustments by shedding labour (Gonthier, 2012). As long as the Portuguese labour market remains highly segmented, labour input adjustments may therefore continue to be made primarily by reducing temporary employment.

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65. Such an argument would apply equally to the use of working time accounts.



## CHAPTER 2

### RECENT LABOUR MARKET DEVELOPMENTS AND OUTSTANDING CHALLENGES IN PORTUGAL

The Portuguese labour market reforms were a move in the right direction. Since economic growth turned positive again in early 2013, Portugal has experienced significant improvements in both employment and unemployment rates – greater, in fact, than what one would have expected given the pace of the recovery. However, despite the progress made, many challenges remain. Unemployment remains high (particularly among youth) and this situation has fuelled an increase in both poverty and long-term unemployment (although there are signs of improvement in the latter). The labour market remains highly segmented and, in the context of very low inflation, the presence of downward nominal wage rigidity is likely to remain a barrier to the competitiveness of the Portuguese economy – unless productivity growth is strengthened.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.





The labour market reforms that Portugal implemented over the period 2011-2015 were described one by one in the previous chapter. While the possible impact of each of these measures was also discussed, this was always done in isolation, assuming a *ceteris paribus* (“all other things held constant”) view of the world. Yet the sheer number of reforms that were undertaken over this period makes it clear that such analysis will only be partial. Indeed, there will be important complementarities between the measures implemented, as well as effects which cancel each other out. There is a need, therefore, to look at the overall evolution of the Portuguese labour market over the reform period.

One should be careful, however, in ascribing general trends in labour market outcomes (whether good or bad) to the reforms that were undertaken. Indeed, establishing any form of causality between the reforms and changes in labour market indicators is complicated by the following facts:

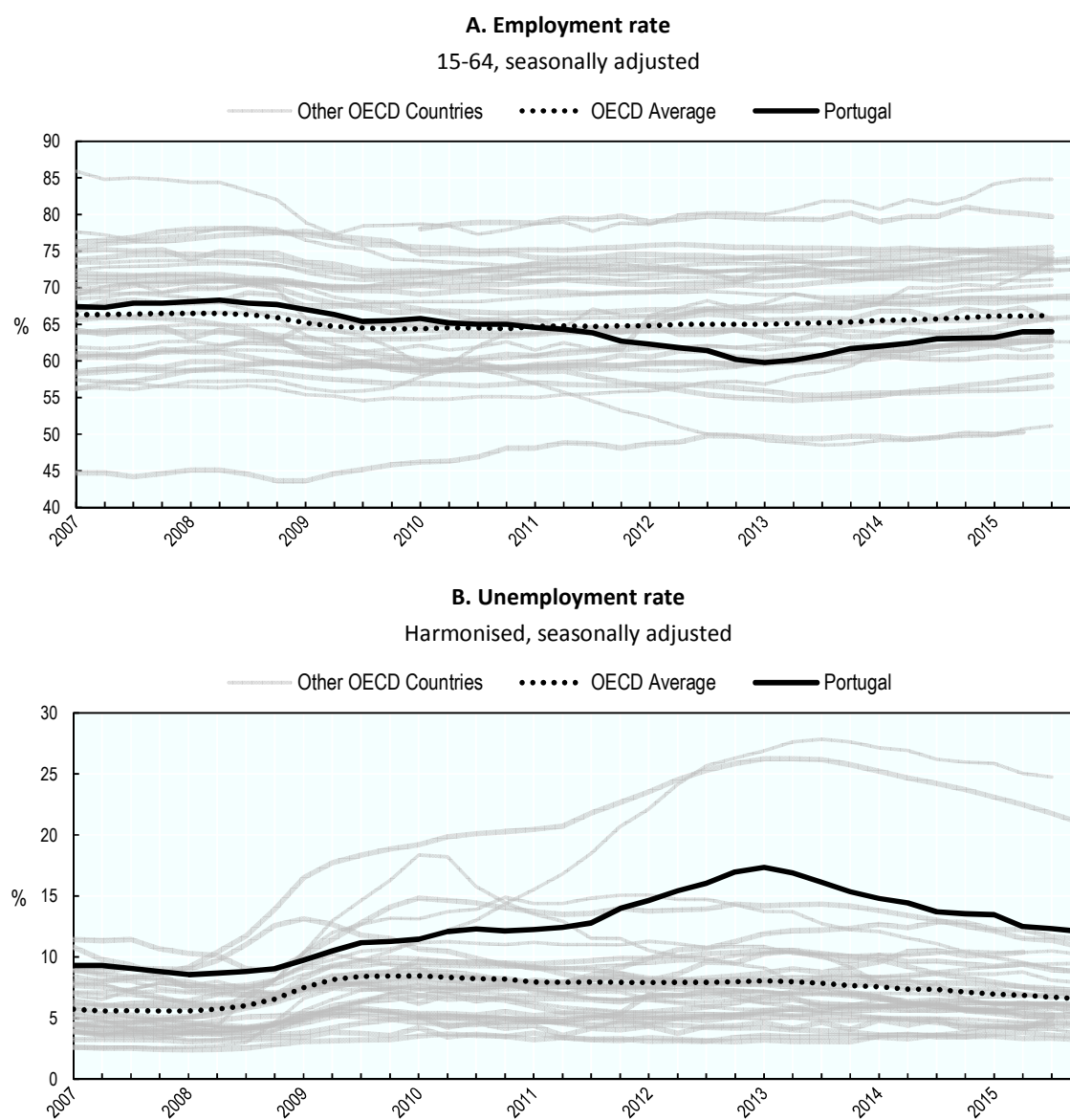
1. The reforms were implemented over a relatively long period of time, which makes it impossible to identify a clear “before” and “after” for the purpose of evaluation.
2. Not much time has elapsed since the labour market reforms, yet some of the measures will take time to produce their full effect and so it may be too soon to evaluate them.<sup>66</sup>
3. Important reforms have been implemented in areas other than employment, which may also have an effect on the labour market.
4. The reforms coincided with a second dip in GDP growth and a gradual recovery. Disentangling the effects of the reforms from those of the economic cycle is notoriously difficult.

Given these difficulties, the purpose of this chapter is: i) to stand back and provide a descriptive overview of the evolution of some key indicators for the Portuguese labour market over the past few years; and ii) to identify the key challenges that lie ahead.

### **Portugal is moving out of recession and there have been significant improvements in the employment and unemployment rates**

After a prolonged period of negative growth, Portugal is starting to emerge from the crisis. Since the beginning of 2013, there have been significant improvements in both the employment and unemployment rates. The Portuguese employment rate, higher than the OECD average prior to the crisis, fell below the OECD average in 2011, where it remained mid-2015 (Figure 22). It reached its trough at the beginning of 2013 (59.8%), but has seen a significant improvement since. Between the first quarter of 2013 and the final quarter of 2015, the Portuguese employment rate rose by 4.5 percentage points – the third highest rate of increase after Hungary and Iceland, and considerably higher than the 1.6 percentage point rise observed across the OECD on average. The unemployment rate in Portugal saw a very sharp increase during the crisis: from 8.6% at the beginning of 2008 to a peak of 17.3% at the beginning of 2013 (Figure 22), when it was second only to the unemployment rates observed in Spain and Greece. Like the employment rate, however, the Portuguese unemployment rate has seen significant improvements between the first quarter of 2013 and the final quarter of 2015: a fall of 5 percentage points (compared to 1.5 percentage points across the OECD on average). Importantly, the decline in unemployment observed in Portugal is much sharper than what one would have expected given GDP growth and the relationship between GDP growth and unemployment observed in the past (see Box 12). While this should not be interpreted as causal evidence that the reforms are having a positive impact on the labour market, these findings are at least consistent with the impact that would be expected from the reforms.

66. One of the reasons why the measures will take time to produce their full effect is that the impact of some of the reforms, particularly those of employment protection legislation, will depend on the interpretation of these laws by the courts and, therefore, the build-up of case law which will influence individuals’ future behaviour.

Figure 22. **Employment and unemployment rates, Q1 2007-Q4 2015**

Source: OECD Employment Database.

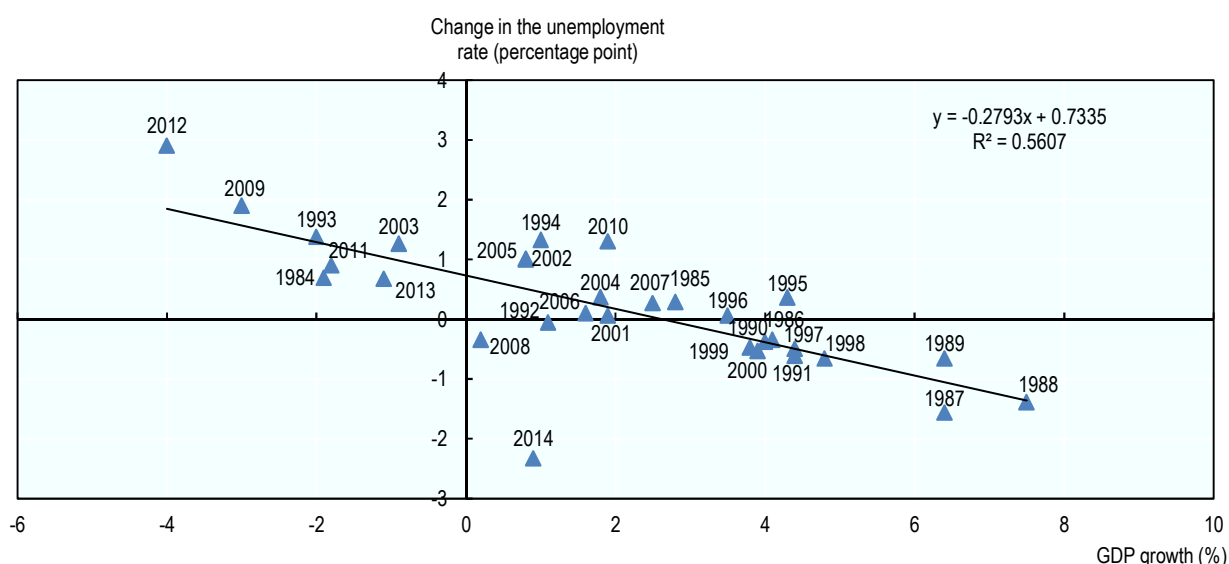
### Box 12. Portugal's strong recovery: How unemployment is falling more sharply than predicted

A well-known stylised fact in economics is the robust relationship between short-term GDP growth and changes in the unemployment rate. This relationship is known as Okun's law, referring to the finding of Okun (1962) that in the United States a 1% increase in real GNP was associated with a 0.3 percentage point drop in the unemployment rate. The existence of a negative relationship has been found for different time periods and countries, although there is substantial variation in the magnitude of the correlation coefficient (Ball, Leigh and Loungani, 2011; Cazes, Verick and Al Hussami, 2013).

Figure A plots this correlation for Portugal for the period 1984-2014 and clearly shows a negative relationship between output and unemployment growth: a 1% increase in real GDP is associated with a 0.28 percentage point drop in the unemployment rate. However, whereas the majority of the observations are very close to the fitted linear regression line, the observation for 2014 is a clear outlier, combining very modest GDP growth (0.9%) with a sharp drop in the unemployment rate (-2.3 percentage points). It seems, therefore, that a departure from the previously observed relationship between output and unemployment growth can be observed during the present recovery, starting in 2013. Indeed, dropping 2013 and 2014 from the sample increases the correlation coefficient (to -0.3) and improves the fit of the regression line (to an  $R^2$  of 0.76).

Figure A. Okun's Law in Portugal, 1984-2014

Relationship between growth in GDP and changes in the unemployment rate

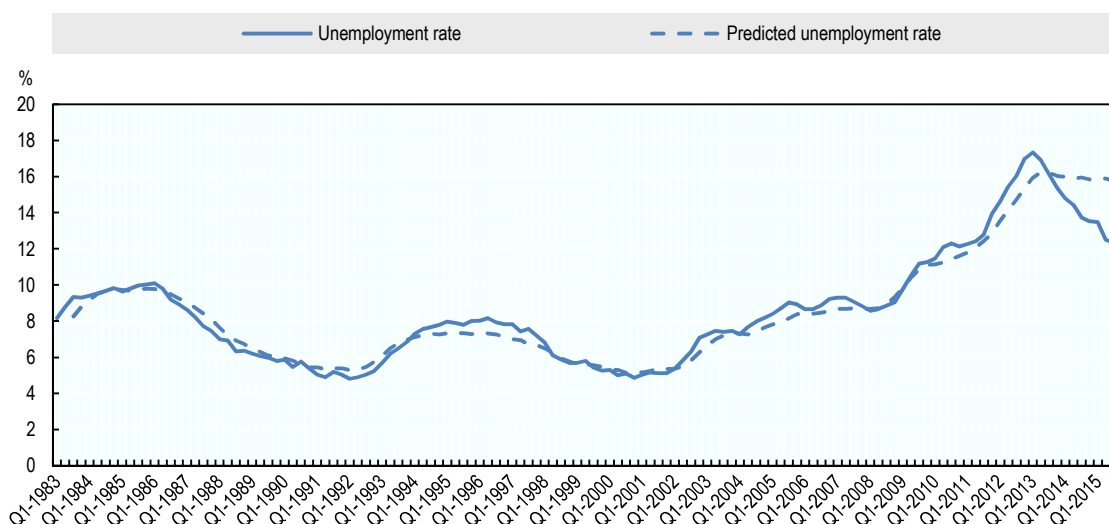


Source: OECD Quarterly National Accounts Database, OECD Short-Term Labour Market Statistics Database.

The departure from the previously observed relationship between output and unemployment growth can be seen even more clearly in Figure B, which compares the actual unemployment rate to the predicted unemployment rate based on the observed relationship between GDP and unemployment rate growth over the period Q1 1984 to Q3 2011 (i.e. prior to the labour market reforms). Whereas the evolution of the predicted unemployment rate follows the trend of the actual unemployment rate closely in most years, including during the most recent recession, there is a big gap between the predicted and actual rates from the second half of 2013 onwards. While according to the predictions, the return to modest growth should have resulted in a levelling off of the unemployment rate, in reality there has been a sharp drop. It would appear, therefore, that the Portuguese labour market has been recovering much faster from the recession than one would have predicted based on pre-reform data, and these findings are in line with those of the European Commission (2015). However, one should also bear in mind that, over the same period, there was a large increase in emigration as well as in the number of unemployed participating in active labour market programmes. Both these factors may have contributed to the pattern observed above.

Box 12. Portugal's strong recovery: How unemployment is falling more sharply than predicted (*cont.*)

Figure B. Predicted and actual changes in the unemployment rate, Q1 1983 to Q3 2015



*Note:* The predicted unemployment rate is estimated by regressing quarterly changes in the unemployment rate on the quarterly GDP growth rate for the period Q1 1984 to Q3 2011, including two lags each for GDP growth and the change in the unemployment rate. The predicted unemployment rate is constructed by adding the predicted change in the unemployment rate to the actual unemployment rate observed in Q1 2001.

*Source:* OECD analysis based on the OECD Quarterly National Accounts Database and the OECD Short-Term Labour Market Statistics Database.

While not proving that the reforms have had the intended effects, these findings are at least consistent with what one would expect. As argued in Chapter 1, the changes to severance pay rules will only slowly change firing behaviour, since accumulated rights were largely preserved. This may be why unemployment did not rise more than expected when GDP was falling, even after the reforms had been implemented. However, the changes to EPL should imply immediate effects on hiring when growth picks up since new hires start accumulating severance pay under the new rules, which significantly reduced the cost of hiring. Indeed, a preliminary OECD assessment of the severance pay reforms in Portugal suggests that they may have had a relatively large effect on hiring.

*Source:* Ball, L.M., D. Leigh and P. Loungani (2013), "Okun's Law: Fit at 50?", *IMF Working Papers*, No. 13/10; Cazes, S., S. Verick and F. Al Hussami (2013), "Why did unemployment respond so differently to the global financial crisis across countries? Insights from Okun's Law", *IZA Journal of Labor Policy*, Vol. 2/10; Okun, A.M. (1962), "Potential GNP: Its measurement and significance", *American Statistical Association, Proceedings of the Business and Economics Section*, pp. 98-104.

### A key challenge consists in reducing high rates of youth unemployment

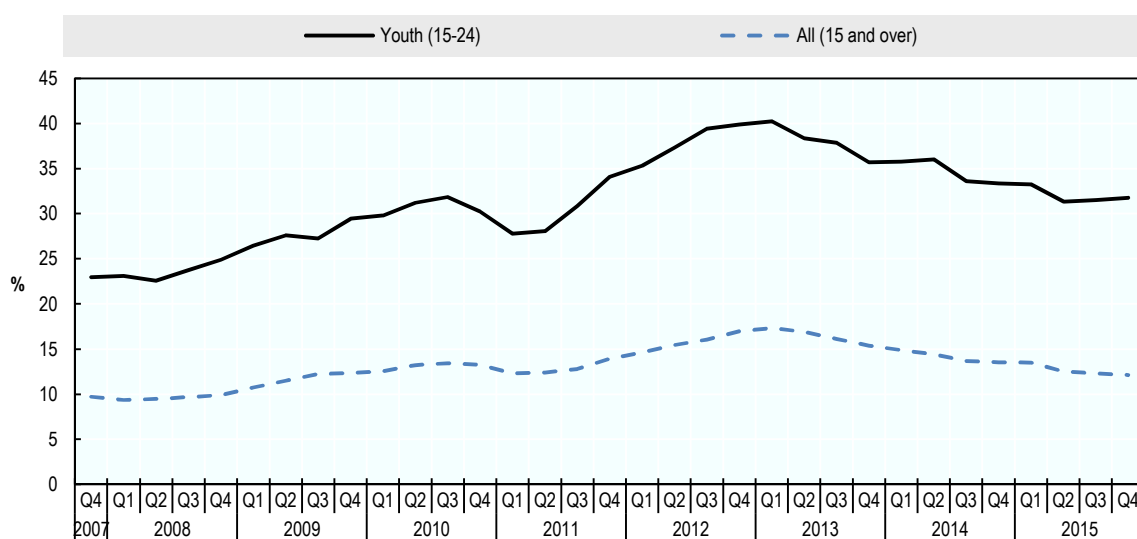
Despite recent improvements, the unemployment rate in Portugal remains high – and certain population groups are more affected than others. A particularly pressing concern going forward is the unemployment rate amongst youth. Young people in Portugal were disproportionately affected by the crisis and, at its peak, youth unemployment stood at 42.5% – 2.3 times the overall unemployment rate (Figure 23). While youth unemployment has also been falling since the beginning of 2013 it remains nearly twice as high as before the crisis. In the third quarter of 2015, Portugal had the 4<sup>th</sup> highest youth unemployment rate in the OECD, after Spain, Greece and Italy.

The disproportionate increase in youth unemployment during the recession also occurred in some other OECD countries, particularly those where (like in Portugal) there is a large gap in employment

protection legislation between temporary and permanent contracts. In those countries, youth are often hired on temporary contracts, with little hope of moving to a permanent position. When a recession hits, it is workers on temporary contracts (and therefore youth) who are most likely to lose their job (Casado, Fernandez and Jimeno, 2015). Further reforms of EPL to reduce labour market duality should therefore be seen as a key ingredient for improving the labour market outcomes of youth in Portugal.

Of course, EPL is not the only front on which youth unemployment should be addressed. Investing in skills, providing adequate income support to the unemployed, putting in place cost-effective active labour market measures, and tackling demand-side barriers are equally important (OECD, 2013a). It is also essential to intervene early to prevent youth at the margins of the labour market from falling into inactivity – after which it becomes much harder to reintegrate them into the labour market. At the European level, there has been a push for member states to adopt a “Youth Guarantee” – a new approach to tackling youth unemployment and inactivity which ensures that all young people under 25 get a good quality, concrete offer (either a job, apprenticeship, traineeship or continued education) within four months of leaving education or becoming unemployed. At the end of 2013, Portugal also adopted a Youth Guarantee, building on the earlier *Impulso Jovem* – a strategic plan to tackle youth unemployment launched in June 2012 and built on four pillars: internships (*Estágios Emprego*), hiring incentives (*Apoios à Contratação*), vocational training (*Formação Profissional*) and entrepreneurship support (*Empreendedorismo*). A more detailed description of these measures is given in Annex A. Going forward, the Portuguese Government should make sure that the Youth Guarantee programme in Portugal is adequately resourced, offers quality and sustainable solutions, and targets the hardest-to-reach (and not just the job-ready). A key challenge here will be to reach out to those youth who are not registered with the Public Employment Service.

Figure 23. Youth unemployment rate, Q4 2007-Q4 2015



Source: OECD Employment Database.

### The incidence of long-term unemployment remains high and continues to rise

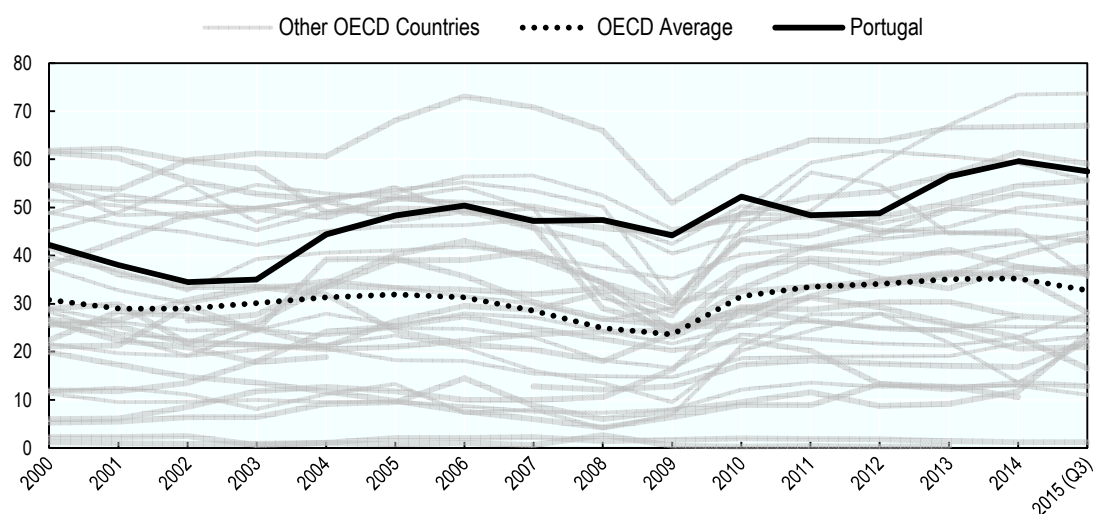
Another challenge the Portuguese labour market faced even prior to the crisis was the high incidence of long-term unemployment, and the reforms of unemployment benefits and activation policy discussed in the previous chapter sought to address this. Some evidence was presented that the strengthening of activation measures has had a positive impact on the monthly reemployment probabilities of the unemployed (Martins and Pessoa e Costa, 2014) – however the reductions in maximum benefit duration

will take time to make their impact felt, as they will only apply from the second unemployment spell after the reform onwards. In addition, the initial evidence suggests that the reductions in benefit levels have not (yet) had an impact on the transition from unemployment to employment.

Moreover, economic conditions remain difficult in Portugal and, while the unemployment rate has fallen in recent years, long-term unemployment remains high and has only been declining slowly since the start of 2015 (Figure 24). In the third quarter of 2015, 57.5% of the unemployed had been out of a job for a year or more, compared to 47% in the third quarter of 2007. Part of the rise in long-term unemployment will reflect a composition effect, as those who have been unemployed least long are most likely to be exiting unemployment as the recovery kicks in, while those who are hardest to help remain behind, which drives up the average duration of unemployment. But long-term unemployment is also self-sustaining: the longer someone has been out of work, the harder it becomes to help that person back into work<sup>67</sup> – which raises the risk of an increase in structural unemployment – and there is some indication that this may already have occurred in Portugal (see Box 13). An additional concern about the rise in long-term unemployment is that it has affected some groups more than others: at the end of 2013, two thirds of the low-skilled unemployed had been out of a job for a year or over – which points to the importance of maintaining (and adapting) the skills of the low-skilled while they are out of work. Chapter 3 delves deeper into the importance of skills investment for improving labour market outcomes in Portugal.

Figure 24. The incidence long-term unemployment, 2000 to Q3 2015

Proportion of the unemployed who have been out of a job for one year or over



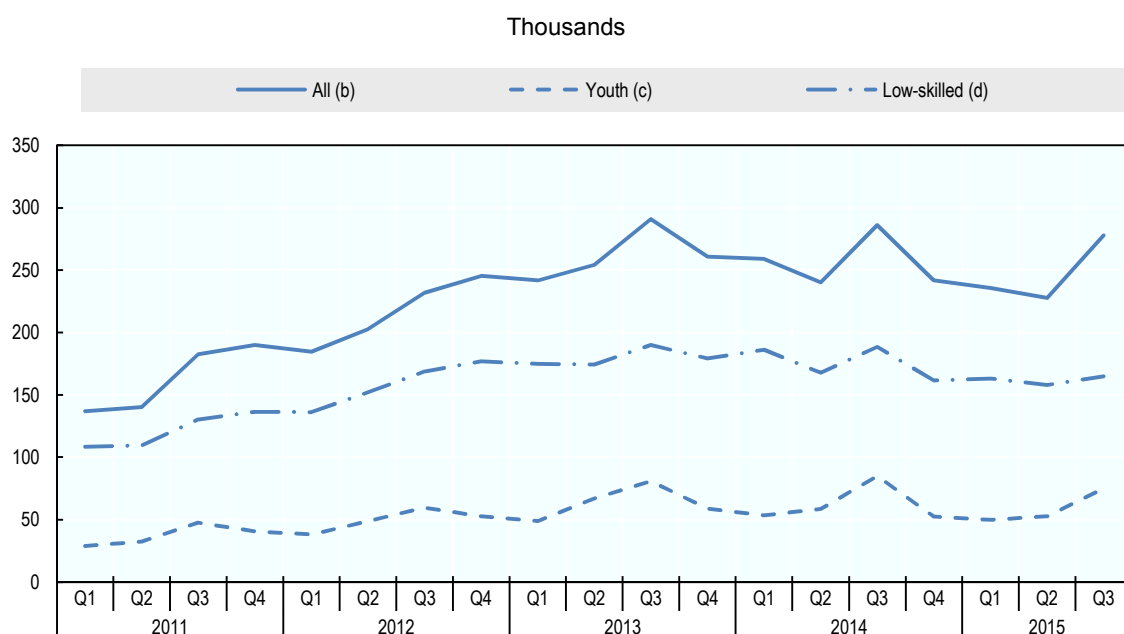
Source: OECD Employment Database.

The recent rise in long-term unemployment is not something that is unique to Portugal, however. Across the OECD, the incidence of long-term unemployment is up by 24% since 2007 (compared to 26% in Portugal). Addressing this high rate of long-term unemployment remains a key challenge for policy makers going forward, since there is a danger that many in this group lose their skills and motivation or, worse even, become permanently disengaged from the labour market. Indeed, the increased risk of marginalisation among the unemployed may not only show up in the form of increased long-term

67. There may be several reasons for this. On the one hand, employers become less and less likely to hire an individual the longer he/she has been unemployed, which could either be a result of employer screening or of human capital depreciation. On the other hand, individuals themselves might become increasingly discouraged and lower their search effort.

unemployment, but also in the rate at which the unemployed are dropping out of the labour force altogether. Figure 25 shows the trend in marginally attached persons (i.e. persons out of the labour force who are willing to work and available for work, but are not actively seeking work). The total number of marginally attached persons in Portugal more than doubled between the first quarter of 2011<sup>68</sup> and the third quarter of 2013, when they totalled 290 000 individuals – most of whom (two in three) were low-skilled. Again, this points to the importance of strengthening skills policies in Portugal. The number of marginally attached persons has been on the decline since the end of 2013, with the exception of a temporary rise in the third quarter of 2014 and an increase in the final quarter of the sample (2015Q3). The most recent fluctuations are mainly driven by youth, with the number of low-skilled marginally attached workers remaining fairly constant.

Figure 25. **Number of persons marginally attached to the labour force<sup>a</sup>, Q1 2011 to Q3 2015**



- a. Persons not in the labour force who did not actively look for work during the past four weeks, but wish to work and are available for work.
- b. All individuals aged 15-64.
- c. Ages 15-24.
- d. ISCED levels 0-2.

Source: OECD analysis based on the Inquérito ao Emprego.

68. Data are presented from 2011 onwards, because the series before and after the break in the LFS data in 2011 are not comparable.

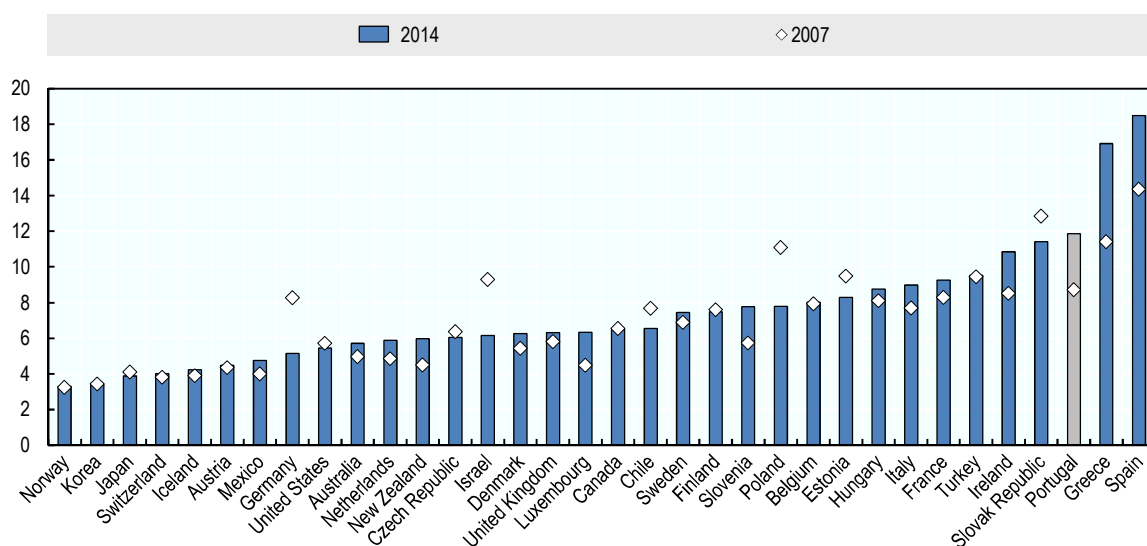


## Box 13. Is structural unemployment rising in Portugal?

**The non-accelerating inflation rate of unemployment (NAIRU) has risen**

The concern with high levels of long-term unemployment is that some of it may turn structural as certain individuals become further and further removed from the labour market and find it increasingly difficult to return to work. Two measures tend to be used to assess whether a rise in structural unemployment is taking place. The first of these is the non-accelerating inflation rate of unemployment (NAIRU), which is a measure of the level of the unemployment rate that is consistent with a constant rate of inflation. Figure A shows not only that the NAIRU is significantly higher in Portugal than it is in most other OECD countries, but also that it has risen substantially over the period 2007-2014. The NAIRU has risen by 5.5 percentage points in Greece, 4.1 percentage points in Spain, and 3.1 percentage points in Portugal.

Figure A. The non-accelerating inflation rate of unemployment (NAIRU), 2007-2014



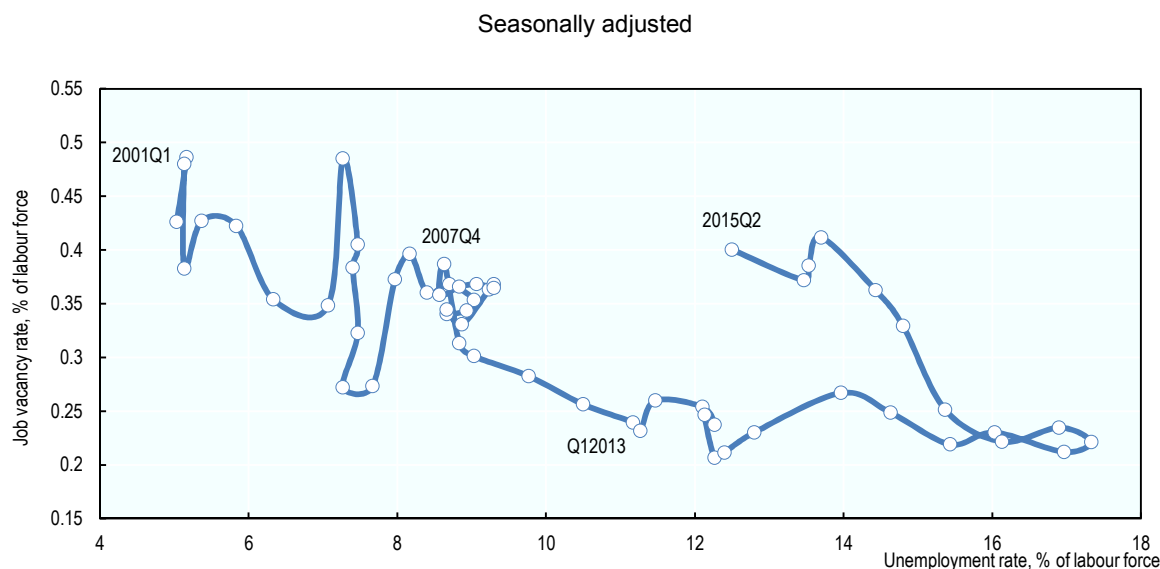
Source: OECD Economic Outlook Database.

**There may be signs of a reduction in matching efficiency**

An alternative way of assessing whether there has been an increase in the structural level of unemployment is to look at whether there has been a reduction in matching efficiency – i.e. whether a given level of vacancies is now associated with a higher level of unemployment, which would signal that it has become more difficult for unemployed jobseekers to find suitable job vacancies (and for firms to fill existing vacancies with qualified jobseekers). The relationship between job vacancies and the level of unemployment is also known as the Beveridge curve, which is downward sloping: as the number of vacancies increases, the unemployment rate falls (and vice versa). Figure B shows that there has been a definite outward shift in the Portuguese Beveridge curve as the crisis progressed (particularly from the beginning of 2013 onwards) – meaning that for a given level of vacancies, the unemployment rate is now higher. One difficulty with deciding whether this shift is permanent or not is that vacancies tend to respond more quickly to business-cycle conditions than the unemployment rate, so that instead of shifting out permanently, the Beveridge curve may simply trace out a counter-clockwise loop. Indeed, there is some indication from Figure B that the situation in Portugal has been improving since around mid-2014, with a fall in the unemployment rate for a vacancy rate which has remained more or less constant.

Box 13. Is structural unemployment rising in Portugal? (cont.)

Figure B. Portugal's Beveridge curve, Q1 2001 to Q2 2015



Source: OECD Short-Term Labour Market Statistics and Eurostat Job Vacancy Survey. See OECD (2014), *OECD Employment Outlook 2014* for more details on the vacancy data.

**The labour market is still highly segmented, and is likely to remain so unless further reforms are undertaken**

*Despite the reforms of severance pay, employers still have strong incentives to hire on temporary contracts*

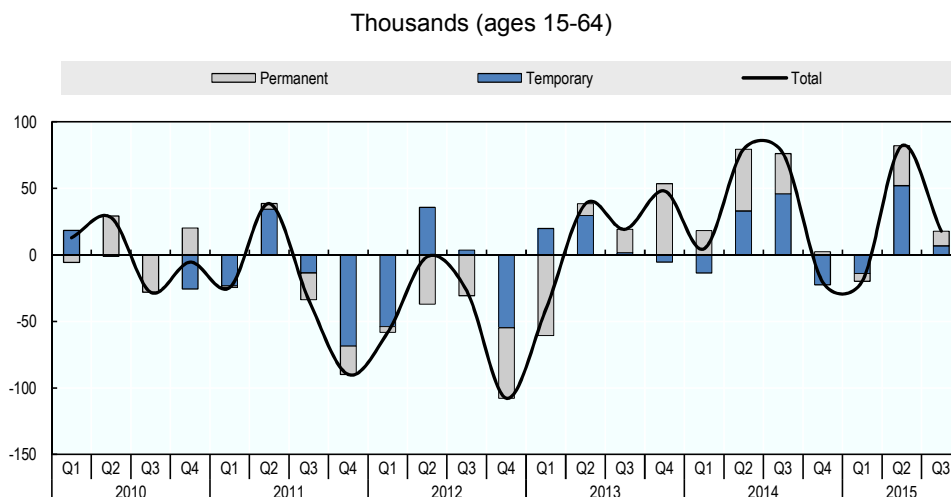
Prior to the crisis, the Portuguese labour market was characterised by a high degree of segmentation: in 2007, 22.3% of workers in dependent employment had a temporary contract, compared to just 12.2% across the OECD on average. The incidence of temporary employment in Portugal was even higher for certain groups, like young people (53.1%). While temporary employment in itself is not necessarily bad (indeed, some workers may prefer the flexibility that it offers), excessive use of such types of contracts can have an adverse impact on both equity and efficiency.<sup>69</sup> In particular, workers on these contracts often face a higher degree of job insecurity than employees on regular contracts, and firms may invest less in non-regular workers, which in turn may depress productivity growth (OECD, 2014b).

The high incidence of temporary employment in Portugal is to a large extent attributable to the important gap in employment protection legislation (EPL) between permanent and temporary contracts (see Chapter 1). Some of the labour market reforms in recent years have sought to reduce this gap. For example, severance pay on new permanent contracts is now lower than on temporary contracts, and there is

69. From the employer's point of view, temporary contracts offer more flexibility. There may also be some economic activity which would be difficult to carry out without such flexibility, e.g. in agriculture, tourism, retail and restaurants – which could be particularly important in the case of Portugal (Alves, 2015). Finally, there is evidence that employers use temporary contracts as a selection mechanism (screening device) into permanent contracts (Portugal and Varejão, 2010).

some evidence that this may have incentivised hiring on permanent contracts (see Box 2 in Chapter 1). Despite this, a large proportion (35%) of the employment growth between Q1 2013 and Q3 2015 has been on temporary contracts (Figure 26) and the share of temporary employment in total employment has barely budged (Figure 27). While the incidence of temporary employment in Portugal is down very slightly (to 21.5% in 2014), a similar reduction occurred on average across the OECD (to 11.1% in 2014) and will largely reflect the fact that workers on temporary contracts were more likely to lose their job during the crisis.

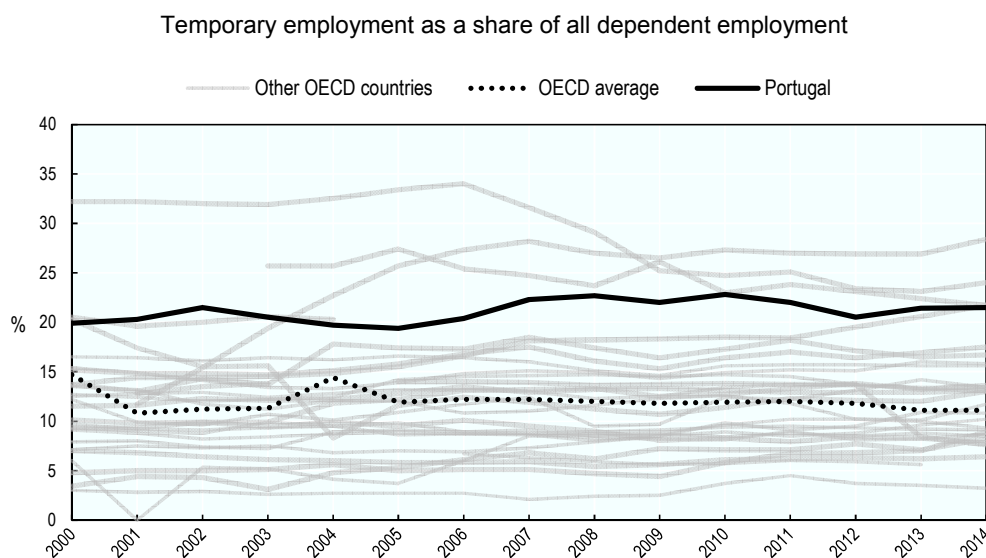
Figure 26. **Change in employment by type of contract, Q1 2010-Q3 2015**



*Note:* Because of a methodological change in the Portuguese Labour Force Survey, data prior to 2011 are not fully comparable with the more recent data. The new methodology results in higher levels of unemployment and inactivity compared to the methodology used prior to 2011. For detailed information, see Statistics Portugal (2011).

*Source:* Eurostat.

Figure 27. **Incidence of temporary employment, 2000-2014**



*Source:* OECD Employment Database.

There are several reasons why one should expect the incidence of temporary contracts in Portugal to remain high, particularly in the short-run. The first of these is that, while the reforms significantly reduced severance pay on new contracts, existing severance pay entitlements were largely preserved so that there is unlikely to be any immediate effect of the reform on firing behaviour (and evidence in support of this was presented in Chapter 1). Secondly (and most importantly), the procedural requirements for firing a worker on permanent contracts remain significantly more demanding than those for workers on temporary contracts, and so the reduction in severance pay may actually not have made much difference to employers. The third reason why there may have been little movement in the share of temporary employment over the period analysed in this report is that, on two separate occasions, employers were allowed to temporarily extend the duration of fixed-term contracts as a crisis-related measure. Finally, as long as employers in Portugal face downward wage rigidity, temporary contracts will remain a key source of flexibility, and so employers will continue hiring on temporary contracts as long as this gap in employment protection legislation between the two types of contracts persists. This last reason may be particularly relevant in the present economic climate: with a weak and hesitant recovery employers will remain uncertain about the future and therefore unwilling to offer workers the promise of a permanent contract.

***The share of self-employed in total employment has fallen***

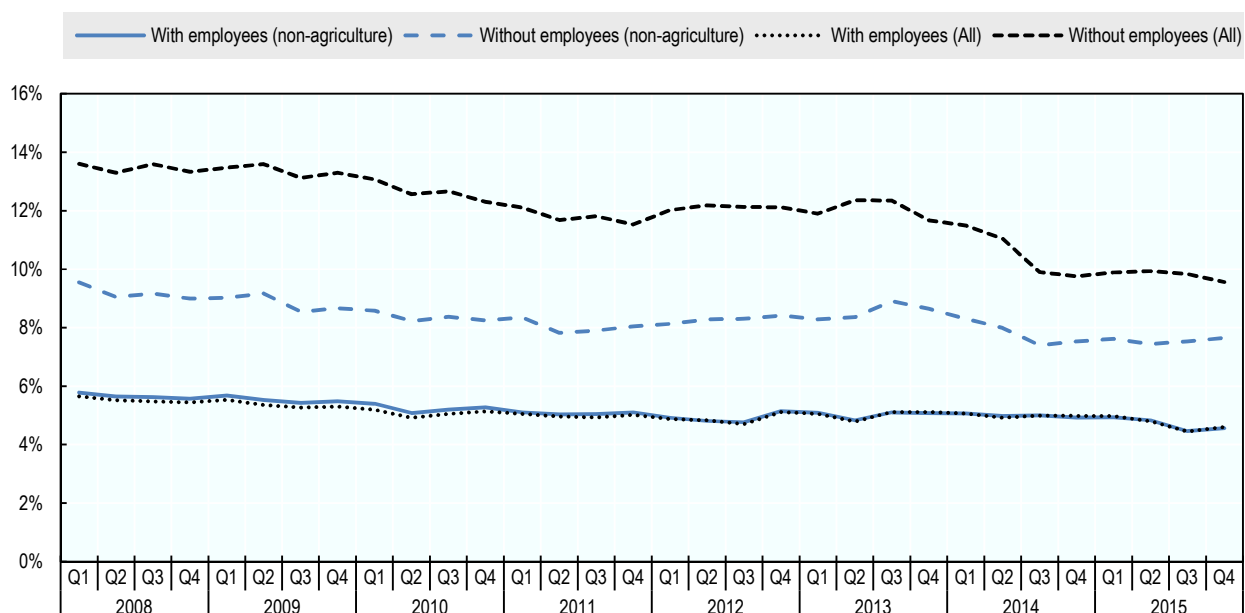
Another facet of labour market segmentation in Portugal is the high prevalence of dependent self-employment. While specific data are not available to assess the extent of this problem (or how it has evolved over the crisis), data from Eurostat (based on the Portuguese Labour Force Survey) show that, at the beginning of 2008, nearly one in five persons in employment was self-employed (19.3%) – 13.6% without employees and 5.6% with (Figure 28). A significant, but declining, share of the self-employed without employees are working in the agricultural sector. Since the end of 2013, there has been a fall in the share of self-employed which is driven largely by a decrease in the share of self-employed without employees (from 12.1% in Q3 2013 to 9.8% in Q3 of 2015).<sup>70</sup> This fall coincides with the introduction of new powers of the labour inspectorate (ACT) to clamp down on false self-employment. However, it occurs primarily in the agricultural sector. It also comes at the same time as the economy starts moving out of recession and could partly reflect individuals who had taken up self-employment during the crisis as a survival mechanism and are now moving back into regular jobs.<sup>71</sup>

70. Note that the fall in self-employment occurs both for individuals active in the private and in the public sector (although it is slightly more marked in the former).

71. Martins (2016b) argues that the reduction in severance pay on new employees encouraged firms to hire employees instead of contractors.

Figure 28. Trends in self-employment, with and without employees, 2008-2015

Self-employed persons aged 15 years and older as a share of total employment



Note: Because of a methodological change in the Portuguese Labour Force Survey, data prior to 2011 are not fully comparable with the more recent data. The new methodology results in higher levels of unemployment and inactivity compared to the methodology used prior to 2011. For detailed information, see Statistics Portugal (2011).

Source: Eurostat.

**There were some improvements in competitiveness during the crisis, but this trend might have started reversing again**

### *Unit labour costs fell significantly in 2011 and 2012*

One major obstacle to achieving higher and more sustainable growth rates in Portugal is its low external competitiveness (OECD, 2014c; IMF, 2015). In most quarters between 2002 and the start of the crisis, unit labour costs (ULCs)<sup>72</sup> in Portugal increased faster than the OECD average (Panel A of 29), while productivity rose less fast than the OECD average and, in some quarters, even fell (Panel C of Figure 29). Throughout this period, rises in labour compensation tended to exceed gains in productivity, leading to a gradual deterioration of Portugal's external competitiveness. Part of the labour market reforms and interventions over the period 2011-2015 (e.g. changes to collective bargaining arrangements, the freeze in extensions as well as in the minimum wage, cuts in overtime compensation, etc.) were targeted at reversing this trend – with some success. As shown in Panel A of Figure 29, there was a fall in ULCs in Portugal in 2010, but especially in 2011 and 2012, with some further falls in 2014. As shown by Panel B of Figure 29, this was related primarily to falls in labour compensation per person employed.

72. Unit labour costs (ULC) are a commonly-used measure of competitiveness, and are obtained as the ratio between total labour compensation per unit of labour input and labour productivity. Two important caveats need to be mentioned about the use of ULCs as a measure of competitiveness. First, they are not a comprehensive measure of competitiveness, but just a reflection of cost competitiveness. Second, ULCs deal exclusively with the cost of labour which, though important, should also be considered in relation to changes in the cost of capital. However, because of problems of international consistency of data, it is usual to take indices of unit labour costs rather than total costs.

***The fall in unit labour costs was larger in the public than in the private sector***

The falls in ULCs and compensation per person employed in Portugal were more marked in the public than in the private sector (Figure 30). Compensation in the public sector rose steadily over the period 2007-2009 (at a higher pace than in the private sector). However, this trend started reversing in 2011 (coinciding with the cuts in wages of civil servants earning more than EUR 1 500), and turned into a very significant drop in ULCs and labour compensation at the start of 2012 (when cuts in 13<sup>th</sup> and 14<sup>th</sup> monthly payments were implemented). In 2013, this fall was entirely reversed with the ruling of the Constitutional Court that the cuts in bonuses were unconstitutional. A similar pattern can be observed in 2014, when the Budget Law introduced new cuts to the wages of public sector workers, which were again declared unconstitutional later that year. These findings are consistent with the observations of INE (2013, 2014) that the overall decline in ULCs in 2011 and 2012 was largely driven by falling general government wages (through the non-payment of holiday and Christmas bonuses to civil servants), while the rise in 2013 was associated with the reinstatement of the bonuses in general government.

***A high level of wage rigidity continues to threaten Portuguese competitiveness***

When looking at the non-agricultural business sector (excluding real estate), there has been a gradual but continuous decline in ULCs over the period 2009-2012 (Panel B of Figure 30). While there were some falls in labour compensation per hour worked in 2011 as well as in 2013, most of the fall in ULCs was driven by productivity gains<sup>73</sup> in the wake of job cuts.<sup>74</sup> Box 14 offers a more detailed look at the evolution of wages in the private non-agricultural business sector (excluding real estate) over the period 2010-2014. It shows how government policies helped achieve wage moderation during the crisis, with around one in two workers experiencing real falls in their base wage in each year over the period 2010-2014. That being said, these real falls were relatively modest and affected job movers in particular. At the same time, the evidence suggests a considerable amount of nominal wage rigidity in the Portuguese economy, with around three quarters of workers having had their base wages frozen in both 2012 and 2013.<sup>75</sup> Such wage rigidity (driven by the legal prohibition to cut nominal base wages) is likely to continue to harm Portuguese competitiveness in years to come if inflation remains low – unless there is a significant strengthening in productivity growth.<sup>76,77</sup> The evidence presented in Box 14 further suggests that, with the exception of a real fall in 2011, “other” wage components kept on rising both in nominal as well as in real terms, and that the reductions in overtime pay, while significant (particularly in 2012), represent only a minute share of the average wage bill per employee.

73. Leal and Martins (2015) argue that there is a relatively strong relationship over the period 2002 to 2014 between nominal wage increases stipulated in collective wage agreements and the percentage change in average compensation per worker – suggesting that moderate wage increases in collective agreements during the crisis contributed to the fall in unit labour costs by reining in increases in average compensation per worker.

74. An alternative possibility is that firms adjust in their effort margins during recessions, requiring workers to produce more than in better times (Card and Mas, 2016).

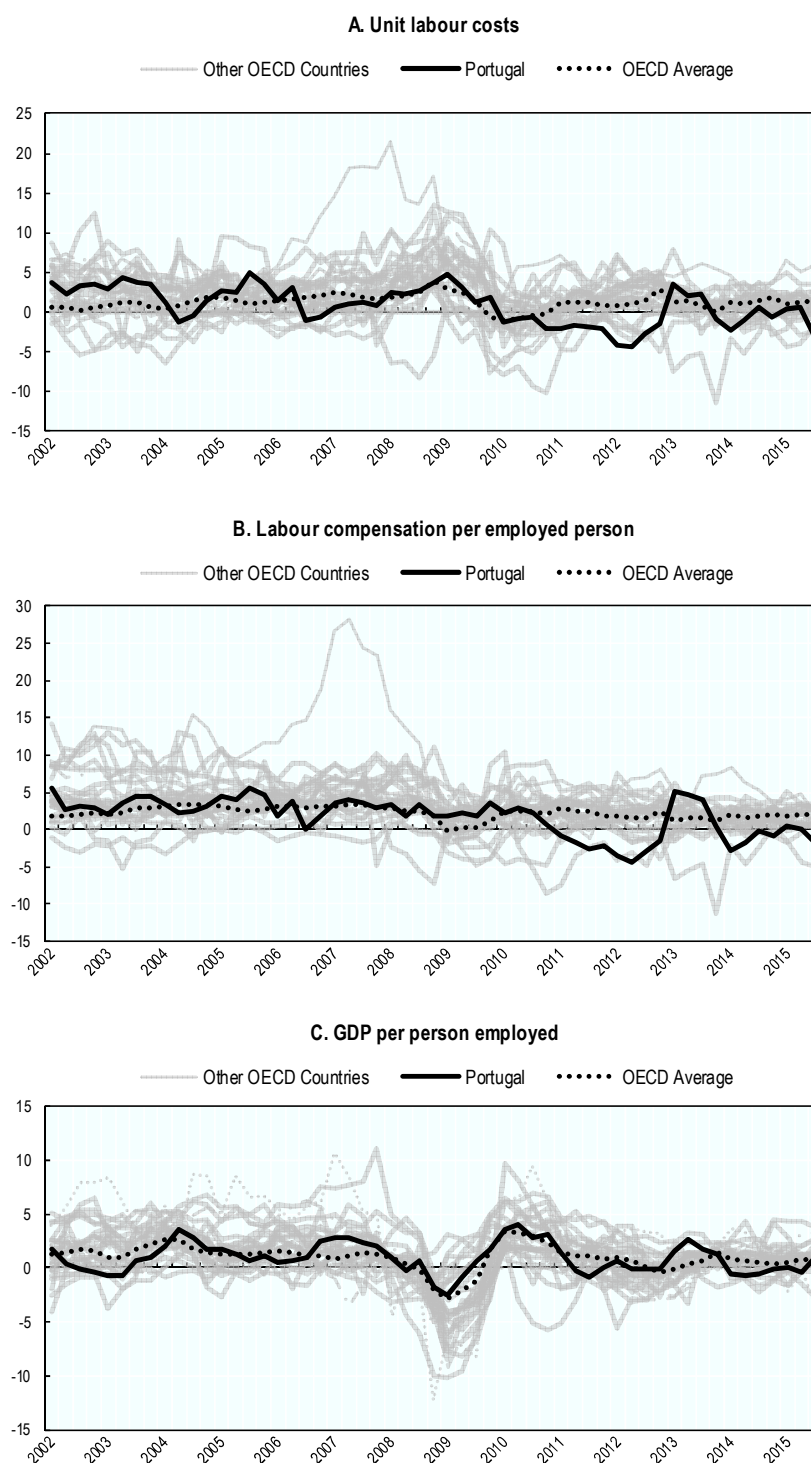
75. These findings are consistent with many published studies for Portugal, including Duarte (2008), Portugal, Carneiro and Guimarães (2010), Carneiro, Portugal and Varejão (2014).

76. Wage rigidity in Portugal has been found to be a greater problem for small firms (Duarte, 2008) and may be part of the reason why those firms also exhibit higher rates of turnover (Centeno, Machado and Novo, 2007). That being said, wage rigidity tends to be higher in the services and construction sectors than in the manufacturing sector.

77. Another possible consequence of high nominal wage rigidity is that wage growth in the Portuguese economy is likely to remain very low in the short-run because of “pent-up wage inflation” (Martins and Portugal, 2014).

Figure 29. Evolution of quarterly unit labour costs and its components, Q1 2002-Q2 2015

Quarterly change on the same quarter of the previous year, seasonally adjusted

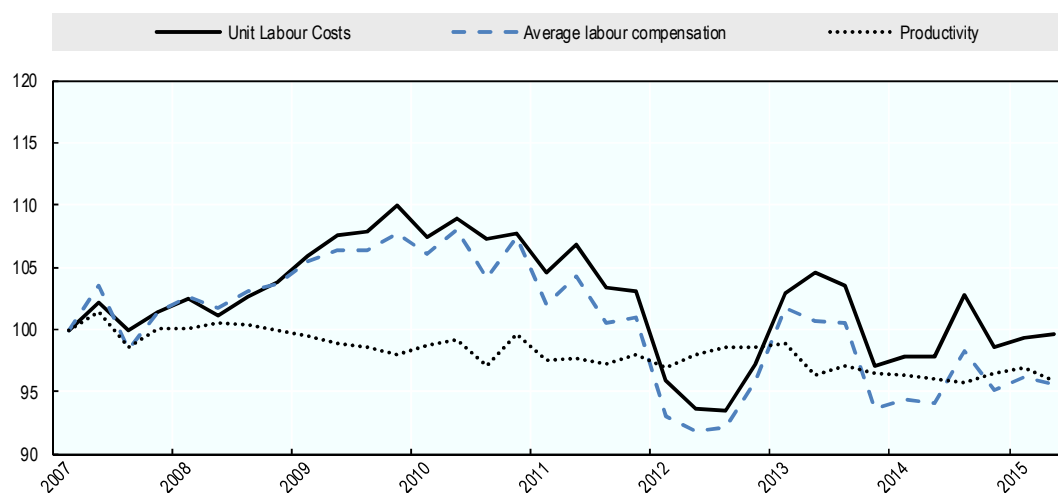


Source: OECD Productivity Database.

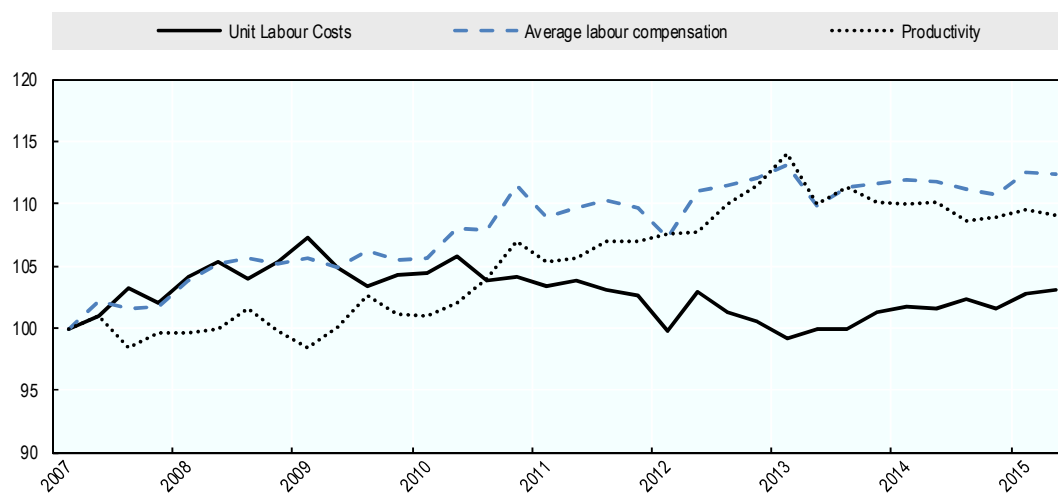
Figure 30. **Evolution of quarterly unit labour costs and its components, public versus private sectors, Q1 2007-Q2 2015**

Index, Q1 2007=100

**A. Public sector**



**B. Private non-agricultural business sector (excluding real estate)**



*Note:* Total labour costs based on hours worked. Data has been deseasonalised.

*Source:* OECD Quarterly National Accounts Database.



**Box 14. Wages in the private sector during the crisis: Wage moderation and nominal wage rigidity**

The significant employment losses observed in Portugal during the crisis can, according to some commentators, be blamed largely on a high level of (nominal) wage rigidity which, combined with an important share of temporary workers, makes it easier for employers to adjust to business cycle fluctuations by reducing headcounts than by revising wages downwards. Indeed, when Portuguese employers are asked how they cut costs in response to negative shocks, 72% say they reduce their workforce – by far the most common strategy cited (Dia, Marques and Martins, 2012).

A number of measures were taken by the government to try and achieve wage moderation during the crisis: the minimum wage was frozen, the number of extensions of collective agreements was kept in check, and significant reductions in overtime pay were brought in.

Against this background, this box uses the *Quadros de Pessoal* data<sup>1</sup> to analyse the behaviour of (nominal and real) wages in the private non-agricultural business sector (excluding real estate) during the crisis and, where possible, breaks this down by wage component. The findings confirm a high degree of downward rigidity in nominal base wages in Portugal: a large number of employees had their base wages frozen during the crisis. Over the period 2010-2013, nominal wage growth was modest in the business sector, and wages fell in real terms. There is evidence also of a significant drop in overtime pay – although this only represents a very small proportion of firms' total wage bill.

**Nominal wage growth was modest, and there were some falls in real wages**

Average hourly wages (in nominal terms) continued to rise modestly in 2011 (+1.0%) and 2012 (+1.7%), but fell slightly in 2013 (-0.5%) and 2014 (-0.3%) – Table A. The fall in 2013 and 2014 was largely due to the substitution of higher-paid with lower-paid workers.<sup>2</sup> Indeed, when looking only at workers who remained employed between two consecutive years, nominal (hourly) wages rose in each year (by 1.9%, 1.4%, 1.6% and 2.5%, respectively). In real terms, average hourly wages fell in each year over this period (although there was real wage growth in 2013 and 2014 for workers who remained employed).

**Table A. Average nominal and real wage growth of private sector employees in Portugal, 2010-2014**

Change in hourly wages

	Year	All workers				People remaining in employment			
		Total	Base	Overtime	Other	Total	Base	Overtime	Other
Nominal	2011	1.0%	0.7%	2.1%	1.4%	1.9%	1.5%	3.2%	3.2%
	2012	1.7%	1.3%	-22.0%	4.2%	1.4%	1.1%	-22.1%	4.5%
	2013	-0.5%	-0.6%	-2.5%	1.2%	1.6%	1.2%	-0.9%	4.1%
	2014	-0.3%	-0.6%	0.4%	0.3%	2.5%	1.9%	3.2%	4.3%
Real	2011	-2.7%	-3.0%	-1.6%	-2.3%	-1.8%	-2.2%	-0.5%	-0.5%
	2012	-1.0%	-1.4%	-24.7%	1.5%	-1.3%	-1.6%	-24.8%	1.8%
	2013	-0.8%	-0.9%	-2.8%	1.0%	1.4%	1.0%	-1.2%	3.8%
	2014	-0.1%	-0.3%	0.7%	0.6%	2.7%	2.2%	3.5%	4.5%

Note: Changes in overtime and other pay are estimated only for employees who receive such payments. Hourly overtime payments are obtained by dividing total overtime pay by the number of overtime hours worked. Hourly "other" payments are obtained by dividing total other pay by the number of regular hours worked. People remaining in employment are defined as workers who are employed in two consecutive years.

Source: OECD analysis based on the *Quadros de Pessoal* 2010-2014; price indices from the OECD Prices and Purchasing Power Parities dataset.

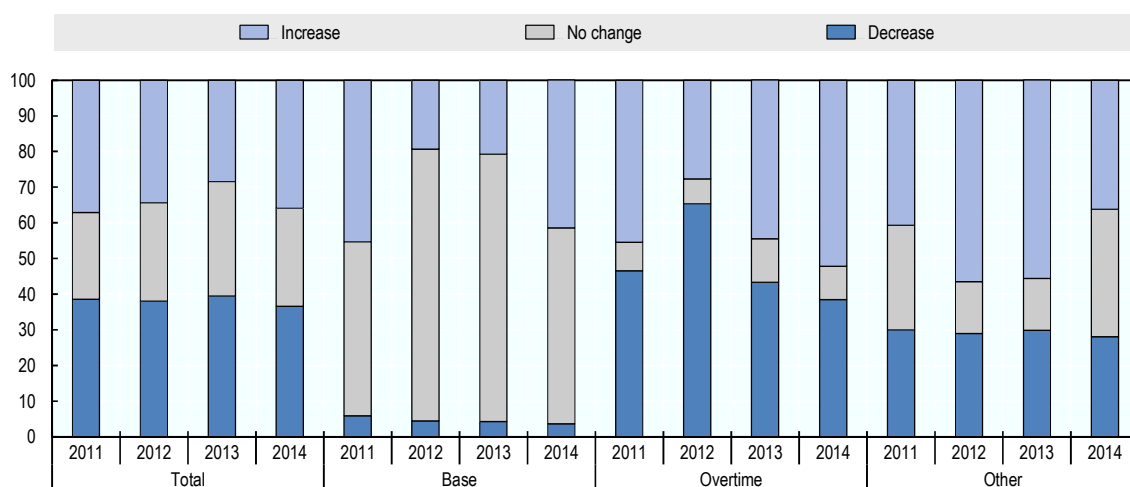
Box 14. Wages in the private sector during the crisis: Wage moderation and nominal wage rigidity (*cont.*)**The base wages of a large proportion of workers were frozen**

Table A also breaks down the evolution of wages by wage component: base wages, compensation for overtime, and other wage components. Changes in base wages were closely aligned to changes in total wages, although they grew even less. Despite the severity of the crisis, the average nominal base wage of workers who kept their job in consecutive years did not fall. Such cuts are in fact forbidden by Portuguese law. Given this constraint, employers still have the option in times of crisis to freeze base wages in the hope that inflation will bring real wages down. This was indeed a very common strategy used by employers in Portugal during the crisis. Looking at employees in the non-agricultural private business sector who remained employed in two consecutive years, Figure A shows that 49% had their base wages frozen in 2011, rising to 76% in 2012 and 75% in 2013. In 2014 the share of workers with constant base wages fell to 55%. These figures are substantially larger than what was observed in countries like the United States (where around 4% of job stayers had their nominal wages frozen) and the United Kingdom (where only around 9% of job stayers had zero nominal wage change) – see Elsby, Shin and Solon (2016). This indicates a substantial element of nominal wage rigidity in the Portuguese labour market.<sup>3</sup> The freezing of nominal base wages by Portuguese employers will have been made easier by government policy during the period, including the freezing of the minimum wage, as well as the reduction in extensions of collective agreements.

As in the case of total wages, however, Table A shows that base wages fell in real terms throughout the period (although workers who remained employed saw a real wage increase in 2013 and 2014). Figure B shows that around one out of two workers saw their base wage fall in real terms in each year.

Figure A. Proportion of workers who experienced nominal hourly wage increases, freezes and falls, 2010-2014

As a proportion of workers who remained employed in two consecutive years



*Note:* Changes in overtime and other pay are estimated only for employees who receive such payments in at least one of period  $t$  or  $t+1$ . Hourly overtime payments are obtained by dividing total overtime pay by the number of overtime hours worked. Hourly “other” payments are obtained by dividing total other pay by the number of regular hours worked. Wages are assumed to exhibit “no change” if wages at time  $t$  and  $t+1$  do not differ more than 1%.

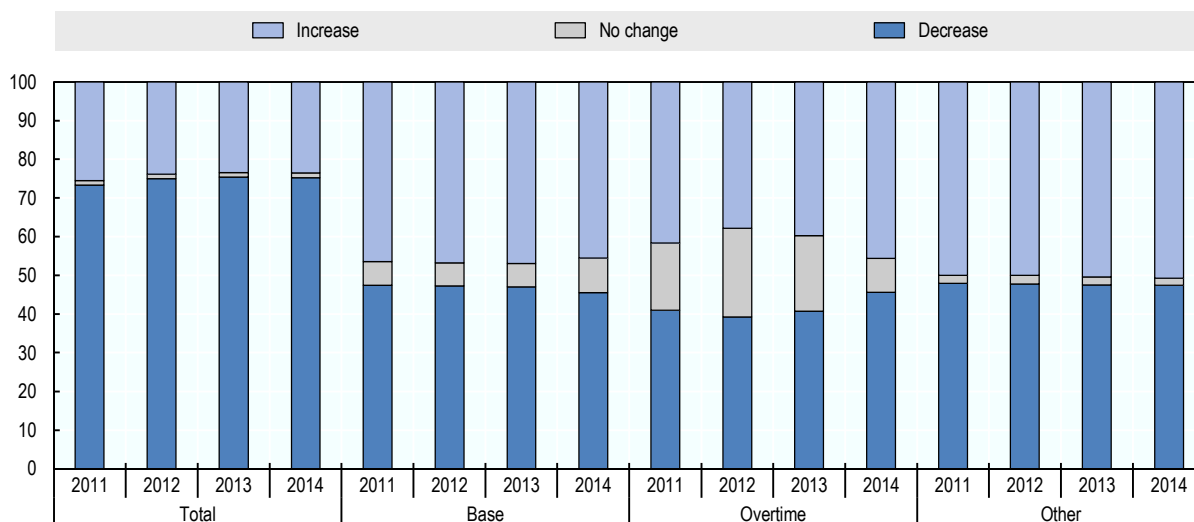
*Source:* OECD analysis based on the *Quadros de Pessoal*.

While Figure A indicates that between 4 and 6% of workers who remained employed had a reduction in their hourly nominal base wage each year, in around 99% of these cases this was accompanied by a change of employer. Note that these percentages are very small compared to the proportion of workers who suffered nominal wage cuts in the United States and the United Kingdom. In the United Kingdom, nearly one in four job stayers experienced a nominal wage cut over the periods 2009-2010 and 2011-2012, while in the United States nearly one in four job stayers experienced a nominal wage cut of at least 0.5% (Elsby, Shin and Solon, 2016).

Box 14. Wages in the private sector during the crisis: Wage moderation and nominal wage rigidity (*cont.*)

Figure B. Proportion of workers who experienced real hourly wage increases, freezes and falls, 2010-2014

As a proportion of workers who remained employed in two consecutive years



Note: Changes in overtime and other pay are estimated only for employees who receive such payments in at least one of period  $t$  or  $t+1$ . Hourly overtime payments are obtained by dividing total overtime pay by the number of overtime hours worked. Hourly "other" payments are obtained by dividing total other pay by the number of regular hours worked. Wages are assumed to exhibit "no change" if wages at time  $t$  and  $t+1$  do not differ more than 1%.

Source: OECD analysis based on the *Quadros de Pessoal*.

### There were significant reductions in overtime pay

While Portuguese law forbids reductions in the base wage, other wage components can be adjusted. Indeed, Figure A shows that, each year, more than a quarter of workers had reductions in their "other" hourly wages from one year to the next. On average, however, and with the exception of a real fall in 2011, these "other" wages kept on rising both in nominal as well as in real terms (Table A).

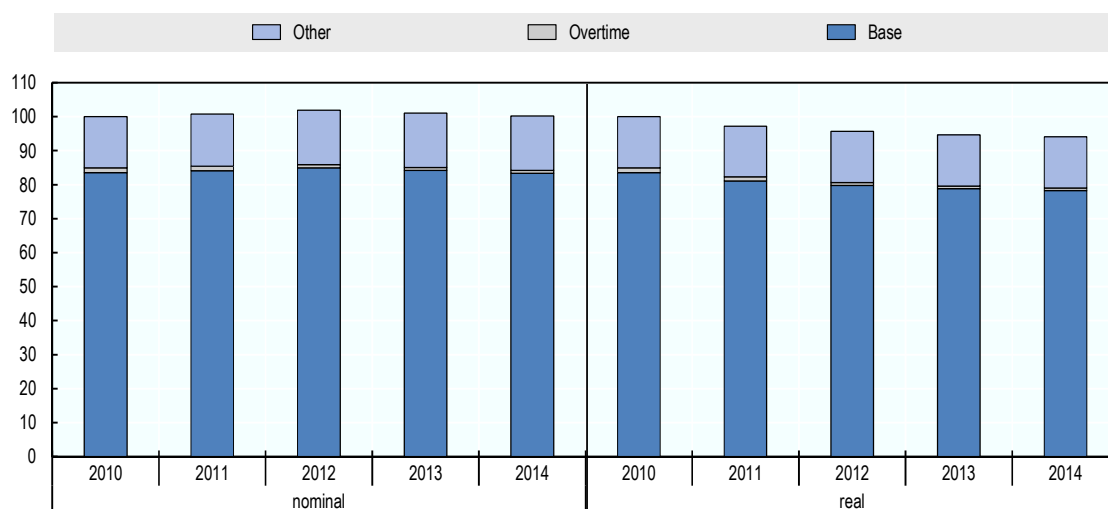
Figure A also shows reductions in hourly overtime pay: in 2011, 47% of workers (who worked overtime and remained employed) experienced a reduction in the hourly rate for overtime pay, rising to 65% in 2012 (when the government reduced the rates for overtime work by half), and back to 43% in 2013 and 39% in 2014. Table A shows that the average reduction in hourly overtime pay was 22% in 2012. These figures suggest that the new law had a significant impact on overtime pay (and may have had an important impact on the incomes of some workers). However, from the perspective of firms, this measure will only have had a marginal impact. Indeed, for firms paying overtime to at least one of their employees, the share of overtime pay in the total wage bill was only around 5.2%. Moreover, only about 3.5% of all firms paid overtime to one or more of their employees.

While these findings confirm that firms can, and do, reduce their wage costs during times of crisis by adjusting overtime and other pay,<sup>4</sup> they also show that the impact of these adjustments on total wages were relatively limited. Figure C shows how the average wage paid by a Portuguese firm (estimated as the average wage bill per employee) evolved over the period 2010-2014, sub-divided into its various components. The average nominal wage bill continued to increase modestly in both 2011 and 2012. While there were some small falls in both 2013 and 2014, the total nominal wage bill in 2014 was still the same as in 2010. Despite the important falls in overtime pay discussed above, Figure C shows that these will have made very little difference to firms in practice. Figure C also confirms how, in real terms, the average wage bill per employee fell in each year.

## Box 14. Wages in the private sector during the crisis: Wage moderation and nominal wage rigidity (cont.)

Figure C. Evolution of average wage bill per employee, by wage component, 2010-2014

Index 2010=100

Source: OECD analysis based on the *Quadros de Pessoal*.

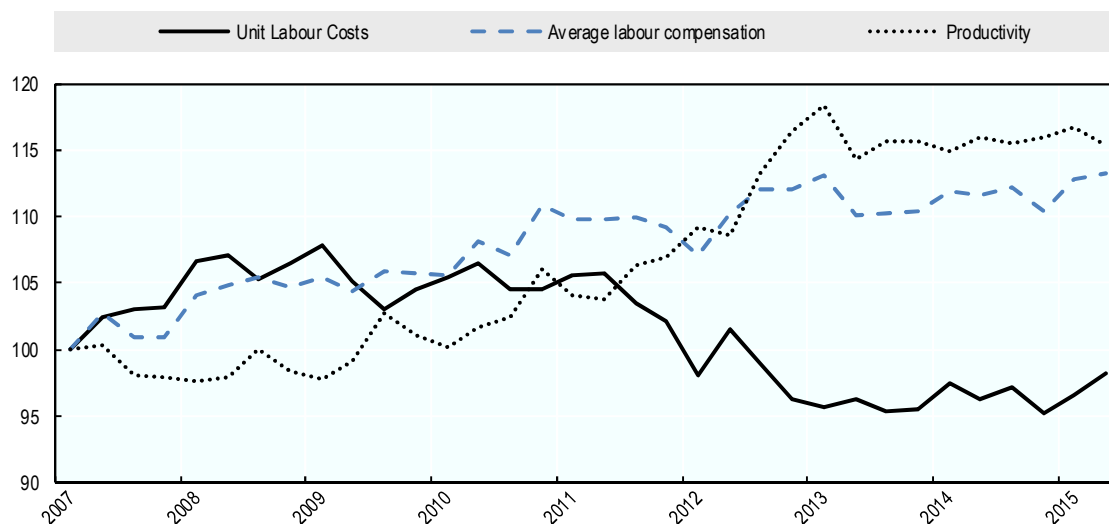
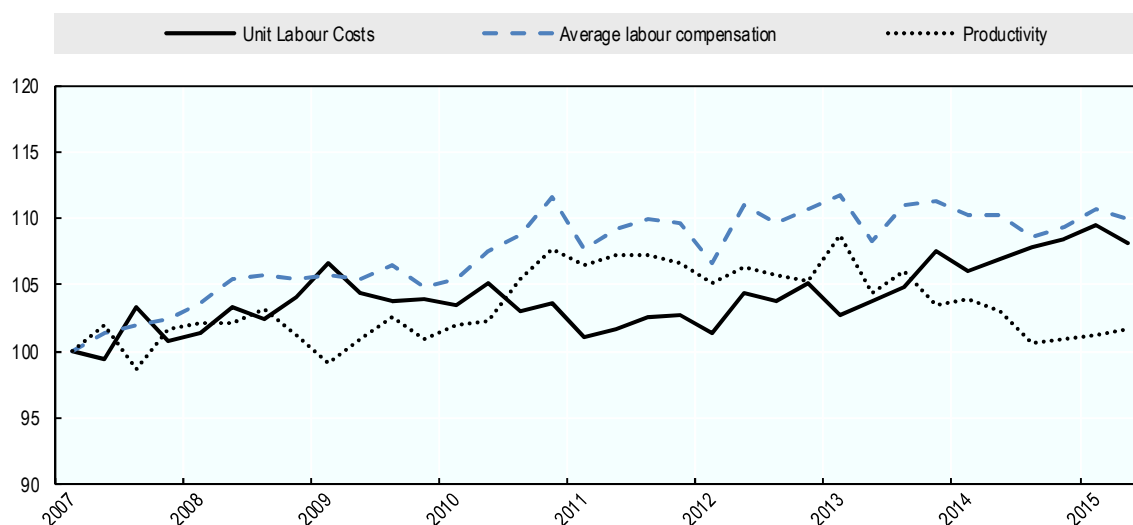
1. The *Quadros de Pessoal* is a compulsory census of all non-public firms with at least one employee which is carried out in October each year. The administrative nature of the data ensures a high degree of coverage and reliability, and unique employer and employee identifiers allow the data to be linked from one year to the next.
2. According to the survey discussed in Dias, Marques and Martins (2012), 30% of firms said they hired workers on lower wages than those that had just left in order to cut costs when faced with an adverse shock. Cyclicalities in hiring wages in Portugal was also documented by Martins, Solon and Thomas (2012).
3. Portugal, Carneiro and Guimarães (2010) noted that when Portugal joined the Euro in 1999, the cyclical elasticity of real wages was significantly reduced.
4. A related measure identified by Dias, Marques and Martins (2012) which firms use to cut costs is the less frequent use of promotions. The *Quadros de Pessoal* data indicate that the share of workers who received a promotion nearly halved from 6.2% in 2010 to 3.8% in 2014.

***There has been a slight rebalancing of labour resources from the non-tradable to the tradable sector***

Within the private sector, it is important to distinguish further between the tradable and the non-tradable sectors, since it is the evolution of ULCs in the tradable sector that will matter most to competitiveness. This distinction is made in Figure 31 and shows that the decline in ULCs in Portugal was larger in the non-tradable than in the tradable sector, and that the latter was particularly marked in the years 2011 and 2012. ULCs in the tradable sector also fell somewhat between 2009 and 2012, after which they started increasing again as productivity fell. By contrast, there was a rise in productivity in the non-tradable sector which was partly driven by employment losses, which were larger in the non-tradable than in the tradable sector (see Figure 32). These differences in employment losses (as well as somewhat greater employment growth in the tradable sector) have contributed to the slight rebalancing that happened between the two sectors: the tradable sector's share of business sector employment increased from around 43% between 2005 and 2007 to 47% in the first half of 2015. However, despite this rebalancing of labour resources to the tradable sector, the latter's share remains relatively low in comparison to other European countries.

Figure 31. **Evolution of quarterly unit labour costs and its components, tradable versus non-tradable sectors, Q1 2007-Q2 2015, Portugal**

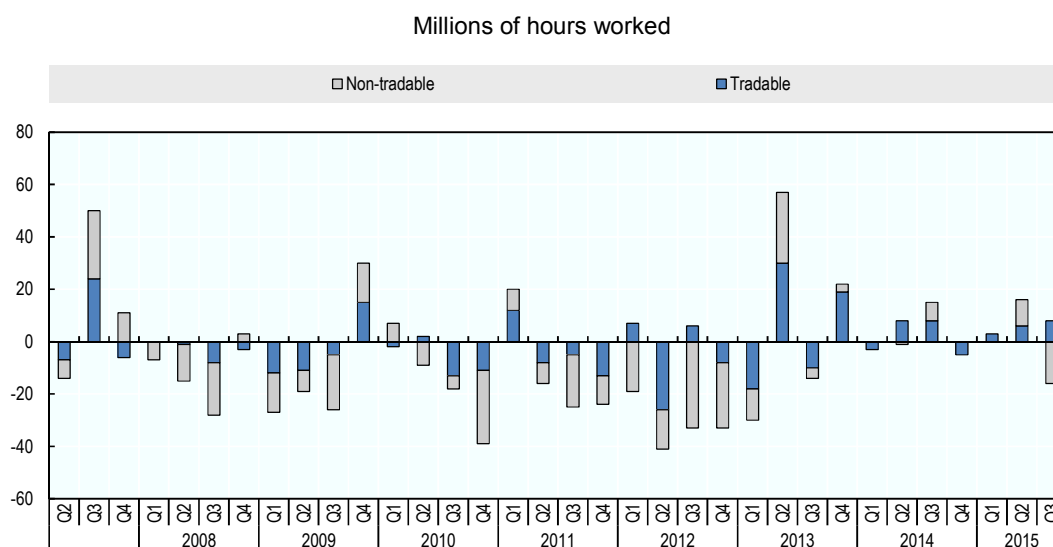
Index, Q1 2007=100

**A. Non-tradable sector****B. Tradable sector**

*Note:* Total labour costs based on hours worked. Data has been deseasonalised. The tradable sector consists of ISIC rev. 4 sectors "Manufacturing", "Information and communication", "Finance and insurance activities", "Professional, scientific and technical activities" and "Administrative and support service activities", the non-tradable sector of "Mining and quarrying", "Electricity, gas, steam and air conditioning supply", "Water supply; sewerage, waste management and remediation activities", "Construction", "Wholesale and retail trade; repair of motor vehicles and motorcycles", "Transport and storage" and "Accommodation and food service activities".

*Source:* OECD Quarterly National Accounts Database.

Figure 32. **Employment losses in the non-agricultural business economy (excluding real estate), Q2 2007-Q3 2015**



Note: Data has been deseasonalised. The tradable sector consists of ISIC rev 4 sectors "Manufacturing", "Information and communication", "Finance and insurance activities", "Professional, scientific and technical activities" and "Administrative and support service activities", the non-tradable sector of "Mining and quarrying", "Electricity, gas, steam and air conditioning supply", "Water supply; sewerage, waste management and remediation activities", "Construction", "Wholesale and retail trade; repair of motor vehicles and motorcycles", "Transport and storage" and "Accommodation and food service activities".

Source: OECD Quarterly National Accounts database.

### High unemployment has resulted in rising poverty

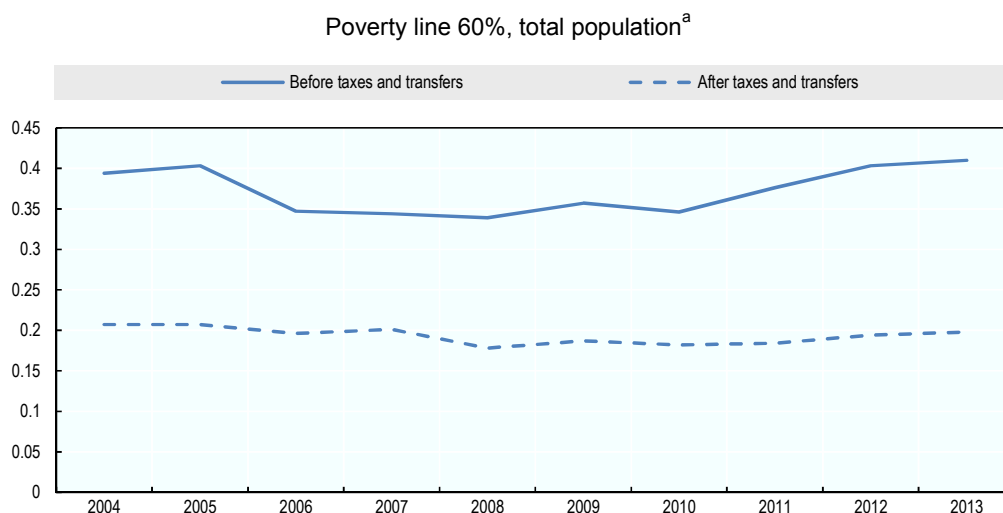
The economic crisis has halted a long-term gradual decline in poverty and, from 2011 onwards, the proportion of individuals living in households with an income below 60% of the median started increasing again (Figure 33). The rise in unemployment has been one of the main contributing factors to this upsurge in poverty (over 40% of the unemployed lived in poverty in 2012), although there is also a substantial share of in-work poverty (10.5% of the employed in 2012).<sup>78</sup>

As Figure 34 indicates, the Portuguese tax-benefit system does a decent job at alleviating poverty: the rise in poverty after taking taxes and transfers is substantially less marked than when these are not taken into account. This is because the tax system in Portugal is very progressive, while transfer payments tend to reduce poverty in a fairly efficient way (Arnold and Farinha Rodrigues, 2015). That being said, it is clear that some other OECD countries achieve even greater reductions in poverty through taxes and transfers, suggesting that there is ample room for improvement in Portugal. This is all the more necessary given that reforms undertaken during the crisis period have resulted in substantial losses in disposable income for the lowest income groups (Avram et al., 2012). In particular, the reduction in generosity of the *Rendimento Social de Inserção* (RSI – social assistance) (the access threshold was lowered and the

78. Analysis carried out for this project using the EU tax-benefit microsimulation model (EUROMOD) model suggests that the increase in poverty between 2007 and 2015 could not be attributed to changes in direct personal taxes (income tax and social contributions) and cash benefits. Simulations applying the 2015 tax-benefit rules on the 2007 population suggest that overall poverty would have been lower in 2007 than it was under the 2007 policy rules. There are some differences by population sub-groups, however. While poverty among adults and the elderly in 2007 would have been lower under the 2015 system, child poverty would have been higher. It is worth noting that the simulations carried out are static and do not take account of any possible behavioural responses to policy changes. It assumes, for example, that the labour supply would not change in response to changes in taxes and benefits.

equivalence scale was made more stringent) resulted in a significant decline in the number of beneficiaries, penalising families with children in particular.<sup>79</sup> Since most of the individuals affected were already below the poverty line, these reforms have not impacted much on measured poverty itself. However, they have made the poor even poorer, with very little fiscal saving.

Figure 33. **Poverty in Portugal, before and after taxes and transfers, 2004-2013**



a. Using the new income definition since 2012. See <http://www.oecd.org/els/soc/IDD-ToR.pdf> for further detail.

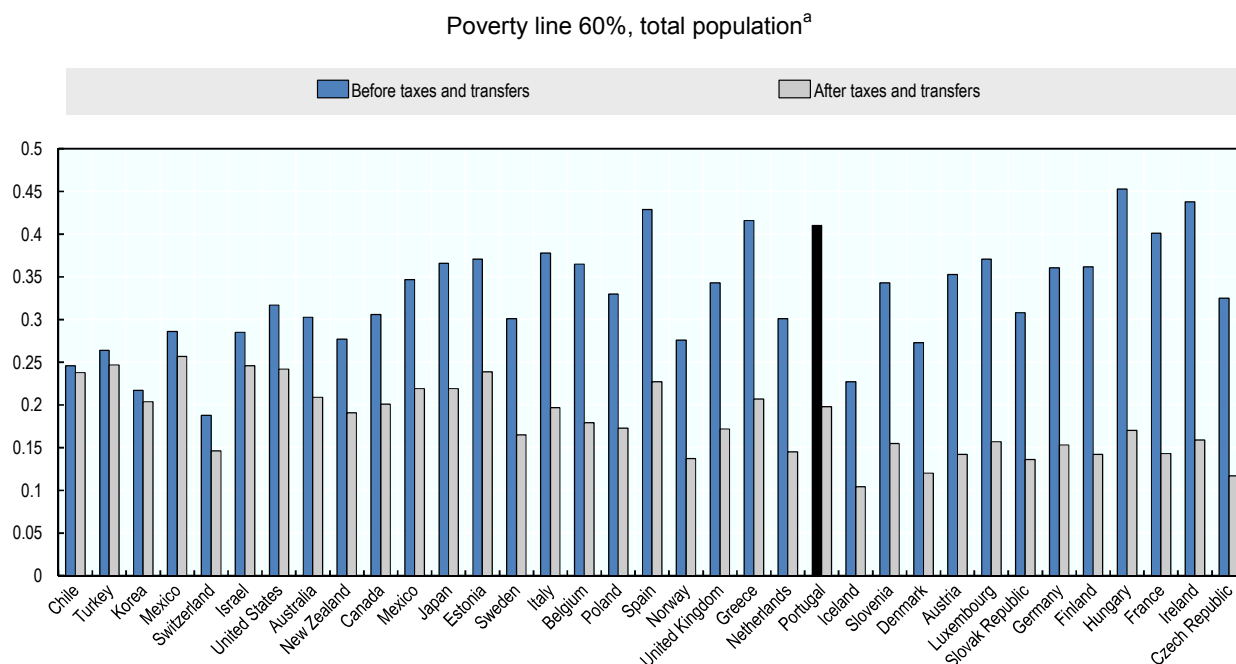
Source: OECD Social Protection and Well-Being Database.

A detailed analysis of how poverty-reducing improvements in the tax-benefit system might be achieved was recently carried out by Arnold and Farinha Rodrigues (2015) and their main recommendations are as follows:

- Given that social expenditures in Portugal are already quite high and that there is limited fiscal space, the priority should be on making existing redistributive policies more efficient as opposed to spending more.
- The benefit system should be rebalanced away from elderly people (who currently receive a disproportionate share of benefit expenditure) and towards families with children instead.
- The efficiency of the benefit system could be enhanced by eliminating benefit overlaps and improving means-testing.
- The RSI threshold should be raised so that more individuals benefit, and more resources should be targeted on children by giving them a more generous weight in the calculation of the benefit. Similarly, raising the means-tested child benefits would be an efficient way of reducing child poverty.

79. The new XXI Constitutional Government established on 26 November 2015 has reversed part of the cuts in generosity of the RSI, which is a welcome development. In particular, the government re-established the weights for dependants and children to their original levels, which was important given the concentration of poverty among children. The reversal of the cut in the income threshold is being done in a phased manner. In 2016, 25% of the cut was reversed; in 2017, another 25% will be restored; and so forth, until the level prior to the cut is fully reinstated in 2019.

Figure 34. Poverty in Portugal and other OECD countries, before and after taxes and transfers, 2013



a. Using the new income definition since 2012. See <http://www.oecd.org/els/soc/IDD-ToR.pdf> for further detail. Data for Mexico, Australia, New Zealand, Japan and Hungary is for 2012. Countries are ranked in increasing ratio of poverty before taxes and transfers over poverty after taxes and transfers.

Source: OECD Social Protection and Well-Being Database.

### Increased labour market insecurity has led to a fall in job quality

While having a job is an important determinant of well-being, the quality of that job matters as well. At various points throughout this report aspects of job quality in Portugal have been discussed, including: earnings, the risk of unemployment and the generosity of unemployment benefits. However these, as well as other measures of job quality, can be usefully summarised by the OECD's job quality framework (OECD, 2014b) which focuses on the outcomes for workers in three broad and complementary areas that are most important for their well-being:

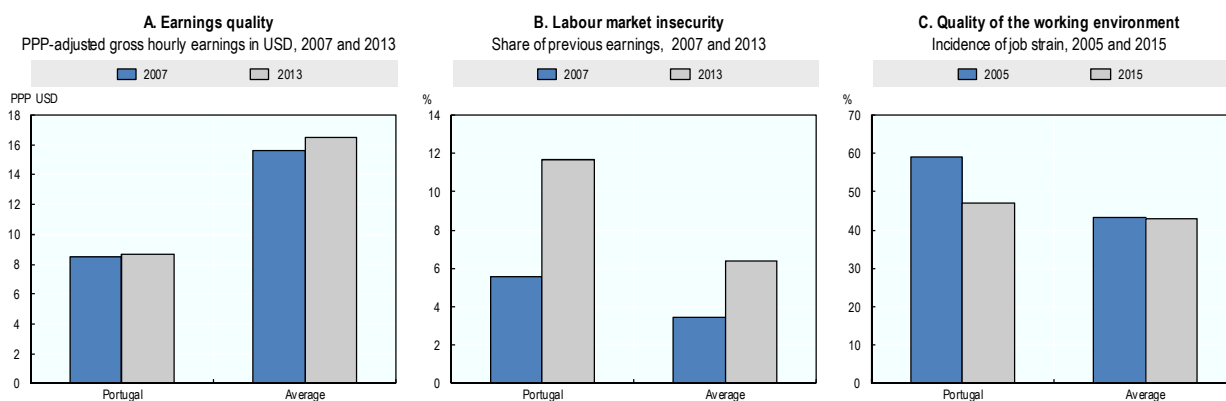
- *Earnings quality*, which captures the extent to which earnings contribute to workers' well-being in terms of average earnings and their distribution across the workforce.
- *Labour market security*, which captures those aspects of economic security related to the risks of job loss and its economic cost for workers. It is defined by the risks of unemployment and benefits received in case of unemployment.
- *The quality of the working environment*, which captures non-economic aspects of jobs including the nature and content of the work performed, working-time arrangements and workplace relationships. These are measured as the incidence of job strain characterised as high job demands with low job resources.

Across all three dimensions of job quality, Portugal performs worse than the OECD average – and this is true both before and after the financial crisis (Figure 35). The evolution of job quality over the crisis is mixed in Portugal. The greatest negative impact has been on labour market security, which reflects the



large upsurge in unemployment. At the same time, earnings quality has more or less stagnated – which is consistent with the analysis presented earlier on in this chapter. For those who remained employed, however, there has been a marked decrease in the incidence of job strain and, therefore, an increase in the quality of the working environment. This will partly reflect a selection effect, given that those in worse quality employment were more likely to have lost their job during the crisis.

Figure 35. **Job quality in Portugal and the OECD, 2005-2015**



*Note:* The average excludes: Turkey, Slovenia and Luxembourg in the case of earnings quality; Chile in the case of labour market insecurity; and Australia, Canada, Chile, Iceland, Israel, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey and the United States in the case of quality of the working environment.

*Source:* OECD Job Quality Database (2016).

## CHAPTER 3

### POLICY PRIORITIES FOR ACHIEVING BETTER LABOUR MARKET OUTCOMES IN PORTUGAL

This final chapter offers some thoughts on the road that lies ahead. The labour market reforms carried out over the past few years in Portugal were comprehensive and, as argued in this report, it will take time for their full effects to become both visible and entirely understood. In this sense, the present report should be seen only as a preliminary assessment of those reforms. That being said, it is possible, even at this stage, to make some observations about key policy priorities for the future. While most of these will require further reforms of labour market institutions, policies and practices, achieving higher levels of employment and greater inclusiveness in Portugal will also depend on factors that lie outside the realm of labour market policy. These include first and foremost the need to return to higher and more sustainable levels of growth, but also, amongst others: further investments in skills, product market and tax reforms, and improving the access that firms have to credit.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

## Labour market policy: The road ahead

### *Employment protection legislation on permanent contracts should be further eased*

The EPL reforms described in Chapter 1 made it clear that Portugal, despite tremendous progress in recent years, remains the country in the OECD with the most stringent regulations around individual dismissal of workers on permanent contracts. Portuguese employers are therefore likely to continue to think twice before they hire a worker on a permanent contract, and may still prefer lower-cost and more flexible temporary contracts instead. Labour market duality is therefore likely to remain a distinctive feature of the Portuguese labour market in years to come, unless even more is done to reduce the gap in employment protection between the two types of contract. A comparative analysis with other OECD countries highlights a few areas where Portugal's legislation still stands out:

- First, *procedural requirements* in the case of individual dismissal of workers on permanent contracts remain high, including notification procedures and the delay involved before notice can start. Easing such requirements would not only bring Portugal's legislation more in line with that of other OECD countries, it would also help to narrow the gap with temporary contracts, where no such requirements are set.
- Second, while Portugal reduced severance pay in the case of fair dismissal, *compensation following unfair dismissal* remains amongst the highest in the OECD. The highest typical compensation (in terms of months of former pay) for unfair dismissal of an employee with 20 years of job tenure can be found in: Sweden (32 months), Italy (estimated at 21 months), China (20 months), Portugal (17.5 months) and France (16 months). These amounts are particularly high if compared with the OECD average, which is close to six months.
- Last but not least, Portugal remains one of the few countries (along with Austria, the Czech Republic and Korea) where *reinstatement* after unfair dismissal is almost always granted or offered to the worker (except in cases of procedural irregularity). OECD (2013b) showed that restricting the possibility of reinstatement has been one of the main policy interventions across OECD countries since 2008 and also that such trend is justified on the basis that reinstatement is one of the aspects of EPL which most affects gross worker flows, and job-to-job flows in particular.

One fundamental barrier to further lowering EPL on permanent contracts in Portugal is Article 53 of the Portuguese Constitution which guarantees “job security” and prohibits dismissals without “just cause”, yet fails to define what the latter means.<sup>80</sup> A very conservative interpretation of this article has significantly restricted the definition of what constitutes a fair dismissal (i.e. disciplinary reasons) and has put the onus on the employer to prove that maintaining the work relationship is practically impossible. It is this narrow interpretation which has frustrated attempts to revise the definitions of fair dismissal during the recent reform period. This restrictive definition of what constitutes a fair dismissal significantly increases the risk of litigation for the employer (and of reinstatement and the payment of compensation) following the dismissal of a worker. It therefore impedes the efficient (re)allocation of labour resources.

Moving forward, it would therefore be particularly important to clarify the conditions under which companies can dismiss workers on permanent contracts for economic reasons. Such reforms were recently undertaken in both Spain and France. In Spain, since the 2012 labour market reform, a dismissal is always justified if the company faces a persistent decline (over three consecutive quarters) in revenues or ordinary income. In addition, and perhaps more importantly, the firm does not have to prove that the dismissal is essential for the future profitability of the firm (OECD, 2013b). In France, since the 2016 labour market

80. For a comprehensive discussion of the interpretation of Article 53 of the Portuguese Constitution, see Phalempin (2014).

reforms, a dismissal on economic grounds will be justified if sales or orders fall for: four consecutive quarters in comparison to those of the previous year for firms with 300 or more employees; three consecutive quarters for firms with at least 50 but fewer than 300 employees; two consecutive quarters for firms with at least 11 but fewer than 50 employees; and one quarter for firms with fewer than 11 employees.

In Portugal, clarifying the conditions under which employers can dismiss workers on permanent contracts for economic reasons would probably require a change to the Constitution (Article 53) – which might not be easy to achieve. Nevertheless, further reductions in employment protection legislation for workers on permanent contracts can still be achieved by: lightening the procedural requirements for dismissal, reducing the compensation following unfair dismissal, and lowering the probability of reinstatement. A pragmatic solution to achieve the latter objective could be modelled on the approach taken in Germany. While severance pay in Germany is not mandatory, most employers do offer it, and employees who accept this severance pay forego their right to go to court. In Portugal a similar system could be introduced whereby employees who are dismissed have a right to (ordinary) severance pay only if, within a certain time period, he/she does not bring the case to court. This approach would reduce some of the risk and uncertainty for the employer.

Labour market duality could also be reduced through other means – e.g. by making hiring on temporary contracts relatively more expensive than hiring on permanent contracts. This could be achieved by charging higher social security contributions on temporary contracts (as was done in Slovenia, France and Italy, for example). While this will likely help reduce labour market segmentation, there is a risk that higher labour costs would reduce employment, particularly for the more marginal workers (Cahuc et al., 2016). Therefore, one may wish to waive these higher social security contributions when firms hire marginal workers (e.g. low-skilled, youth and the long-term unemployed). Also, higher social security contributions on temporary contracts may pose a particular challenge for sectors that rely heavily on seasonal workers (e.g. agriculture and tourism).

The report has also argued that the system of severance pay in Portugal could be reformed further to emulate the one of Austria. In that system, workers accumulate rights to severance pay into individual savings accounts which are transferable from one employer to another, or can be transformed into a cash payment or annuity upon retirement. The advantage of this system is that it removes the disincentive to worker mobility inherent in systems where severance pay entitlements are strictly linked to the current employer. That being said, the advantages of increased portability will need to be carefully weighed against the additional cost of running such a scheme – particularly if it falls on employers.

A final observation relates to the direction of future reforms, which should be aimed primarily at reducing the stringency of employment protection legislation on permanent contracts, rather than on making hiring on temporary contracts more difficult and costly. Indeed, as pointed out in OECD (2014b), making hiring regulations on temporary contracts too restrictive might be counterproductive, by increasing perceptions of job insecurity for those workers who are unable to use non-regular contracts as a stepping-stone into open-ended ones. It is on the difficulty of firing permanent workers that Portugal stands out compared to other OECD countries, not on the difficulty of hiring temporary ones.

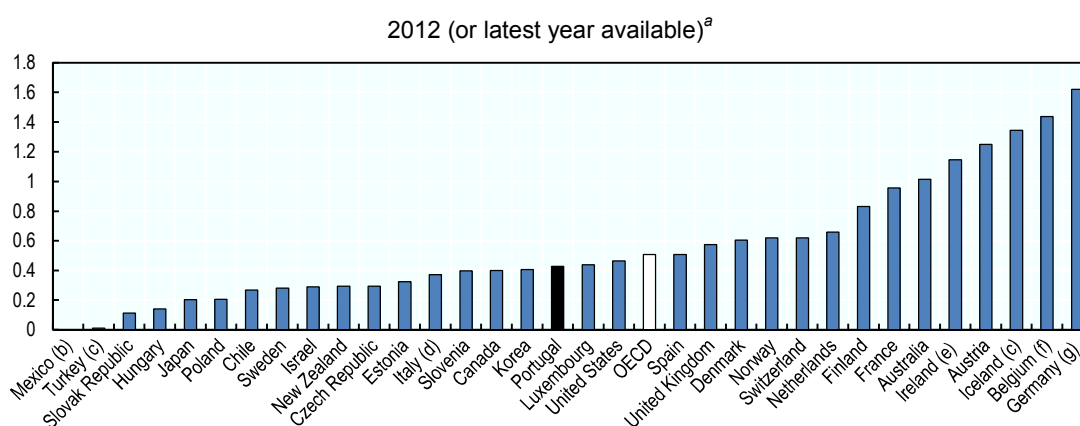
### ***Coverage of unemployment benefits should be increased, but their maximum duration further reduced***

The reforms of unemployment benefits in Portugal were a move in the right direction. Access to unemployment insurance was eased and coverage held up well despite a substantial increase in the number of unemployed (and, in particular, in the number of long-term unemployed and individuals with short contribution histories). In order to fight long-term unemployment, both the replacement rate of

unemployment insurance and the maximum duration of benefits were reduced, which brought the Portuguese system more in line with OECD norms.

Despite these positive steps, coverage of the unemployed in terms of unemployment insurance or assistance remains modest in Portugal compared to other OECD countries (Figure 36). In 2012, the ratio of beneficiaries to the number of unemployed stood at 0.43 in Portugal, compared to 0.52 across the OECD on average (and below the coverage rates for countries like Spain and the United States). Going forward, further improving coverage should be a priority for the Portuguese Government and a key challenge will be to cover young people and others with incomplete contribution records (e.g. those on non-regular employment contracts). Self-reported data from the EU-LFS suggest that, in 2013, fewer than 5% of unemployed youth in Portugal said they received benefits or assistance, compared to over 40% of adults. Another, related issue is that access to unemployment assistance in Portugal has been falling gradually over time because the means test threshold (80% of the IAS) has not been updated since 2009. Increasing this threshold would help raise the coverage of unemployment assistance in a targeted way. Finally, while those who are not (or no longer are) eligible for unemployment assistance may be eligible for the last-resort RSI income support, access to this benefit itself has reduced over time (see discussion at the end of Chapter 2).

Figure 36. **Ratio of unemployment insurance/assistance beneficiaries to LFS unemployed, 2012**



a. 2011 for Chile, 2010 for Iceland.

b. In 2012, there was no unemployment insurance or assistance in Mexico.

c. In Turkey and Iceland, some programmes included in the total are partially missing. Consult the country note for details: <http://www.oecd.org/social/recipients.htm>.

d. In Italy, recipients of the *Cassa Integrazione Guadagni* (CIG) are not included (even those who did not work at all).

e. In Ireland, all recipients of unemployment benefit are included, even those who work very few hours.

f. In Belgium, recipients of unemployment insurance aged over 65 are included.

g. In Germany, the number of beneficiaries of unemployment assistance is usually expressed in terms of the number of family members that benefit (not just the unemployed individual). In order to make the estimates for Germany more comparable to those of the other OECD countries, the graph counts the number of families (and not family members) that receive unemployment assistance.

Notes: In some countries the ratio of beneficiaries to unemployed can exceed one because entitlements to unemployment assistance are not necessarily based on ILO definitions of unemployment. The OECD average is calculated assuming ratios of 1 in all those countries where they exceed 1.

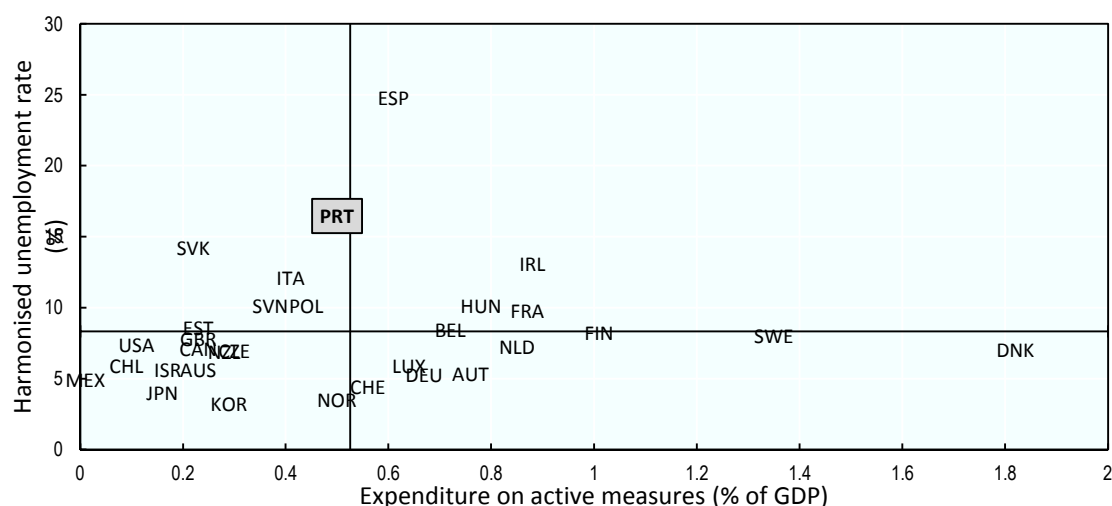
Source: OECD Social Benefits Recipients Database.

As has already been mentioned, there is also scope for further shortening the maximum duration of unemployment benefits in Portugal, which would help reduce the high rate of long-term unemployment (and would also free some resources which could be ploughed back into funding higher coverage rates). This is an issue for older workers in particular, who face the highest incidence of long-term unemployment (Portugal et al., 2015). In most OECD countries maximum benefit duration is age-related (either directly or through the link with previous work experience) and this may be justified on the basis that older workers tend to face worse re-employment prospects when they become unemployed. However, there is a risk that unemployment benefits are used as a pathway to early retirement and the incentive to exit unemployment is likely to fall as retirement nears (Tatsiramos and van Ours, 2012). Going forward, Portugal should consider further reducing the maximum duration of unemployment benefits, particularly for older workers. This should include restricting the possibility of extending unemployment assistance until the age of retirement to only those older people who remain unemployed despite taking active steps to find work. Further reforms of unemployment benefit duration should be combined with efforts to reinforce employment programmes to support the reintegration of job seekers into employment (see below).

***Reforms of the Public Employment Service should be completed, and activation measures targeted on those who need most help***

As the discussion in Chapter 1 showed, Portugal implemented various measures to strengthen its activation strategy over the past few years. Going forward, it is important to build on these successes to further improve the way the unemployed are helped, supported and encouraged to move into rewarding and productive jobs. In particular, Portugal needs to ensure that the measures outlined in the *Programa de Relançamento do Serviço Público de Emprego* are fully implemented. There may also be a need to dedicate more resources to activation. While this may be difficult in the current fiscal climate, it should be remembered that such spending can bring important savings in terms of reduced expenditure on benefits, as well as increased tax revenues. While Portugal's current spending on active measures (as a proportion of GDP) is very close to the OECD average, there are many countries with much lower unemployment rates that spend considerably more (Figure 37). There are also some efficiency gains to be made, for example by better targeting the measures on those who need them most, or by taking a bolder approach to the digitalisation of PES services (European Commission, 2015).

Figure 37. Unemployment and expenditure on ALMPs, 2013



Note: 2010 instead of 2013 for the United Kingdom. 2011 instead of 2013 for Israel. 2012 instead of 2013 for France, Korea, New Zealand, Poland and Spain.

Source: OECD Short-Term Labour Market Statistics Database and OECD Labour Market Programmes Database.

Another interesting recommendation to come out of the Portuguese evaluation literature on active labour market programmes is that the authorities should aim to achieve more stability in the measures available to jobseekers. Writing back in 2012, Costa Dias and Varejão already noted that, between 2000 and 2011, the Public Employment Service offered 167 different programmes, which were often small variations of one another or of previous programmes. As the tables produced in Annex A of this report testify, this continuous change in ALMPs on offer continued over the crisis period, which makes it difficult for jobseekers and firms to know what help is available and also costly for the PES to have to adapt each time to a new set of tools. At the same time, there is a need for more monitoring and evaluation of the existing measures.

Finally, Portugal could try and build stronger incentives into ALMPs to reduce labour market duality. For example, some OECD countries train the unemployed to fill existing vacancies and, in return, expect the employer to hire the individual on a permanent contract (e.g. Individual Job Training in Flanders, Belgium and Work and Income Support in New Zealand). A similar approach could be tried in Portugal – although there is a possibility that such conditions reduce take-up by employers if the risks and costs of taking on an unemployed person on a permanent contract are perceived as being too great. In addition, some of Portugal's existing ALMPs already offer greater subsidies to employers if they hire on permanent contracts (e.g. *Medida Estímulo Emprego* and its predecessors *Estímulo* and *Apoio à Contratação via Reembolso da TSU*). It is important that the effectiveness of such measures be evaluated first, before new measures are introduced.

***The collective bargaining system should promote a closer alignment between wages and productivity at the firm level***

The Portuguese experience has shown that putting restraint on the use of administrative extensions of collective agreements during times of crisis may help achieve wage moderation, preserve jobs and restore competitiveness. There is, of course, a role for extensions of collective agreements, particularly during times of healthy economic growth: they reduce wage inequality as well as gender pay gaps (Villanueva, 2015) – and this is one of the reasons many OECD countries have legal provisions in place for them. However, most of these countries also impose rules on the representativeness of collective agreements before they can be extended and, in Portugal, this is an issue that should continue to be monitored closely. While the first condition requiring signatory employers to represent 50% of workers in the sector/occupation/geographical area was too stringent, the second condition which allows extension when 30% of signatory firms are small and medium enterprises is too lax, given that 99.7% of firms in Portugal are SMEs. It would make sense, therefore, to continue revising these criteria so that they are challenging (and therefore encourage employer organisation), as well as realistic.

The key issue with quasi-automatic extensions of collective agreements is that they risk imposing conditions on non-signatory firms which do not reflect their own economic and financial circumstances. This can be particularly damaging in cases (like in Portugal) where: i) the employer organisations and trade unions that negotiate the agreement are not representative of the sector/occupation/region to which the agreement is to be extended; and ii) where the law prohibits nominal wage cuts. Indeed, there is evidence that, in Portugal, the indiscriminate use of extensions has harmed both competitiveness and employment. One possibility going forward would be for the government to extend collective agreements only if they meet certain “public interest” criteria. What exactly these criteria are can vary, depending on economic circumstances. The important thing is that they are announced well in advance by the government, so that the negotiating parties can take them into account during the bargaining process – knowing that, if these criteria are not met, no extension of the agreement will be possible. In the late 1990s in the Netherlands, for example, the minister (successfully) put pressure on the social partners to set the lowest pay scales close to the national minimum wage. By making clear that this measure was intended to save the credibility of extensions, the minister managed to convince the central organisations to influence their affiliates and negotiators to adjust the lowest pay scales.

Another option for limiting the potential negative effects of extensions would be to make them conditional on the inclusion of an opt-out clause in the original agreement. Such clauses, negotiated by the social partners, would allow companies to deviate from certain sectoral minima or standards under conditions specified in the higher-level agreement. Such firm-level bargaining under the umbrella of a sectoral agreement is common in Scandinavia, as well as in large firms in Germany and France (Visser, 2016). In the case of Germany, some research found that where collective agreements contained opening clauses, firms had lower job reallocation rates, lower job destruction rates and higher job growth rates (Brändle and Heinbach, 2013) – the reason being that opening clauses give firms more flexibility to save jobs through increased flexibility.

It is important, however, that opening clauses, when activated, are done so upon agreement between employers and their worker representatives. An increased use of derogation should therefore go hand-in-hand with measures to improve worker representation at the firm-level, which would strengthen the control function and reduce the risk of abuse by employers. While in most countries unions have tended to oppose the use of opening clauses for fear that it would entail an erosion of their influence, the increased use of such clauses could actually mean that unions have to strengthen their direct engagement with the needs and requirements of employers (Keune, 2010). Opening clauses also increase the likelihood of organised (as opposed to disorganised) decentralisation and, in the context of increased globalisation and declining union membership, they could be seen as a way to stabilise the bargaining system. In Germany, for example, this was the view of the Mining, Chemicals and Energy Industrial Union (Keune, 2010). That being said, opening clauses may also increase conflict between management and workers, and clear and swift procedures should be put in place to resolve potential disagreement. One way of doing this will be suggested below when the temporary withdrawal from collective agreements for “inability-to-pay” or “hardship” will be discussed. Another is to make sure that the conditions under which firms may opt out are clear and objective.

Whether Portugal opts for the use of public interest criteria or the increased use of opening clauses, it may also want to consider introducing an independent body or committee responsible for deciding (or advising the government on) whether an extension should be granted. Such bodies exist in both Finland and Germany, and play a similar role to minimum wage committees in that they distance the decision to increase wages from the political arena. In Germany, this committee consists of three trade union and three employer representatives (from sectors other than the one covered by the agreement), and extensions are granted only if a majority of at least four votes is achieved (Eurofound, 2011). As in minimum wage committees, this body could also include experts.

While increased worker representation would increase the control function in case opening clauses were introduced, it would also help resolve another bottleneck in the Portuguese collective bargaining system, which relates to the possibility of firm-level bargaining. While the most recent reforms in Portugal have attempted to extend the possibility of firm-level bargaining to a greater number of firms, this is unlikely to make much difference in practice because of the poor worker representation in Portuguese firms. Improving worker representation can be achieved by making works councils compulsory in companies of a certain size (as they have done in France with the *Comités d'Entreprise*). Another option is to provide financial incentives. In Italy, while not promoting worker representation *per se*, social security and tax breaks have been introduced for wages negotiated at the firm-level.

In addition to general opening clauses, more flexibility at the firm-level can be achieved through “inability-to-pay” (or “hardship”) clauses which allow employers to temporarily suspend a collective agreement at times of crisis. These are different from the general opening clauses discussed above, which are primarily instruments of organised decentralisation within sectoral agreements and have no place in firm-level agreements (Visser, 2016). By contrast, temporary hardship clauses can apply to any collective agreement at any level and act as a safety valve for employers (Visser, 2016). Late in 2014, Portugal



introduced the possibility of temporary hardship clauses. As with the more general opening clauses, however, an issue arises of how disagreement between employers and worker representatives is resolved – which, if left unaddressed, risks reducing the practical applicability of such clauses. To minimise such disagreements, either the law or collective agreements should include objective conditions under which employers may temporarily suspend a collective agreement. In Spain, for example, sectoral agreements have to include objective conditions (such as a fall in sales or productivity over a specified period of time) that specify when firms may opt out of what was agreed. In addition, a swift arbitration process in the case of disagreement between employers and worker representatives. Again, the example of Spain could be followed, where employers wanting to opt out can now, in the absence of an agreement with workers' representatives, unilaterally refer the matter to arbitration by a public tripartite body. Importantly, once the issue has been settled by arbitration, it may no longer be challenged (except on some very limited grounds; OECD, 2012). Such arbitration could also be used in the case of disagreement about the activation of standard opening clauses discussed above.<sup>81</sup>

Finally, it will be important in Portugal to improve trust between the social partners. Evidence from the Global Competitiveness Report, which gathers the opinions of business leaders around the world, suggests that trust in social partners in Portugal is consistently lower than across the OECD on average. The crisis years, and the reforms and austerity measures that were implemented during those years, have put significant strain on the relationships between the social partners. Távora and González (2014) provide a comprehensive overview of the strikes and demonstrations that took place during this period which include several general strikes, of which three were organised by the two union confederations “in an (almost) unprecedented display of unity of the Portuguese labour movement” (Távora and González, 2014). The main union confederation (CGTP) refused to sign any agreement with the government. In some cases (e.g. the fixing of the statutory minimum wage in 2011), the social partners were not even consulted by the government. At the same time, the issue of trust is gaining growing attention as an important determinant of the outcome of the collective bargaining process (Addison, 2015), and some researchers, like Blanchard, Jaumotte and Loungani (2013), have argued that “trust among the social partners appears to be just as important in bringing about macro flexibility as the structure of collective bargaining.” This was already recognised by Freeman and Medoff (1984), according to whom good labour relations are more likely to result in positive performance outcomes. While building trust between social partners is a complex process, implementing some of the reforms put forward by this report would help, including: making unions and employer organisations more inclusive; introducing objective criteria for both extensions and opt-outs; and encouraging regular negotiations (e.g. by reducing the maximum length of time for which agreements can remain valid) (Hijzen, Martins and Parlevliet, 2016).

### ***Minimise the possible negative employment effects of future increases in the minimum wage***

Chapter 1 argued that the freezing of the minimum wage between 2010 and 2014 hurt workers and that, in 2013, minimum-wage workers needed to work a relatively high number of hours to be able to move above the relative poverty line. At the same time, the Portuguese minimum wage is high relative to median wages and is also very binding: in October 2014, it was estimated that one in five full-time workers was earning the minimum wage, which was up from 13% in April that same year (GEP, 2015). Of particular concern in Portugal is that employer social security contributions on minimum-wage workers tend to be higher than in other countries, which would exacerbate any negative effect of the minimum wage on hiring. Given that Portugal continues to struggle with competitiveness (Chapter 2), the raising of the minimum wage to EUR 530 in 2016 and to EUR 600 by 2019 should raise some alarm bells. While some reductions in employer social security contributions for existing minimum wage workers will continue to

81. One concern, as pointed out by Ramalho (2013) is that in Portugal “There [...] appears to be no tradition of resolving differences of opinion between parties in regard to collective agreements and collective bargaining by means of mediation and arbitration.”

be available, the next section of this chapter will argue that, in order to stimulate labour demand, this measure should be extended to all minimum wage workers (not just existing ones). This may be particularly important in the case of small firms since these are likely to bear the brunt of any minimum wage increase (GEP, 2015).<sup>82</sup>

An alternative (or, rather, complementary) way of supporting the incomes of low-wage workers is through in-work benefits. Indeed, a recent review of minimum wage policy in OECD countries concluded that a careful combination of minimum wages and in-work benefits can be more effective in tackling in-work poverty than either instrument on its own (OECD, 2014b). The advantage of in-work benefits is that they have no negative effect on labour demand. Their introduction would however put additional pressure on the public purse, which may not be feasible given the current fiscal climate in Portugal. An additional concern often raised with in-work benefits is that they would simply be off-set by lower wage increases, but this risk is mitigated for the lowest earners by the presence of the minimum wage. Indeed, one of the stated aims of introducing the UK National Minimum Wage, for example, was to ensure that in-work benefits would actually increase the incomes of workers (rather than being “pocketed” by employers who might reduce wages by a similar amount). In addition, there is no need for employers to know which employees applied for and received the in-work benefit (as is the case in the United States with the Earned Income Tax Credit). Finally, while Portugal may not currently have an in-work benefit or tax credit along these lines, it should be remembered that the tax system in Portugal is very progressive which, to all intents and purposes, is a functional equivalent (except, perhaps, that it is less targeted than in-work benefits can be).

Looking forward, Portugal should consider setting up an independent body responsible for providing the government with impartial advice on future changes to the minimum wage, based on up-to-date and accurate information on current labour market conditions and the views of social partners. Such bodies, which bring together labour market experts, employer and employee representatives, now exist in different forms in several OECD countries, including: Australia, France, the United Kingdom and several US states. They have the advantage of making the minimum-wage uprating mechanism more fair, open and transparent.

## **Other challenges**

### ***Returning to higher and more sustainable rates of growth***

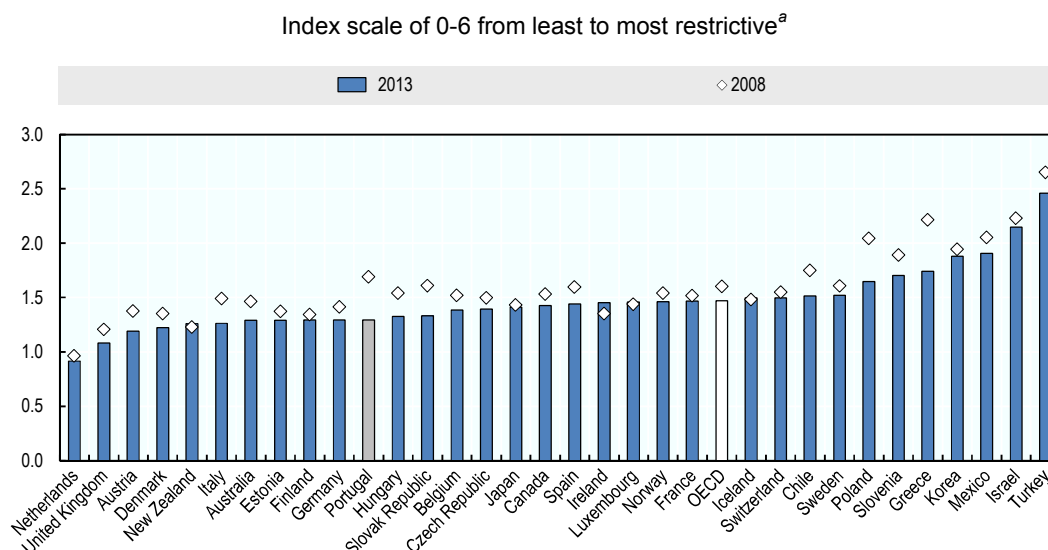
A return to higher and more sustainable growth remains a critical condition for further improvements in the labour market. Projections by international organisations, including the OECD, expect a continuation of the economic recovery in Portugal with growth rates in the range of 1.25% in 2017 and 2018. This implies that growth will remain substantially below the average growth rates projected across the OECD. Based on these projections, the pace of the recovery in Portugal would probably allow further reductions of the unemployment rate, albeit only small ones.

### ***Pushing through further product market reforms***

Economic growth can be held back by product market regulations that put frictions on the entry and expansion of firms. Since 2008, Portugal has implemented a wide range of measures to strengthen the competition-friendliness of its product market regulation and has moved up 15 ranks among OECD countries. For the aggregate indicator, Portugal is currently ranked 11th of 33 OECD economies for which data is available (Figure 38).

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82. There is also a concern that a high national minimum wage floor may undermine future collective agreements, since employers will be less willing to negotiate increases in wages when the national minimum wage is already so high.

Figure 38. **Aggregate product market regulation indicator, 2008-2013**

a. The OECD aggregate is an unweighted average of the data shown.

Source: OECD (2013), OECD Product Market Regulation Database.

However, while markets for tradable goods are generally competitive in Portugal (as is to be expected in a small open economy), some non-tradable sectors such as energy, transport and professional services continue to be characterised by low levels of competition. Given that intermediate inputs from non-tradable sectors are one of the most important cost inputs for firms in the tradable sector, the scope for further competitiveness gains and enhanced export performance depend crucially on the economy's ability to restrain input prices.

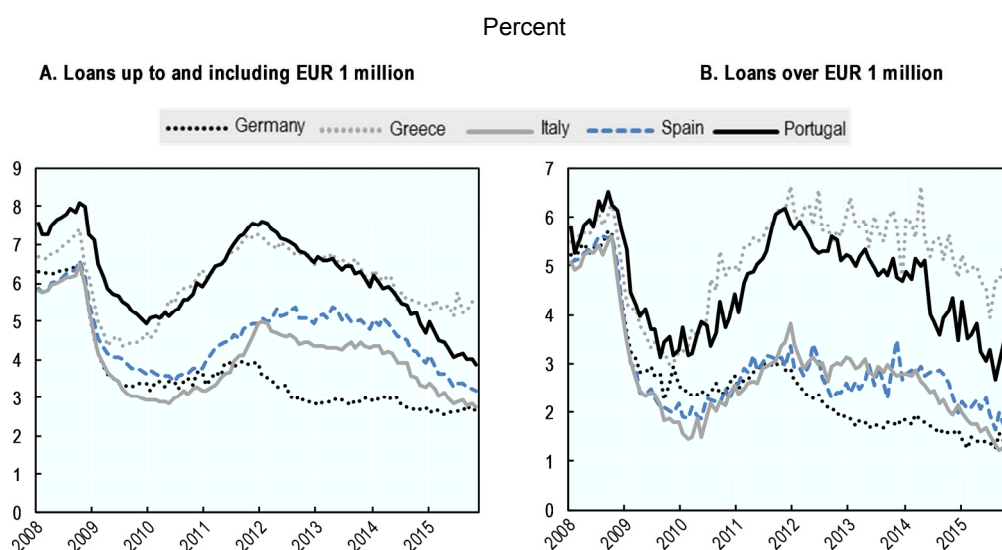
Recent OECD simulations (OECD, 2014c) suggest that further reductions in regulatory barriers to competition could significantly boost growth rates in Portugal. For example, in a scenario where Portugal reduces such barriers by 20% (corresponding roughly to the magnitude of changes observed over the past ten years in those OECD countries that have implemented product market reforms), GDP would increase by an additional 2% by 2020. In a more ambitious scenario in which Portugal aligns its regulation to best practice among all OECD countries in the various areas and sectors of product market regulations would yield an increase in the level of productivity and GDP of 5.5% by 2020, and even more over the longer term.

Going forward, it is therefore essential that Portugal continues to look for ways to improve its product market regulation which, in turn, will allow firms in other sectors to benefit from better inputs at lower prices, as well as better quality products and services. While a new framework law was approved in 2013 that reforms regulations in 18 professional services, none of the new statutes and internal rules for the professional bodies have been approved yet (nine have reportedly been finalised but not yet approved, while nine others are experiencing delays – European Commission, 2015). Similarly, some measures aimed at reducing the cost of energy and the use of transport infrastructure still need to be implemented.

### ***Improving access to credit for firms***

Job creation in Portugal has been held back also by financial constraints weighing on firms. Although the cost of credit in Portugal has been falling substantially, it remains high compared to some other OECD countries, including Italy and Spain (Figure 39) and, for large loans, recent data indicate that interest rates might be rising again. Against this backdrop, lending to the private sector still continues to fall, although at a decreasing rate (Figure 40). One of the issues that may have to be addressed to enhance access to finance for firms with strong growth potential is the high level of corporate indebtedness and the poor performance of some assets on banks' balance sheets, which is restraining their lending capacity.

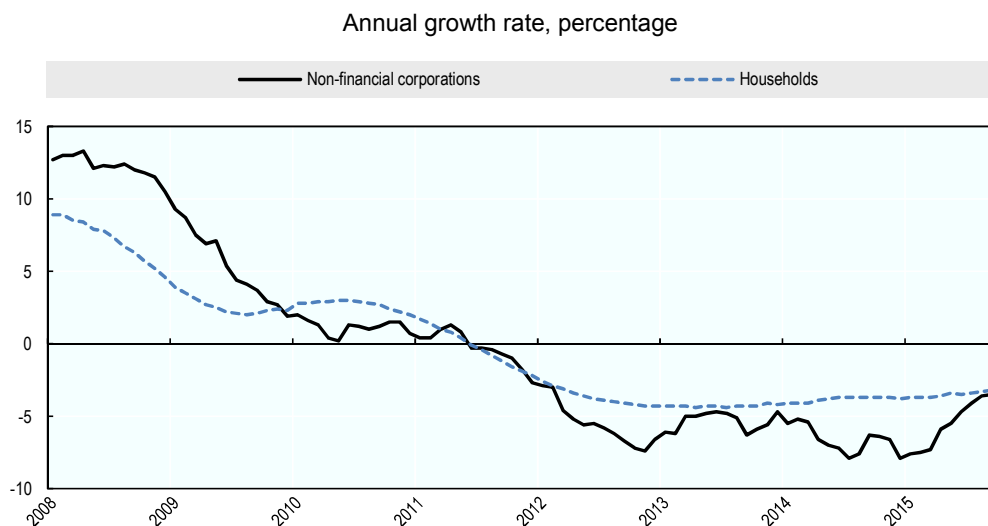
Figure 39. Interest rates on loans to non-financial corporations, January 2008–November 2015, Portugal and other EU countries



Note: Balance sheet item: loans other than revolving loans and overdrafts, convenience and extended credit card debt. Original maturity/Period of notice/Initial rate fixation: up to one year. MFI interest rate data type: annualised agreed rate (AAR) / Narrowly defined effective rate (NDER).

Source: ECB (2015), "MFI Interest Rates", Statistical DataWarehouse, European Central Bank, September.

Figure 40. Lending to the private sector, January 2008–September 2015



a. Loans of other monetary financial institutions (excluding securities and including credit to emigrants) to households and non-financial corporations. Adjusted for securitisation.

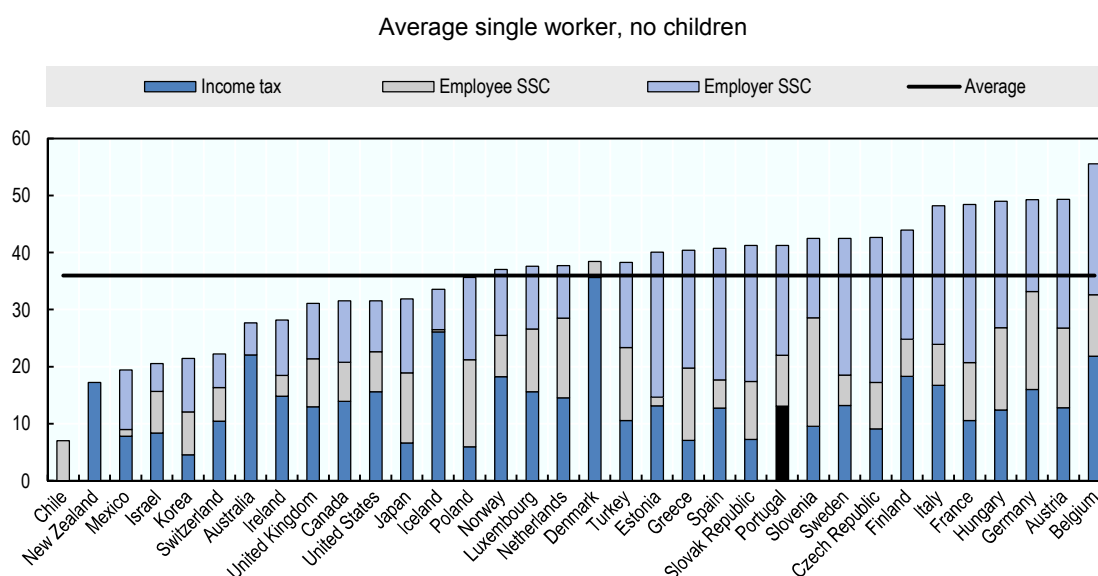
Source: Banco de Portugal (2015), Main Indicators, BP Stat, November.

### Reducing the tax wedge

Portuguese companies are taxed more than in the average OECD country (OECD, 2014c), and this has negative consequences for their competitiveness. Some commentators even go as far as saying that this tax burden is one of the key barriers to better labour market performance in Portugal (Palma Ramalho,

2013; Carvalho Martins, 2014).<sup>83</sup> Of particular relevance for the present report is the tax wedge on labour income, which measures the sum of personal income tax, employee and employer social security contributions (net of family benefits) as a proportion of total labour costs (i.e. gross wages plus employer social security contributions). It is a measure of the difference between how much employers pay to hire a worker, and how much that worker takes home in net pay. The tax wedge therefore has an impact on both labour demand (by affecting the cost of hiring) as well as on labour supply (through its relationship with the reservation wage). As an illustrative example, Figure 41 shows the average tax wedge in OECD countries on a single worker with no children. At 41.2% versus 36.0%, the tax wedge in Portugal is considerably higher than the OECD average, and this difference is due entirely to higher social security contributions paid by Portuguese employers.<sup>84</sup>

Figure 41. **Average tax wedge, 2014**



Source: OECD (2015), *Taxing Wages 2015*, OECD Publishing, Paris.

Plans to reduce employer social security contributions and compensate for the lost revenue through increases in VAT were, unfortunately, shelved (Portugal, 2015) – but such reductions would still be useful in boosting labour demand. While an across-the-board cut in employer social security contributions may be unrealistic in the current financial climate, more targeted reductions for disadvantaged workers might be more feasible. For example, a number of OECD countries (France most notably, but also Hungary, the Netherlands, Belgium and the United Kingdom) have lower employer social security contributions on minimum-wage earners than on median-wage earners (OECD, 2015c). Similarly, when Portugal increased the minimum wage to EUR 505 in October 2014, it introduced a cut in employers' social security contributions (of 0.75 percentage points) – though only for minimum-wage workers who were already hired prior to June 2014. While this measure was welcome, a wider application of it to all minimum-wage

83. The adverse effect of the tax wedge on employment may be larger in countries where extensions are common (Murtin, de Serres and Hijzen, 2014).

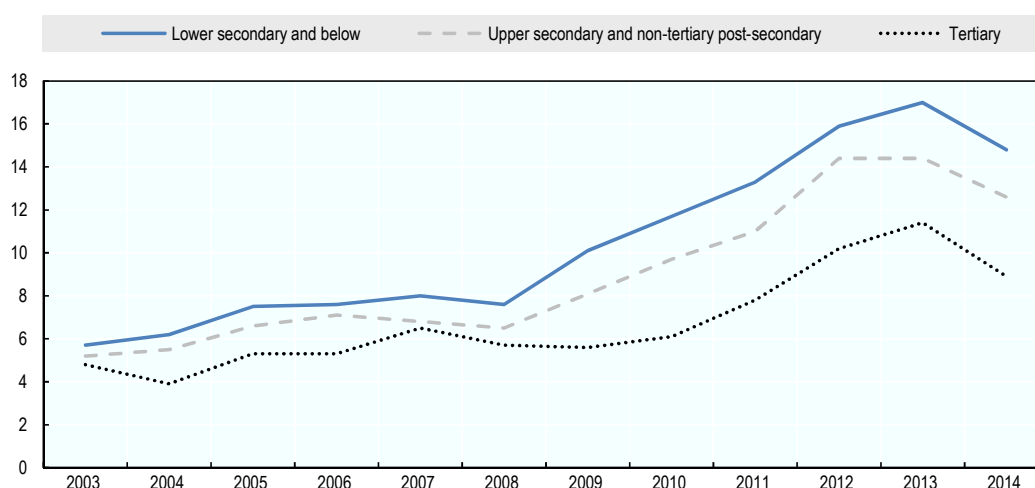
84. In 2013, the government introduced an exceptional income tax surcharge of 3.5% (*sobretaxa extraordinária em sede de Imposto sobre o Rendimento das Pessoas Singulares – IRS*). The new XXI Constitutional Government established on 26 November 2015 has approved a reduction in this surcharge from 3.5% to 1.75% in 2016 and to 0% in 2017. Finally, the new government has plans to introduce a negative income tax (*Complemento Salarial Anual*) for the poorest workers.

workers would have been even more helpful so as to encourage new hiring. With large increases planned in the minimum wage (to EUR 600 by 2019), such cuts in employer social security contributions gain even more relevance. The fiscal cost of such a measure would be mitigated by the reductions in benefit expenditure resulting from higher levels of employment.<sup>85</sup>

### *Investing in skills*

One key challenge that Portugal continues to face in achieving higher levels of productivity (but also inclusiveness) lies in the poor (and unequally distributed) skills of its workforce. Individuals with higher skills have better labour market outcomes. In Portugal, for example, the unemployment rate of 25-64 year-olds with less than tertiary education more than doubled between the start and the peak of the crisis. While those with tertiary education also saw a significant increase in their unemployment rate, the increase was significantly less marked than for those with lower levels of education (Figure 42). In 2014, an individual with less than upper-secondary education was 1.7 times more likely to be unemployed than an individual with tertiary education. There are also important returns to higher education in Portugal, reflecting the fact that demand outstrips supply. The internal rate of return to a tertiary education is 18.7% for men and 20.5% for women (compared to 14.0% and 11.5% across the OECD on average; OECD, 2015d).

Figure 42. Unemployment rates of the population aged 25-64 by educational attainment, 2003-2014, Portugal



Note: Because of a methodological change in the Portuguese Labour Force Survey, data prior to 2011 are not fully comparable with the more recent data. The new methodology results in higher levels of unemployment and inactivity compared to the methodology used prior to 2011. For detailed information, see Statistics Portugal (2011).

Source: Eurostat.

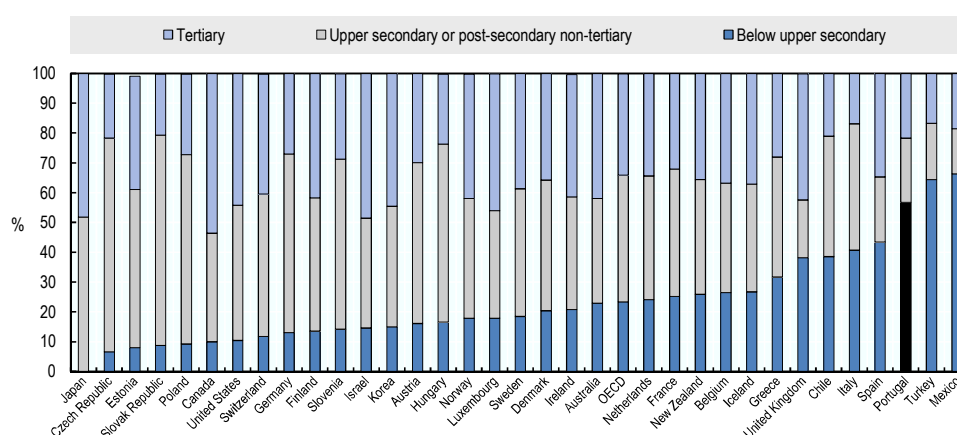
In recent years, Portugal has made significant improvements in the educational attainment of its adult population (OECD, 2015d). Despite this, Portugal lags behind all other OECD countries (except Turkey and Mexico) in terms of the proportion of 25-64 year-olds who have attained at least upper secondary education (Figure 43). Such low levels of attainment can be explained by the low level of attainment among older adults (55-64 year-olds), where eight out of ten have not attained upper secondary education.

85. The XXI Constitutional Government has proposed a reduction in VAT on restaurants as part of the 2016 budget. While such measure might promote employment, it is much less targeted: i) on employment and ii) on low-paid workers than reductions in social security contributions would be. There are many low-paid workers in other sectors, and similarly there are many high-paid workers in the restaurant sector.

Similarly, although Portugal was one of the OECD countries that made the greatest progress between 2003 and 2012 on the PISA tests of mathematics performance of 15-year-olds, its average score remains below the OECD average (Figure 44). Against this background, it is worth mentioning the fact that Portugal has engaged with the OECD in a comprehensive diagnosis of its key skills challenges (OECD, 2015e). The outcome of the exercise provides a solid basis for identifying possible actions to enhance skills development, skills activation and skills use. It provides examples illustrating how other countries have tackled similar challenges, which can be used as input for framing potential policy options for Portugal.

Figure 43. **Educational attainment of 25-64 year-olds, 2014**

Percentage of adults with a given level of education as the highest level attained

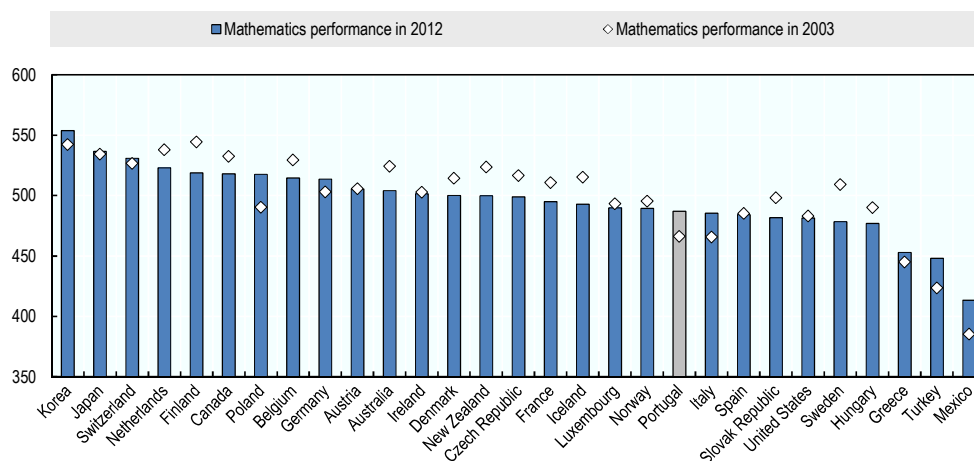


Note: 2013 for Chile and France.

Source: OECD (2015d), *Education at a Glance 2015*, OECD Publishing, Paris.

Figure 44. **Average mathematics performance of 15-year-olds, 2003-2012**

Points



Source: OECD (2014d).

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## ANNEX A

### DETAILED OVERVIEW OF LABOUR MARKET REFORMS IN PORTUGAL OVER THE PERIOD 2011-2015

#### Employment Protection Legislation

##### *Severance pay reforms*

##### *Open-ended contracts*

Prior to the reforms, the severance pay of workers on open-ended contracts was calculated as one month (30 days) of base wage and tenure-based increments for every full year of tenure – with a minimum of three months.<sup>86</sup>

Over the period 2011-2013, several amendments were made to the severance pay system for open-ended contracts:

- From 1 November 2011 onwards,<sup>87</sup> severance pay on all new open-ended contracts was reduced from 30 to 20 days for each year of tenure, and the minimum requirement of three months was removed. In addition, limits were introduced to the maximum amount of severance pay that could be paid out. Specifically: the base wage (including tenure-based increments) for calculating the entitlement was capped at 20 times the national monthly minimum wage; and the total amount of severance pay could not exceed 12 times the worker's base wage (including tenure-based increments) – i.e. 240 times the national monthly minimum wage.
- From 31 October 2012,<sup>88</sup> some of these new rules were also applied to contracts signed prior to 1 November 2011 – although rights accrued so far were preserved. So, for these contracts, the rules now stipulated that compensation accrued at 30 days per year of tenure up until 31 October 2012, and then at 20 days per year of tenure for years after that. The minimum of three months' pay was maintained, and the new upper limits would also be applied. One exception would be for those individuals whose accumulated compensation rights on 31 October already exceeded the upper limits. In those cases, individuals would simply keep the rights already accrued (even if above the limit), but with no further accruals beyond that date.

86. The formula for calculating the amount of severance pay was originally defined by Decree-Law 372-A/75 of 16 July and workers were entitled to one full month of severance pay for every year (or fraction of a year) of tenure. Decree-Law 64-A/89 of 12 February specified that the basis on which the amount of severance pay was to be calculated was the base wage (excluding overtime pay or bonuses). However, the Labour Code of 2003 subsequently added tenure-based increments to the calculation. The LC 2003 also specified that, in the case of fractions of years of tenure, the amount of severance payment was to be calculated proportionally.

87. Law 53/2011 of 14 October.

88. Law 23/2012 of 25 June.



- From 1 October 2013,<sup>89</sup> a further reduction in severance pay was introduced: from 20 to 12 days per year of tenure, with a temporary regime for contracts for which the duration on 1 October 2013 was inferior to three years. Because rights accrued to date were preserved, three regimes now applied depending on when the employment contract was signed:
  - For contracts signed before 1 November 2011:
    - 30 days per year of tenure until 31 October 2012;
    - 20 days per year of tenure between 1 November 2012 and 30 September 2013;
    - For the period after 1 October 2013:
      - ❖ If the overall contract duration was inferior to three years on 1 October 2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that.
      - ❖ If the overall contract duration was three years or more on 1 October 2013: 12 days per year of tenure.
  - For contracts signed between 1 November 2011 and 30 September 2013:
    - 20 days per year of tenure for the period up to 30 September 2013;
    - For the period after 1 October 2013:
      - ❖ If the overall contract duration was inferior to three years on 1 October 2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that.
      - ❖ If the overall contract duration was three years or more on 1 October 2013: 12 days per year of tenure.
  - For contracts signed after 1 October 2013:
    - 12 days per year of tenure.

#### *Fixed-term contracts*

Prior to the reforms, temporary workers whose contracts were not renewed or converted to permanent ones by their employers were entitled to severance pay equal to: three days of base pay and tenure-based increments per month of work in case of contracts that lasted six months or less; and two days of base pay and tenure-based increments per month of work in case of contracts that lasted more than six months.

From 1 November 2011 onwards,<sup>90</sup> severance pay on all new fixed-term contracts was aligned with that of all new open-ended contracts – i.e. 20 days for each year of tenure, with fractions of a year counted proportionally and upper limits applying.

From 31 October 2012 onwards, the new rules were also extended to contracts signed prior to 1 November 2011 – although rights accrued to date were preserved. Severance pay was therefore equal to two or three days per month of tenure for the period up until the 31<sup>st</sup> of October 2012, and 20 days per year of tenure for years after that (with the new upper limits applicable).

89. Law 69/2013 of 30 August.

90. Law 53/2011 of 14 October.

Finally, from 1 October 2013, severance pay was further reduced to 18 days per year of tenure, up to the ceilings defined above. As in the case of open-ended contracts, rights accrued to date were preserved, so that three separate regimes are now applicable, depending upon when the original contract was signed (and taking account of the two exceptional extensions of temporary contracts which were allowed):

- For contracts signed before 1 November 2011:
  - For the period up to and including 31 October 2012: three days of base pay and tenure-based increments per month of work in case of contracts that lasted six months or less; and two days of base pay and tenure-based increments per month of work in case of contracts that lasted more than six months.
  - For the period between 1 November 2012 and 30 September 2013: 20 days per year of tenure (with fractions of a year counted proportionately).
  - For the period after 1 October 2013:
    - ❖ If the overall contract duration was inferior to three years on 1 October 2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that.
    - ❖ If the overall contract duration was three years or more on 1 October 2013: 12 days per year of tenure.
- For contracts signed between 1 November 2011 and 30 September 2013:
  - For the period up to and including 30 September 2013: 20 days per year of tenure (with fractions of a year counted proportionately).
  - For the period after 1 October 2013:
    - ❖ If the overall contract duration was inferior to three years on 1 October 2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that.
    - ❖ If the overall contract duration was three years or more on 1 October 2013: 12 days per year of tenure.
- For contracts signed between 1 October 2013:
  - 18 days per year of tenure (with fractions of a year counted proportionately).

Table A1 below summarises all the changes to severance pay (for both open-ended and temporary contracts).

Note that, in addition to the reforms outlined above, the 2012 amendment of the Labour Code declared void all provisions contained in collective agreements signed prior to the entry into force of the new Labour Code which established higher amounts of severance pay than those resulting from the Labour Code.

Table A1. Changes over time in severance payment for open-ended and fixed-term contracts

## Rules for calculation of severance pay for open-ended contracts

Contract signed	Before	01-11-2011	31/10/2012	01/10/2013
< 01/11/2011	30 days per year of tenure minimum of 3 months no upper limits	30 days per year of tenure minimum of 3 months no upper limits	until 31/10/2012: 30 days per year of tenure from 1/11/2012: 20 days per year of tenure • minimum of 3 months • upper limits applicable [except contracts exceeding the upper limit on 31/10/2012: entitlement frozen]	until 31/10/2012: 30 days per year of tenure until 30/09/2013: 20 days per year of tenure from 01/10/2013: • If overall contract duration was < 3 years on 01/10/2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that • If overall contract duration was > 3 years on 01/10/2013: 12 days per year of tenure minimum of 3 months upper limits applicable [except contracts exceeding the upper limit on 31/10/2012: entitlement frozen]
01/11/2011 < x ≤ 30/09/2013		20 days per year of tenure no minimum upper limits applicable	20 days per year of tenure no minimum upper limits applicable	until 30/09/2013: 20 days per year of tenure from 01/10/2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that no minimum upper limits applicable
> 01/10/2013				12 days per year of tenure no minimum upper limits applicable

## Rules for calculation of severance pay for fixed-term contracts

Contract signed	Before	01-11-2011	31/10/2012	01/10/2013
< 01/11/2011	contracts < 6 months: 3 days per month; contracts > 6 months: 2 days per month no upper limits	contracts < 6 months: 3 days per month; contracts > 6 months: 2 days per month no upper limits	until 31/10/2012: contracts < 6 months: 3 days per month contracts > 6 months: 2 days per month from 1/11/2012: 20 days per year of tenure upper limits applicable	until 31/10/2012: contracts < 6 months: 3 days per month contracts > 6 months: 2 days per month until 30/09/2013: 20 days per year of tenure from 01/10/2013: • If overall contract duration was < 3 years on 01/10/2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that • If overall contract duration was > 3 years on 01/10/2013: 12 days per year of tenure upper limits applicable
01/11/2011 < x ≤ 30/09/2013		20 days per year of tenure upper limits applicable	20 days per year of tenure upper limits applicable	until 30/09/2013: 20 days per year of tenure from 01/10/2013: 18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that upper limits applicable
> 01/10/2013				18 days per year of tenure for the first three years of the contract and 12 days per year of tenure for every year after that upper limits applicable

### ***Introduction of a dismissal fund***

Two dismissal funds were set up in October 2013<sup>91</sup> which collect compulsory monthly contributions from employers into individual savings accounts of workers, and which are intended to cover part of the severance payment in case of dismissal.

To be precise, the new law introduced a severance pay fund (*Fundo de Compensação do Trabalho – FCT*), the “equivalent mechanism” (ME) and the severance pay guarantee fund (*Fundo de Garantia de Compensação do Trabalho – FGCT*). Monthly contributions to these funds are compulsory for each worker hired on or after 1 October 2013 and are set at 0.925% of the worker’s wage for the FCT and 0.075% in case of the FGCT. In practice, these contributions are waived for the first two years of the existence of the fund (or until the employment contract is terminated, whichever comes first) through the temporary Employment Incentive measure (*Incentivo Emprego*).<sup>92</sup> Since September 2015, contributions to the fund stop once the accumulated amount has reached 50% of the severance pay due to the employee in case of dismissal.<sup>93</sup>

The FCT acts as a savings account for the employer and is intended to cover up to half of the severance payment. In this way, it reduces the up-front cost of high severance payments. The fund is managed by the Institute for Social Security Funds Management (*Instituto de Gestão de Fundos de Capitalização da Segurança Social*), but employers may also opt to go with a private fund instead (through the equivalent mechanism) if they think they can obtain better returns that way. When an employee is dismissed, the employer applies to the fund to pay the part of the severance pay that has been saved up, with the employer paying the remaining part.

The FGCT is intended as an insurance fund to which the employee can apply in case the employer’s payment plus the accumulated amount in the FCT fail to add up to 50% of the severance pay entitlement. The FGCT essentially makes sure that, in case of dismissal, the employee receives at least 50% of his/her severance pay entitlement.

If the employee leaves the employer of his/her own accord, the employer can obtain a refund of that worker’s dismissal fund.

### ***Changes to the definitions of fair dismissal***

Changes were introduced to the definitions of fair dismissal linked to: i) the extinction of a work position; and ii) inadaptability. The new regulations have been in force since 1 August 2012.<sup>94</sup>

#### ***Dismissal for extinction of a work position***

Prior to the reforms, the law laid down a number of conditions that needed to be fulfilled in case an employer wanted to dismiss a worker for extinction of a work position. The first of these required the employer to prove that s/he could not offer the worker another position, compatible with his/her professional profile. Second, in the event that several comparable positions existed within the workplace, the employer needed to follow strict, seniority-based rules to select the worker to be dismissed (“last in,

91. Law 70/2013 of 30 August.

92. Ordinance 286-A/2013 of 16 September. Ordinance 17/2014 of 27 January brings some improvements in the administrative process of the *Incentivo Emprego*.

93. Decree-Law 210/2015 of 25 September.

94. Law 23/2012 of 25 June.

first out”), namely the worker with: i) the least seniority in the position; ii) the least seniority in the professional category; iii) the lowest level within the professional category; iv) the least seniority within the firm.<sup>95</sup>

Regarding the criteria for deciding which worker to dismiss, these were removed as of 1 August 2012 and replaced by “relevant and non-discriminatory” criteria to be defined by the employer him/herself and which should be directly related to the reason for extinction of the work position. However, in September 2013, this change was judged to be unconstitutional by Portugal’s Constitutional Court<sup>96</sup> and, in response to this, another revision of the criteria took force on 1 June 2014.<sup>97</sup> The new dismissal criteria require employers to select the worker: i) with the worst performance evaluation (measured against benchmarks previously known to the employee); ii) with the lowest academic and professional qualifications; iii) who presents the greatest cost burden to the employer; iv) with the least experience in the position; v) with the least seniority within the firm.

The second change introduced as of 1 August 2012 was the elimination of the requirement that the employer should try and find another suitable position for the worker s/he intends to dismiss (sometimes referred to as *repêchage*). While the removal of this condition was unlikely to make much difference in practice,<sup>98</sup> the Constitutional Court also ruled this change unconstitutional,<sup>99</sup> and it was subsequently reinstated (as of 1 June 2014).<sup>100</sup>

#### *Dismissal for inadaptability*

According to the Labour Code of 2009 a worker could be dismissed for inadaptability in situations where s/he: i) displayed a continuous fall in productivity or quality; ii) caused repeated damage to equipment or machinery; iii) presented a risk to the health and safety of him/herself, other employees, or third parties.

In order to dismiss a worker for inadaptability, a number of conditions needed to be met by the employer: i) six months prior to the start of the dismissal procedure, changes needed to have been introduced to the nature of the job as a result of technological change or the adoption of new production/sales practices; ii) the worker needed to have been offered appropriate training in a certified institution to allow him/her to adapt to the changes in the post; iii) after the training, the worker needed to have been granted a period of adaptation on the job of at least 30 days; iv) there was no other suitable position within the organisation that could be offered to the worker; and v) the situation of inadaptability did not derive from a lack of health and safety conditions for which the employer was at fault. If these

95. One exception to this rule applied to firms with fewer than 50 registered employees in the previous calendar year, in which case the employer could resort to the rules governing collective dismissal (which do not contain seniority-based requirements for choosing the worker to be dismissed) if at least two workers were to be dismissed (Pestana Nascimento, 2012).

96. Decision n° 602/2013 of the Constitutional Court on 20 September 2013. The new criteria were judged to be too subjective.

97. Law 27/2014 of 8 May.

98. It would hardly be accepted that an employer eliminated a work position while, at the same time, recruiting workers for an equivalent position/professional category (Pestana Nascimento, 2012).

99. Decision n° 602/2013 of the Constitutional Court on 20 September 2013.

100. Law 27/2014 of 8 May.

conditions were all fulfilled, the employer also needed to comply with certain notification and consultation procedures prior to proceeding with the dismissal.<sup>101</sup>

On 1 August 2012, two changes were introduced to this procedure.<sup>102</sup> First, as in the case of dismissal for extinction of a work position, the *repêchage* condition was removed – although this has subsequently been re-introduced after the Constitutional Court judged this change to be unconstitutional.<sup>103</sup> There is one important exception to this, however. Indeed, the second change introduced on 1 August 2012 implied that, henceforth, dismissal on the grounds of inadaptability could also apply in cases where no changes to the nature of the job had been introduced. In addition, there is no requirement under this modality that the employer offers the worker an alternative and suitable position within the workplace (Monteiro Fernandes, 2014).

### ***Exceptional extension of temporary contracts***

In Portugal, fixed-term contracts can only be used to meet a temporary need of the company and for the period strictly necessary to meet this need. In addition, fixed-term contracts may be used: i) for the launch of a new activity of undefined duration or the start-up of a company (or establishment) with fewer than 750 workers; and ii) in the case of first-time jobseekers, the long-term unemployed, or other situations specified in special employment policy legislation. Fixed-term contracts can be renewed up to three times and their total duration (including all renewals) cannot normally exceed three years (in the case of temporary contracts of pre-defined duration). Some exceptions to this rule are made for: i) first-time jobseekers (18 months overall duration); ii) the long-term unemployed and contracts signed in the context of the launch of a new activity and or a new start-up (24 months overall duration). Temporary contracts of uncertain duration may last up to six years.

During the period of the reforms, two exceptional extensions of temporary contracts (of pre-defined duration) were allowed. The first exceptional extension came into force on 11 January 2012<sup>104</sup> and allowed two additional extensions (not exceeding 18 months overall) of all fixed-term contracts that were set to reach the maximum limit of duration by the end of June 2013. In addition, the duration of each exceptional renewal could not be less than one sixth of the maximum duration of the fixed-term contract or its effective duration, whichever is lower. The validity of contracts renewed under this law expired on 31 December 2014. The second exceptional renewal came into force on 8 November 2013<sup>105</sup> and allowed all fixed-term contracts that would reach the maximum limit of duration by 7 November 2015 to be extended twice (but not exceeding 12 months overall). Once again, the duration of each exceptional renewal could not be less than one sixth of the maximum duration of the fixed-term contract or its effective duration, whichever is lower. The validity of contracts renewed under this law expires on 31 December 2016.

### ***Employment contracts of very short duration***

The Portuguese Labour Code specifies a special form of temporary contract of very short duration (*muito curta duração* – introduced in 2009) which can be used for the purposes of seasonal agricultural

101. In addition, inadaptability can arise in situations where workers assigned to technically complex posts or in positions of management did not meet the objectives previously agreed with them in writing. In this case, the employer only needs to fulfil conditions i) and v) in order to proceed with the dismissal.

102. Law 23/2012 of 25 June.

103. Decision n° 602/2013 of the Constitutional Court on 20 September 2013; and Law 27/2014 of 8 May.

104. Law 3/2012 of 10 January.

105. Law 76/2013 of 7 November.

activities or the organisation of touristic events. This contract is not subject to written form, although its celebration should be communicated electronically to social security. Prior to the reforms, these contracts could last no longer than a week, with a limit of 60 days over a period of 12 months. The length of these contracts was increased to 15 days, and the overall annual limit to 70 days.<sup>106</sup>

### ***Measures to tackle dependent self-employment***

The reforms also attempted to tackle labour market segmentation by reducing the level of “dependent self-employment”. The Labour Code of 2009 already defined the conditions under which an employment contract would be presumed (i.e. under which the worker would be considered a wage earner), but the new law<sup>107</sup> provides labour inspectors with the necessary tools to enforce the existing regulations. In particular, a procedure was introduced which should be followed in case a labour inspector detects misuse of service provider contracts. In a first instance, the employer is given ten days to regularise the situation. If this fails, a process is initiated to establish an employment contract. The new law came into force on 1 September 2013.

### **Collective bargaining**

The recent labour market reforms introduced a number of changes to collective bargaining in Portugal.

#### ***New criteria for the extension of collective agreements***

Prior to the reform, the most common form of collective agreement in Portugal was the sectoral agreement (*Contrato Coletivo de Trabalho*, CCT), which is an agreement negotiated between one or more employer organisations and one or more trade unions. The two other forms of collective agreement in Portugal are: i) agreements between groups of firms (*Acordos Coletivos de Trabalho* – ACT), which are signed by several employers that are not part of an employer organisation and one or more trade unions; and ii) firm-level agreements (*Acordos de Empresa*) involving just a single employer. ACTs are common in the financial and utilities sectors, while firm-level agreements (which are less common) occur most often in the oil, transport and communication sectors (Addison, Portugal and Vilares, 2015).

In Portugal, collective agreements are only binding for trade union members. In practice, however, employers who sign an agreement generally extend its application to their entire workforce, irrespective of the union status of their workers.<sup>108</sup> This is partly because there is no legal mechanism in Portugal that obliges trade unions and employer organisations to disclose their membership. In addition, the Ministry of Employment, Solidarity and Social Security has traditionally extended collective (sectoral) agreements to the whole sector (using *portarias de extensão* or extension ordinances), upon request of at least one of the parties to the agreement.

The extension of collective agreements was frozen from May 2011 onwards, and this suspension remained in force until 2012, when changes were introduced to the criteria for awarding extensions.<sup>109</sup> The idea behind the reform was to extend agreements only if they were representative of the sector,

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106. Law 23/2012 of 25 June.

107. Law 63/2013 of 27 August.

108. Employers extending collective agreements to non-union employees is common practice in most countries, if only to prevent tensions within the workforce. In some countries application to non-union members is required by law (as in the Netherlands).

109. Cabinet Resolution 90/2012 of 31 October 2012.

geographical area or occupation they are meant to cover. So, besides a new requirement that at least one union and one employer organisation now needed to request the extension, the latter will only be granted if the employers that signed it employed at least 50% of the workers in the sector, geographical area or occupation to which the agreement is to be extended. In June 2014, this requirement was softened by addition of a new, alternative requirement which stated that extension agreements will also be considered if the signatories to the agreement consist of at least 30% of micro-, small- and medium-sized enterprises (employing up to 250 employees each).<sup>110</sup>

### ***Firm-level bargaining***

Since 1 August 2012, works councils have been able to negotiate at plant level in firms with at least 150 employees (previously this was limited to firms with at least 500 employees). However, because the Portuguese Constitution gives trade unions exclusive rights to represent workers in the negotiation process (Article 56 of the Constitution), this can only happen if the latter delegate the power to negotiate to workers' associations. The attempt to encourage greater decentralisation of collective bargaining was accompanied by the creation of an Industrial Relations Centre (*Centro de Relações Laborais*), whose purpose it is to provide information and technical assistance to the parties involved in collective bargaining.<sup>111</sup>

From September 2014 onwards,<sup>112</sup> the government also introduced the possibility of collective agreements to be temporarily suspended in cases where the firm finds itself in a situation of crisis, due to market conditions, structural or technological reasons, or other events that have seriously impacted on the normal, day-to-day activity of the firm – as long as this suspension is indispensable for the survival of the firm and to avoid employment losses. Prior agreement needs to be reached with trade unions, and such agreement needs to state very clearly the reason for the suspension and its duration.

Finally, while articulation has, in theory, already been possible since the 2003 Labour Code,<sup>113</sup> this rarely occurred in practice (MTSS, 2006; Távora and González, 2015). The recent reforms further encouraged the inclusion of articulation clauses between different levels of bargaining, particularly on matters of functional and geographical mobility, the organisation of working time, and compensation.<sup>114</sup>

### ***Expiry of collective agreements***

The reforms also targeted cessation clauses contained within certain collective agreements which stipulate that the agreement remains in force until it is replaced by a new agreement (which, in practice, means it could remain in force indefinitely). The Labour Code of 2009 already prohibited such clauses in new agreements, and put a limit on the validity of cessation clauses in existing agreements i.e. they would expire five years after either: i) the last publication of the full agreement; ii) one of the parties withdraws from the agreement; or iii) one of the parties proposes a revision of the agreement. From 1 September 2014 onwards, the expiry period of these clauses was further reduced from five to three

110. Cabinet Resolution 43/2014 of 27 June 2014.

111. Decree-Law 189/2012 of 22 August.

112. Law 55/2014 of 25 August.

113. Article 563 of Law 99/2003 of 27 August.

114. Article 482 of Law 23/2012 of 25 June.



years.<sup>115,116</sup> It is important to note that the expiry of such clauses does not necessarily imply the expiry of the collective agreement itself.

The reforms also altered the grace period (*sobrevigência*) which kicks in when one of the parties withdraws from a collective agreement. Prior to the reforms, this period could last for as long as the negotiations lasted, or for a minimum of 18 months when no negotiations were taking place. From 1 September 2014 onwards, this grace period was reduced to a minimum of 12 months and a maximum of 18 months.<sup>117</sup>

Finally, if the negotiations ended without new agreement, the old collective agreement would remain valid for another 60 days following the date on which one of the parties informed the relevant ministry (and the other party) of the failure to reach a new agreement (*ultra sobrevivência*). This period was also reduced from 1 September 2014 onwards from 60 to 45 days.<sup>118</sup>

Law 55/2014 of 25 August also envisaged a further reduction of the validity period of cessation clauses to two years and of the grace period to six months, upon positive evaluation by the social partners sitting on the Standing Committee for Social Dialogue (*Comissão Permanente de Concertação Social*) (where positive evaluation involves the consent of at least 50% of the employer organisations and 50% of the trade unions).

## Working-time arrangements

### *Working time accounts*

Portugal introduced a system of working-time accounts with the 2009 Labour Code (*Banco de Horas*) which allowed working time to be extended by four hours per day, but not exceeding a total of 60 hours per week and with a limit of 200 hours per year. Prior to the reform, however, working time accounts could only be set through collective agreements and applied exclusively to the workers covered by those agreements. The new regulations allow the employer to extend the working time accounts agreed as part of a collective agreement to all employees within a certain team, section or unit, as long as 60% of the employees concerned are covered by the collective agreement, or 75% of them agree to it.<sup>119</sup>

The reform also introduced individual working time accounts, which could be set by agreement between an employer and an employee, and which can be obtained by the latter's non-refusal (after two weeks) of a written proposal from the employer. This mechanism allows normal working time to be extended by two hours per day, up to a total of 50 hours per week, and the total increase in working hours cannot exceed 150 hours per year.<sup>120</sup>

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115. In the absence of such clauses, collective agreements remain in force either: i) for the time period specified in the agreement; or ii) if no such time is specified, for one year (and renewable for one more year). Whether such clauses exist or not, collective agreements can also be terminated upon agreement between the signatory parties.

116. Law 55/2014 of 25 August.

117. Law 55/2014 of 25 August.

118. Law 55/2014 of 25 August.

119. Law 23/2012 of 25 June.

120. Law 23/2012 of 25 June.

The working time accumulated through these accounts can be compensated either: by an equivalent reduction in working hours; by an increase in holiday entitlement; or financially (or some mixture of the three).<sup>121</sup>

### ***Short-time work compensation***

A number of changes were also introduced to simplify the procedures required for employers wishing to implement short-time work schemes, such as temporary reductions in working time or temporary lay-offs (*redução temporária do período normal de trabalho ou suspensão do contrato de trabalho*).<sup>122</sup> The notice period for employers to inform workers of the measure to be applied was reduced from ten to five days, with a possibility to implement immediately if the works council (or the majority of workers concerned) agrees. In addition, the workers' representative body can no longer oppose an extension of the short-time work scheme, as long as the employer follows the necessary communication procedures. The reform also put in place some additional measures to protect workers (e.g. to avoid the dismissal of workers immediately following the end of the scheme) and gives them an increase in pay in case they attend a training course during the short-time work period (0.3 x IAS, divided equally between the employer and employee).

### ***Reductions in holiday entitlements***

Four public holidays were abolished by the reforms (from 1 January 2013 onwards), reducing the total number of bank holidays per year from 15 to 11.<sup>123,124</sup> In addition, workers who had not been absent during the previous year, or only had a small number (<3) of justified absences, were previously entitled to 1-3 extra days of annual leave. This entitlement was also revoked by the revision of the Labour Code (again, from 1 January 2013 onwards). The reward for lack of unjustified absences was instead replaced by a punishment for unjustified absence: an unjustified absence on either a Monday, Friday, or immediately preceding or following a public holiday, will now entail the loss of two days of wages. Furthermore, employers can now unilaterally decide to close for business for five consecutive days during Christmas, or for one day between the weekend and a bank holiday which falls on either a Tuesday or Thursday, and take this out of a worker's annual leave entitlement.

## **Wages**

In addition to freezing extensions of collective agreements: i) public sector wages were frozen/cut; ii) the national minimum wage was frozen; and iii) overtime pay and other compensation was reduced.

### ***Public sector wages***

In 2011, the wages of civil servants earning more than EUR 1 500 were cut (by between 3.5% and 10%). The government intended to further cut public sector wages by: i) suspending the 13<sup>th</sup> and 14<sup>th</sup> monthly salary payments for those workers with monthly salaries of EUR 1 100 or more; ii) suspending the equivalent of one of those payments for workers with monthly salaries between EUR 600 and EUR 1 100. However, Portugal's Constitutional Court ruled that these cuts were unconstitutional and

121. Law 23/2012 of 25 June.

122. Law 23/2012 of 25 June.

123. Law 23/2012 of 25 June. The law further specified that this measure will be re-evaluated after a period of five years. The new XXI Constitutional Government has approved plans to re-introduced all four bank holidays from 2016 onwards.

124. Law 23/2012 of 25 June also tried to enforce an equivalent reduction (of up to three days) in the additional holiday entitlements contained in collective agreements and employment contracts signed after 1 December 2003 and prior to 1 August 2012 – but the Constitutional Court rules this to be unconstitutional (Decision no. 602/2013).

that payment of bonuses should be resumed in 2013. These cuts were nevertheless implemented in 2012. In addition, in 2013, the government increased the working hours of public sector workers from 35 to 40 hours per week, without any increase in pay.

Further adjustments to public sector wages were introduced in the 2014 budget. Article 33 of the budget law cuts the total gross pay of public sector employees earning between EUR 675 and EUR 2 000 per month by 2.5% to 12% (progressively), and by 12% for all public sector wages above EUR 2 000. These wage cuts, together with other articles of the Budget Law concerning pensions and unemployment benefits, were ruled unconstitutional by the Portuguese Constitutional Court on 31 May 2014. As this ruling did not apply retroactively, the wage cuts were nonetheless implemented in the first and second quarters of 2014. Other provisions in the Budget Law with an impact on public sector wages, such as a reduction in overtime pay, an uncompensated increase in the weekly hours worked, and a ban on pay increases for promotions or bonuses for public sector managers, were not challenged by the Constitutional Court.

Given that this constitutional ruling had major implications for Portuguese public finances, a new package of austerity measures was introduced in July 2014, which imposed public sector wage cuts of between 3.5% and 10% on wages above EUR 1 500 per month. These cuts would be reversed over a period of four years, with a 20% reduction in the cut programmed in 1 January 2015 and further reductions in the next two years based on budget availability. The austerity measures also specified that the wage cuts had to be entirely reversed within four years. While the Constitutional Court approved the 2014 and 2015 wage cuts in August 2015, it ruled the proposed 2016 wage cuts unconstitutional.

### ***The minimum wage***

The value of the minimum wage was frozen in 2011 and in 2012 and 2013 stood at the level of 2011 (EUR 485). The minimum wage was increased to EUR 505 on 1 October 2014 (and until 31 December 2015). To help employers with existing minimum-wage workers absorb this increase, the government simultaneously announced a temporary decrease of 0.75 percentage points in employer social security contributions on minimum-wage workers who were hired no later than May 2014. This measure would be in place until January 2016.<sup>125</sup>

### ***Compensation for overtime work***

The reform reduced additional compensation for overtime work by half:<sup>126</sup> from 50% to 25% for the first hour of work; and from 75% to 37.5% for every subsequent hour carried out during a normal working day. For overtime work carried out on a weekly rest day or public holiday, additional compensation was reduced from 100% to 50%. In addition, the reform revoked the right of workers who performed overtime work to paid compensatory time off equal to 25% of the number of overtime hours carried out.<sup>127</sup>

Additional compensation for normal work carried out on a bank holiday in a firm not forced to shut on that day was halved from 100% to 50% (and the compensatory time off from work, should the employer opt for this *in lieu* of additional compensation, was reduced from a number of hours equal to the number of overtime hours supplied to half those hours).

In addition, the government suspended for a period of two years all clauses regarding overtime pay and compensatory time off contained in collective agreements and employment contracts signed prior to

125. Decree-Law 154/2014 of 20 October.

126. Law 23/2012 of 25 June.

127. The revision of the Labour Code kept the right to paid compensatory time off (equivalent to the number of hours of overtime carried out) if the overtime: i) impeded the worker from taking 11 hours of daily rest between two working days; or ii) was carried out on a compulsory weekly rest day.

the date on which the new rules entered into force (i.e. 1 August 2012).<sup>128</sup> This suspension was later extended until 31 December 2014.<sup>129</sup>

### Unemployment benefits

On 1 April 2012, a number of changes were introduced to unemployment benefits which aimed to: i) increase access to those benefits; while ii) reducing their generosity (both in terms of their replacement rate and duration).<sup>130</sup>

- Access to unemployment insurance (*subsídio de desemprego*) was increased by easing the employment conditions that a worker needed to satisfy in order to receive the benefit from 450 to 360 days of employment over the past 24 months preceding the unemployment spell. The employment condition for receipt of unemployment assistance (*subsídio social de desemprego*) was maintained at 180 days over the past 12 months.
- The maximum amount of unemployment insurance was reduced from 3 to 2.5 times the social support index (*indexante dos apoios sociais* – IAS)<sup>131</sup> (while it can never, as before, exceed 75% of the average salary over the 12 months period ending 2 months before unemployment).
- A declining replacement rate rule was introduced: after six months (180 days), unemployment insurance would now be reduced by 10% to encourage recipients to actively look for work.
- There was a temporary increase of 10% in the unemployment insurance of households with children where both parents are in receipt of unemployment benefit (equally applicable to single-parent families) – valid between 1 April 2012 and 31 December 2012.<sup>132</sup>
- Maximum benefit duration of unemployment insurance and assistance was cut from 900 to 540 days – although additional increments based on contributory history were maintained, which means that benefit duration for those with a long contribution history (and especially those aged over 50) could exceed this maximum (see Table A2). This new rule was not applicable, however, to the first unemployment spell after the date on which the law entered into force (in which case the old rules would continue to apply). The minimum duration of

128. Law 23/2012 of 25 June also declared void all clauses of collective agreements and employment contracts signed prior to 1 August 2012 and which concern compensatory time off for overtime work carried out on a working day, a complementary weekly rest day, or on a bank holiday. However, the Constitutional Court ruled this change to be against the Constitution (Decision no. 602/2013). Similarly, Law 23/2012 stated that from 1 August 2014 onwards (i.e. two years after the new law entered into force), all additional compensation for overtime work specified in collective agreements and employment contracts would be reduced by half (though not below the rates set by Law 23/2012). Again, however, the Constitutional Court ruled that this change was unconstitutional (Decision no. 602/2013).

129. Law 48-A/2014 of 31 July.

130. Decree-Law 64/2012 of 15 March.

131. Until 2006, welfare benefits in Portugal were determined in relation to the minimum wage. This link meant that increases in the minimum wage had a significant impact on public finances. This is why, in 2007, Portugal introduced the social support index (IAS) to serve as the reference for the determination of welfare benefits. The IAS was initially set at the value of the minimum wage, however it has been frozen at EUR 419.22 since 2009 (with no adjustments for inflation), meaning that it has significantly lost in purchasing power.

132. All unemployment assistance which ran out between 1 January and 31 December 2009 was extended by another six months as a temporary, crisis-related measure (Decree-Law 68/2009 of 20 March).

unemployment spells before and after the reform (without additional increments based on contributory history) are shown graphically in Figure A1.

- The duration of unemployment assistance for those who had already received unemployment insurance was increased for those aged 40 or over. Whereas previously, they would have received unemployment assistance for half the time they had received unemployment insurance for, they would now receive unemployment assistance for the same amount of time (although this was only applicable from the second spell of unemployment after the date on which the new law entered into force).
- In order to incentivise a return to work, the government also introduced a new measure which allows individuals who had: i) been unemployed for at least six months<sup>133</sup> and ii) had at least six months of entitlement to unemployment benefit left,<sup>134</sup> to keep part of their unemployment benefit if they accept a full-time job with earnings lower than the value of their unemployment benefit.<sup>135</sup> The amount that an individual is entitled to keep is calculated in accordance with the following rules: 50% of the individual's unemployment benefit during the first six months of employment (capped at EUR 500 per month); and then 25% of the individual's unemployment benefit for the following six months (capped at EUR 250 per month). The duration of the subsidy cannot exceed the remaining length of time for which the individual is entitled to unemployment benefit, and is capped at 12 months. The measure could initially not be combined with any of the wage subsidies available, although this was later changed.<sup>136,137</sup>

In addition to the above, the government introduced a contributory system of unemployment protection for the self-employed who work mainly with only one contracting entity<sup>138</sup> – i.e. those self-employed receiving at least 80% of their annual income from a single employer. To access the benefit, the individual needs to have exercised his/her dependent self-employment activity (with the necessary contributions) for a minimum of 720 days (24 months) over the 48 months preceding the date of termination of the service agreement. The daily subsidy amount is calculated using the formula  $[(E \times 0.65)/30 \times P]$ , where E is the self-employed income bracket of the worker at the time the service agreement was terminated, and P represents the proportion of the individual's income that originated from that employer – with upper limits identical to those applied to normal unemployment insurance. The duration of the subsidy depends on the age of the beneficiary and is as described in Table A2. The unemployment protection system for these self-employed workers is financed through a 5% tax paid by employers. The system will be evaluated after two years of operation.

133. This was later reduced to three months, with no minimum for individuals aged 45 or over (Ministerial Ordinance 26/2015 of 10 February).

134. This was later reduced to three months (Ministerial Ordinance 26/2015 of 10 February).

135. Ministerial Ordinance 207/2012 of 6 July.

136. Ministerial Ordinance 26/2015 of 10 February.

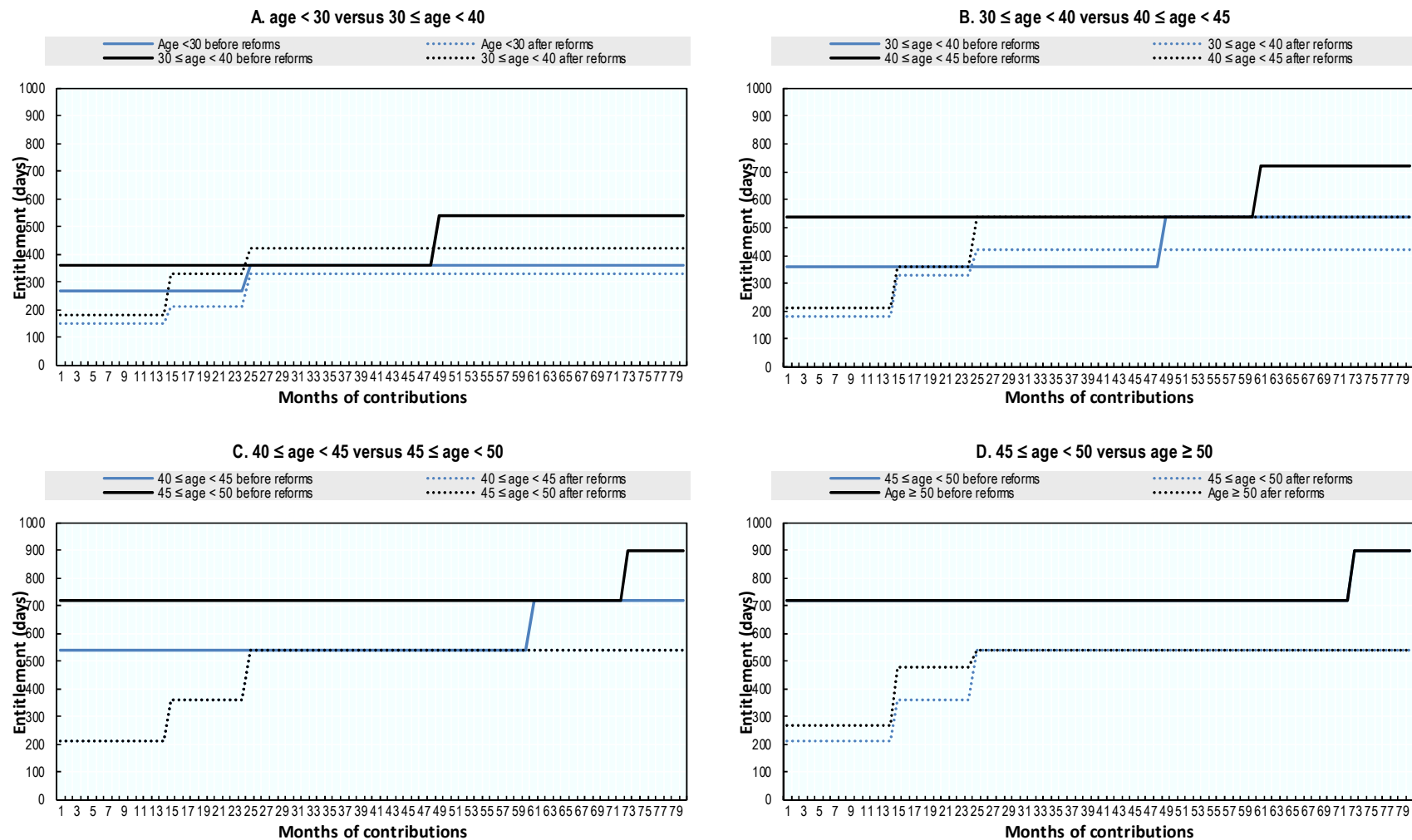
137. Note that it was already possible prior to the reforms to combine part-time work and receipt of unemployment benefits (*subsídio de desemprego parcial*). Unemployment benefit recipients who found part-time work (between 20%-75% of normal full-time working hours) with earnings below their current unemployment benefit were entitled to keep part of their unemployment benefit (calculated as the difference between 1.35 times the unemployment benefit and the part-time earnings) – Decree-Law 220/2006 of 3 November.

138. Decree-Law 65/2012 of 15 March.

Table A2. **Changes in unemployment benefit regulations**

Old rules				New rules			
Age	Contributions (months)	Entitlement (days)	Increment based on contribution history	Age	Contributions (months)	Entitlement (days)	Increment based on contribution history
Age < 30	≤ 24	270		Age < 30	< 15	150	+ 30 days for every 5 years over the past 20 years
	> 24	360	+ 30 days for every 5 years of contributions		15 ≤ x < 24	210	+ 30 days for every 5 years over the past 20 years
					≥ 24	330	+ 30 days for every 5 years over the past 20 years
30 ≤ age < 40	≤ 48	360		30 ≤ age < 40	< 15	180	+ 30 days for every 5 years over the past 20 years
	> 48	540	+ 30 days for every 5 years of contributions over the past 20 years		15 ≤ x < 24	330	+ 30 days for every 5 years over the past 20 years
					≥ 24	420	+ 30 days for every 5 years over the past 20 years
40 ≤ age < 45	≤ 60	540		40 ≤ age < 50	< 15	210	+ 45 days for every 5 years over the past 20 years
	> 60	720	+ 30 days for every 5 years of contributions over the past 20 years		15 ≤ x < 24	360	+ 45 days for every 5 years over the past 20 years
					≥ 24	540	+ 45 days for every 5 years over the past 20 years
Age ≥ 45	≤ 72	720		Age ≥ 50	< 15	270	+ 60 days for every 5 years over the past 20 years
	> 72	900	+ 60 days for every 5 years of contributions over the past 20 years		15 ≤ x < 24	480	+ 60 days for every 5 years over the past 20 years
					≥ 24	540	+ 60 days for every 5 years over the past 20 years

Figure A1. Minimum unemployment duration before and after the reform (without increments based on contributory history)



## Activation

### *Modernisation of the Public Employment Service*

In 2012, the government launched a programme for the modernisation of the Public Employment Service (*Programa de Relançamento do Serviço Público de Emprego*) – see Box A1.<sup>139,140</sup> Many of these measures aimed to strengthen Portugal's activation strategy – in particular the reporting requirements and referrals to active labour market measures of two groups of jobseekers: i) those aged 45+; and ii) those unemployed for six months or over (*convocatórias*).

#### **Box A1. Modernisation of the Public Employment Service: Goals and measures**

The PES modernisation programme aimed to: i) strengthen the employability of jobseekers; ii) better capture existing job opportunities; iii) improve co-operation between stakeholders; iv) modernise information systems; v) adopt a more systematic approach to active labour market policies (ALMPs); vi) improve the coherence between active and passive labour market policies; vii) regularly evaluate the performance of local PES offices; and viii) re-organise the PES network. A series of measures were outlined under each of these objective, as follows:

#### **Strengthening the employability of jobseekers:**

- Referral of jobseekers to either job search assistance or short-term training, within two weeks of registration.
- Priority referral of young jobseekers to job offers, internships or training in the context of the *Iniciativa Oportunidades para a Juventude*.
- PES staff to take up the role of “career manager” accompanying a certain number of jobseekers on an individual and continuous basis.
- More detailed and regularly updated individual action plans (*Plano Pessoal de Emprego*) and profiling.
- Measures to strengthen jobseekers' skills through training programmes.
- Better identification of shortage occupations on the basis of difficult-to-fill vacancies.
- Retraining of jobseekers based on labour market needs.

#### **Better capturing existing job opportunities:**

- Setting up a job-registration mechanism, disseminated via social media, and integrated with an online vacancy database (*Portal NetEmprego*).
- Simplify the procedure for seeking employer authorisation to publish their vacancies on the *Portal NetEmprego* webpage.
- Publicly-available electronic register of all vacancies registered with the PES.

#### **Stakeholder co-operation to place jobseekers:**

- Regular collaboration between Job Centres (*Centros de Emprego*), temporary work agencies, and private employment agencies to improve, among others, information about job vacancies.
- Promote partnerships between Job Centres and employer associations to facilitate the registration and treatment of their members' job vacancies.
- Stronger partnerships with the PES from other countries.

139. Cabinet Resolution No. 20/2012 of 9 March.

140. The Public Employment Service in Portugal is called the *Instituto de Emprego e Formação Profissional* (IEFP).



- Stronger integration with the EURES network.
- Establish partnerships with private employment agencies for placing jobseekers not in receipt of unemployment insurance or assistance.
- Carry out pilot projects based on best practices from around Europe.

**Modernise information systems:**

- Re-design the website (*Portal NetEmprego*).
- Improve the electronic registration of the unemployed, including the possibility to upload individual action plans.
- Implement a system for arranging interviews through e-mail and/or text messages.
- Breathe new life into the *Serviços de Atendimento Interativos* (SAI) [interactive customer service].
- Better matching between jobseekers and vacancies based on the available information.

**A more systematic approach to ALMPs:**

- Classification of ALMPs into five categories: employment incentives and direct job creation; internships; social work; self-employment and entrepreneurship support; training.
- Consolidate ALMPs and clearly define their objectives and the conditions under which they should be administered.
- Train “career managers” in the use of ALMPs.
- External evaluation of the effectiveness of ALMPs.

**Improve the coherence of active and passive labour market policies:**

- Mandatory meetings with PES case workers for unemployment benefit recipients aged 45+ and referral to ALMPs to strengthen their employability and/or promote their return to work.
- Referral of those receiving unemployment benefit for six months or more to active labour market policies.
- Reduce fraud in active job search activities (i.e. benefit recipients who attend job interviews just to fulfil the requirements for continued benefit receipt) through accompanied interviews.
- Enable jobseekers to keep part of their unemployment benefit while accepting full-time job offers.

**Create permanent evaluation mechanisms of local PES offices:**

- Introduce an efficiency rating system of local PES offices.
- Carry out customer satisfaction surveys (particularly among the unemployed).
- Evaluation of placement efforts and control of job search activity.

**Restructure the current network of Job Centres and Vocational Training Centres (*Centros de Formação Profissional*):**

- Merging of Job Centres, creating larger local offices that cover a greater territory.
- Merge Job Centres and Professional Training Centres to form Employment and Professional Training Centres (*Centros de Emprego e de Formação Profissional*).
- Develop a human resources strategy to strengthen resource allocation in local offices.
- Eliminate duplication in tasks between different local offices.

### *Private employment and temporary work agencies*

The government also made it easier to set up private employment and temporary work agencies:<sup>141</sup> prior authorisation is no longer required and was replaced by simple prior communication. The alteration to the law also eliminated the incompatibility between the activities of temporary work and private employment agencies, and the deposit required to set up an agency was cut by half. While there were also plans to allow the PES to contract out some of its activities to private employment agencies, in practice this still has not materialised.

### **Hiring subsidies**

During the crisis period, a number of hiring subsidies were introduced, which were revised on a number of occasions and, eventually, merged into one programme.<sup>142</sup>

### ***Estímulo 2012***

The strengthening of activation measures was accompanied by the introduction of a new hiring subsidy, *Estímulo 2012*,<sup>143</sup> on 14 February 2012, and which was aimed at those who had been (registered) unemployed for at least six consecutive months. The subsidy was payable for a period of six months and was equivalent to 50% of the individual's wage over that period – or as high as 60% in case the person hired: i) was on a permanent contract; ii) was in receipt of income support (*rendimento social de inserção*); iii) was aged 25 or under; iv) had a disability; v) was low-skilled (i.e. had not completed basic education); or vi) was long-term unemployed (12 months or more). However, the overall monthly value could not exceed the IAS. While the subsidy could be combined with social security reductions that the employer was entitled to, it could not be used in combination with other direct employment support for the same position. In return for the subsidy, the employer needed to provide either: i) on-the-job training under the supervision of a specially assigned tutor; or ii) at least 50 hours of training with a certified training provider (during normal working hours). Only employers with at least five employees could apply for the subsidy, except where the employer opted for the second training option. The position offered needed to be full-time and on a contract lasting at least six months. Employers could not cumulate more than 20 subsidies and needed to prove that the subsidy was leading to net employment creation within the firm. In case the employer breached any of the conditions of the subsidy, it would need to be refunded (at least in part).

141. Law 5/2014 of 12 February.

142. Prior to the introduction of these new hiring subsidies, a programme (*Incentivos à Contratação*) was already in place which offered a temporary exemption from social security contributions for a period of up to three years as well as financial support for employers who hired an individual who was either long-term unemployed (one year or over) or a first-time jobseeker (aged 16-30). 100% of the social security contributions were exempted in case of a permanent contract, reduced to 50% in case of a temporary contract. In case of permanent contracts, employers were also entitled to financial support equal to 12 times the minimum wage applicable for that activity (Decree-Law 89/1995 of 6 May). This programme has been changed a number of times since its introduction. Currently, the programme consists in an exemption from employer social security contributions for the duration of three years (or of the contract, whichever is shorter) for employers who hire, on an open-ended contract, an individual who was either long-term or first-time jobseeker.

143. Ministerial Ordinance No. 45/2012 of 13 February.

### ***Estímulo 2013***

On 14 April 2013, a revised programme (*Estímulo 2013*) replaced *Estímulo 2012*.<sup>144</sup> The coverage of the programme was extended to a larger group of potential beneficiaries. In particular, those who had been unemployed for three consecutive months could now also benefit from the programme if they fulfilled one of the following conditions: i) they were low-skilled (i.e. had not completed basic education); ii) they were aged 45 or over; iii) they were single parents; iv) they lived in a workless household. In addition, those who had not been registered with social security (and were not studying) – i.e. inactive – for the past 12 months were now also eligible. The higher value of the subsidy (i.e. 60% of wages instead of 50%) was now also paid in case the hired worker was aged 50 or over, or in case his/her gender was under-represented in the particular sector of activity of the employer. Additional incentives were put in place to encourage employers to either offer a permanent contract to start with or convert a subsidised temporary contract into a permanent one. In the first case, the subsidy was awarded for a period of 18 months (instead of six) and the maximum monthly value of the subsidy could be 1.3 x IAS. In the second case, a conversion reward equivalent to an additional nine months (capped at nine times the IAS) would be paid. Some additional, smaller changes included: i) an upper limit of 25 subsidies per employer in the case of fixed-term contracts, and no upper limit in the case of open-ended contracts; ii) external training did not necessarily have to be carried out during working hours (although there then needed to be an equivalent reduction in working hours); and iii) the subsidy could now also be paid (proportionately) to part-time workers.

### ***Apoio à Contratação via Reembolso da TSU***

In the context of *Impulso Jovem*, the government launched the *Apoio à Contratação via Reembolso da TSU*<sup>145</sup> – a reduction in social security contributions targeted at long-term unemployed (12 months or more) youth (aged 18-30). These youth could be hired either on a permanent or on a temporary contract of at least 18 months. The subsidy, payable for 18 months, consisted in: a 100% waiver of the Single Social Tax (Taxa Social Única) in case of a young person hired on a permanent contract; and a 75% waiver in case the contract was temporary. Employers could not benefit from more than 20 subsidies. The maximum value of the reimbursement could not exceed EUR 175 per month. This measure could be used in combination with *Estímulo 2012*. The programme was launched on 4 August 2012. As with the *Estímulo* programme, there was a requirement of net job creation by the employer.

The programme was reviewed on 14 February 2013.<sup>146</sup> One of the most important changes was the extension of the coverage of the programme to include: i) young people unemployed for at least six months (instead of the previous 12 months); and ii) young people who had been inactive (but not studying) since leaving school and for at least 12 months. The programme was also extended to part-time contracts.

### ***Apoio à contratação de desempregados com idade igual ou superior a 45 anos via reembolso da TSU***

In February 2013, an *Apoio à Contratação via Reembolso da TSU* was created for unemployed individuals aged 45 or over.<sup>147</sup> The programme was virtually identical to the one for young people, except that the maximum value of the reimbursement was higher (EUR 200 per month instead of EUR 175).

144. Ministerial Ordinance 106/2013 of 14 March.

145. Ministerial Ordinance 229/2012 of 3 August.

146. Ministerial Ordinance 65-A/2013 of 13 February.

147. Ministerial Ordinance 3-A/2013 of 4 January, and revised by Ministerial Ordinance 97/2013 of 4 March.

### ***Apoio à contratação via Reembolso da TSU***

From July 2013 onwards, the two hiring incentives through reductions in social security contributions (*Apoio à Contratação via Reembolso da TSU* and *Apoio à contratação de desempregados com idade igual ou superior a 45 anos via reembolso da TSU*) were merged into one programme: *Apoio à contratação via Reembolso da TSU*.<sup>148</sup> There is no longer a minimum period of unemployment necessary for individuals to become eligible for the programme, and the maximum amount of the reimbursement has been equalised across all target groups (EUR 200). In addition, the programme has been extended to individuals aged 31 to 44 as long as they fulfil one of the following criteria: i) they are low-skilled (i.e. have not completed basic education); ii) they are single parents; or iii) they are in a workless household.

### ***Medida Estímulo Emprego***

All hiring subsidies cited above were merged into one programme, *Medida Estímulo Emprego*, from 25 July 2014 onwards.<sup>149</sup> In their current state, these subsidies have the following characteristics:

- Eligible individuals are those unemployed registered with the PES and who fulfil one of the following conditions:
  - Are in receipt of unemployment benefit
  - Are in receipt of income support
  - Have been unemployed for at least 60 consecutive days (in case of the unemployed aged 30 and under, or 45 and over), or inactive for the past 12 months
  - Have been unemployed for at least six consecutive months
  - Are living in a workless household
  - Are single parents
  - Have a disability
  - Are either a victim of domestic violence; or ex-convicts; or re-habilitated drug users
- Conditions on employers:
  - Offer a contract (full- or part-time; permanent or temporary, but of at least six months)
  - Generate net employment creation
  - Provide training during the period of the subsidy, either i) work-based under the supervision of a specially assigned tutor, or ii) externally in a certified training agency and for at least 50 hours
  - The person hired on a subsidy cannot have worked for the employer for the past 24 months
  - Cannot take on more than 25 subsidised workers on temporary contracts (but no limit on open-ended contracts)
- Value of the subsidy:
  - For temporary contracts: 80% of the IAS x (number of full months of the contract) / 2, capped at 80% of the IAS x 6. The 80% is replaced by 100% for the unemployed who are:

148. Ministerial Ordinance 204-A/2013 of 18 June.

149. Ministerial Ordinance 149-A/2014 of 24 July.

- ❖ Long-term unemployed (12 months or over)
  - ❖ Young (<30)
  - ❖ 45 or over
  - ❖ In receipt of unemployment benefit
  - ❖ Single parents
  - ❖ Living in a workless household
  - ❖ Either victims of domestic violence; or ex-convicts; or re-habilitated drug users
  - ❖ Have a disability
  - ❖ In receipt of income support
- For open-ended contracts:  $110\% \times \text{IAS} \times 12$
  - In case of part-time contracts, the subsidy is calculated proportionally (on the assumption of a standard week of 40 hours)
  - In case a subsidised temporary contract is converted to a permanent one, the employer is entitled to the 6 x IAS paid at the percentage previously applicable (80% or 100%).

Table A3 summarises the main changes to these hiring subsidised over the past few years.

More recently, Ministerial Ordinance 84/2015 of 20 March introduced a new, financial incentive for the “Promotion of Gender Equality in the Labour Market” which consists in an increase in the value of the *Estímulo Emprego* of 20% (for a temporary contract) or 30% (in case of a permanent contract or conversion) in case the employer hires a worker from a sex that is under-represented in that particular profession (i.e. represents less than a third of all workers in that profession).

Table A3. Changes to hiring subsidies introduced during the crisis

	Estímulo 2012	Estímulo 2013	Estímulo Emprego
Date of introduction	14 February 2012	14 April 2013	25 July 2014
Legal text	Ministerial Ordinance No. 45/2012 of 13 February	Ministerial Ordinance 106/2013 of 14 March	Ministerial Ordinance 149-A/2014 of 24 July
Eligibility	unemployed 6+ months	unemployed 6+ months <b>unemployed 3+ months IF:</b> • no basic education • aged 45+ • workless household inactive past 12 months	unemployed (XXX)
Duration	6 months	6 months	6 months
Value	50% of wage 60% if: • on permanent contract • in receipt of income support • age <25 • disability • no basic education • long-term unemployed MAX 1x IAS	50% of wage 60% if: • on permanent contract • in receipt of income support • age <25 • disability • no basic education • long-term unemployed • age 50+ • under-represented gender MAX 1x IAS	0.8 x IAS x months/2 (capped at 0.8 x IAS x 6) if temporary contract 1.0 x IAS x months/2 (capped at 0.8 x IAS x 6) if temporary contract AND: • Long-term unemployed • Age <30 • Age 45+ • In receipt of unemployment benefit • Workless household • Victims of domestic violence; or ex-convicts; or re-habilitated drug users • In receipt of income support
Bonus for permanent contract		18 months subsidy MAX 1.3x IAS	1.1 x IAS x 12
Bonus for conversion to permanent contract		+ 9 months MAX 1x IAS	0.8 (or 1.0) x 6 x IAS (depending on previous situation)

	Apoio à Contratação via Reembolso da TSU	Apoio à Contratação via Reembolso da TSU	Apoio à Contratação via Reembolso da TSU
Date of introduction	4 August 2012	14 February 2013	18 July 2013
Legal text	Ministerial Ordinance 229/2012 of 3 August	Ministerial Ordinance 65-A/2013 of 13 February	Ministerial Ordinance 204-A/2013 of 18 June
Eligibility	Age 18-30 & long-term unemployed (≥ 12 months)	Age 18-30 and unemployed (≥ 6 months) <b>Age 18-30 and inactive (≥ 12 months)</b>	Age 18-30 and unemployed (XXX) Age 45+ and unemployed (XXX) <b>Age 31-44 IF:</b> • no basic education • workless household
Duration	18 months	18 months	18 months
Value	100% waiver of the Single Social Tax (Taxa Social Única) if hired on a permanent contract 75% waiver if hired on a temporary contract MAX EUR 175 per month	100% waiver of the Single Social Tax (Taxa Social Única) if hired on a permanent contract 75% waiver if hired on a temporary contract MAX EUR 175 per month	100% waiver of the Single Social Tax (Taxa Social Única) if hired on a permanent contract 75% waiver if hired on a temporary contract MAX EUR 200 per month

	Apoio à Contratação via Reembolso da TSU 45+
Date of introduction	4 February 2013
Legal text	Ministerial Ordinance 3-A/2013 of 4 January Ministerial Ordinance 97/2013 of 4 March
Eligibility	<b>Age 45+ and unemployed (≥ 6 months)</b> <b>Age 45+ and inactive (≥ 12 months)</b>
Duration	6-18 months
Value	100% waiver of the Single Social Tax (Taxa Social Única) if hired on a permanent contract 75% waiver if hired on a temporary contract MAX EUR 200 per month

## Subsidised internships

In addition to the hiring subsidies, the government introduced a number of new subsidised internship programmes, or changed existing ones.

### *Programa de Estágios Profissionais*

In February 2011, the subsidised internship programme (*Estágios Profissionais*)<sup>150</sup> was revised. It became targeted at: i) young people (aged 30 or under) who had completed levels 4, 5, 6, 7 or 8 of the National Qualifications Framework (QNQ); or ii) people aged 30+ who had been inactive for the past 12 months and who had completed levels 2, 3, 4, 5, 6, 7 or 8 of the QNQ less than three years ago; or iii) people with disabilities, regardless of their age. Internships lasted nine months and the intern was given a bursary commensurate with his/her level of education: 1 x IAS for those with level 2 of the QNQ; 1.2 x IAS for those with level 3; 1.3 x IAS for those with level 4; 1.4 x IAS for those with level 5; and 1.65 x IAS for those with levels 6, 7 or 8. The intern was also entitled to a food allowance. These costs were partially covered by the PES as follows: 75% for employers with fewer than ten employees; 65% for employers with between ten and 250 employees; and 40% for employers with more than 250 employees. The PES covered an additional 10% in case the intern had a disability. The employer remained responsible for the payment of taxes and social security contributions. Employers who, over a period of two years, had not absorbed at least one third of their interns into their regular workforce were not entitled to any further internships for a period of one year. In January 2013,<sup>151</sup> the *Estágios Profissionais* were extended to the unemployed who were either single parents or part of a workless household, irrespective of their age, and the PES covered 100% of the bursaries paid to these interns.

### *Passaportes Emprego*

Against the backdrop of the strategic plan to tackle youth unemployment, *Impulso Jovem*, launched in June 2012, the government set out the details of one of its measures, the *Passaportes Emprego*, in July 2012.<sup>152</sup> The *Passaportes Emprego* were a set of subsidised internship programmes aimed at youth (primarily aged between 18 and 30) who had been unemployed for at least four months. They lasted for a period of six months and needed to take place in one of the disadvantaged regions of Portugal.<sup>153</sup> Employers needed to provide training of at least 50 hours through a certified training centre, and needed to pay the intern a bursary commensurate with his/her level of education: 1.65 x IAS for those who had completed tertiary education; 1.25 x IAS for those who had completed at least secondary education; 1 x IAS for those who had not completed secondary education. In addition, the employer was expected to pay a food allowance and transport expenses. The PES would cover some (or all) of these expenses: 100% for the first intern if the employer had ten or fewer employees and 70% for the second; 70% also in case the employer had more than ten employees. In case the internship was converted into an open-ended contract, the employer would receive a reward equal to six times the monthly value of the bursary.<sup>154</sup>

150. Ministerial Ordinance 92/2011 of 28 February.

151. Ministerial Ordinance 3-B/2013 of 4 January.

152. Ministerial Ordinance 225-A/2012 of 31 July.

153. This geographical restriction was due to the fact that the measures included in the *Impulso Jovem* were financed by the European Social Fund. In reality, the *Passaportes Emprego* were also implemented in Lisbon, financed through the PES budget.

154. It is important to note that the *Passaporte Emprego* has a number of variations depending on the specific target group, and not all of these have been described here. For more detail, the reader is therefore referred directly to the Ministerial Ordinance itself.

### *Harmonisation between Passaportes Emprego and the Estágios Profissionais*

In February<sup>155</sup> and March<sup>156</sup> 2013 the *Passaportes Emprego* and the *Estágios Profissionais* were more closely aligned with one another. Whereas the *Passaportes Emprego* would be aimed primarily at unemployed youth aged 18-25, the *Estágios Profissionais* would cover the unemployed aged 25-30 as well those aged 30+ if they have been inactive for the past year and obtained their qualification less than three years ago; or if they were single parents, living in a workless household, or had a disability. The duration of both programmes was increased to 12 months and the value of the bursaries were homogenised: 1 x IAS for those with level 2 of the QNQ; 1.2 x IAS for those with level 3; 1.3 x IAS for those with level 4; 1.4 x IAS for those with level 5; and 1.65 x IAS for those with levels 6, 7 or 8. The *Passaportes Emprego* were also extended to the whole of Portugal (being previously restricted to economically disadvantaged areas), the minimum unemployment spell durations for eligibility for the programme were eliminated, and the definition of training to be provided to the intern was broadened (it could now also be work-based).<sup>157</sup> Finally, the contributions of the PES for both programmes were revised as follows: 100% of the bursary for the first intern for employers with fewer than ten employees; 80% of the bursary for interns hired by employers with more than ten employees (as well as from the 2<sup>nd</sup> intern onwards in the case of employers with fewer than ten employees). In the case of the *Estágios Profissionais*, an additional 10% would be covered if the intern has a disability. In the case of the *Passaportes Emprego*, the employer would still be offered a financial reward if the internship was converted into an open-ended contract.

### *Estágios Emprego*

*Passaportes Emprego* and *Estágios Profissionais* were replaced by *Estágios Emprego* from 18 July 2013 onwards.<sup>158</sup> The programme is aimed primarily at: i) youth aged 18-30 who are unemployed and registered with the Public Employment Service, and who hold a qualification of level 2-8 of the QNQ; as well as ii) those aged over 30 who are registered with the Public Employment Service, have completed a qualification of level 2-8 of the QNQ in the past three years, and have no social security record for the past 12 months. Individuals with a disability, those living in a workless household, and victims of domestic violence are also eligible, regardless of age and qualifications held. Internships last for a period of 12 months and interns are paid a bursary commensurate with their level of education (1 x IAS for those with level 2 of the QNQ; 1.2 x IAS for those with level 3; 1.3 x IAS for those with level 4; 1.4 x IAS for those with level 5; and 1.65 x IAS for those with levels 6, 7 or 8). 100% of this bursary is covered by the PES for first interns in firms with ten employees or less, and who are hired prior to 31 December 2014. In all other cases, 80% of the bursary is covered by the PES (increased to 90% if the intern has a disability).

### **REATIVAR**

Ministerial Ordinance 86/2015 of 20 March introduces a new internship of six months (REATIVAR) aimed at the long-term unemployed aged over 30. The bursary received during the internship is in line with those of the *Estágios Emprego* covered by the PES: i) for 80% in the case of non-profit legal entities and for the first intern with an employer who has fewer than ten employees; ii) for 65% in all other circumstance. An additional 15% are covered in case the intern fulfils one of the following criteria: has

155. Ministerial Ordinance 65-B/2013 of 13 February.

156. Ministerial Ordinance 120/2013 of 26 March.

157. Note that there is no training requirement in the case of the *Estágios Profissionais*.

158. Decree 204-B/2013 of 18 June, as changed by Decree 375/2013 of 27 December and Decree 20/2014 of 30 January.



been unemployed for at least two years; is older than 45; has a disability; is a single parent; lives in a jobless household; is a victim of domestic violence; is an ex-convict; or is an ex-drug user in rehabilitation.

### ***Contratos Emprego-Inserção***

In place since 2009,<sup>159</sup> the Contrato Emprego-Inserção and Contrato Emprego-Inserção+ are subsidised internship programmes that aim to improve the socio-professional skills of disadvantaged unemployed individuals through a subsidised internship doing socially useful work. These internships can last up to 12 months and were initially aimed at the unemployed: with disabilities, aged 55+, who are ex-convicts, or who have been out of a job for more than a year (i.e. the long-term unemployed). There are two types of contract: the Contrato Emprego-Inserção is aimed at those who are in receipt of unemployment benefits; and the Contrato Emprego-Inserção+ is aimed at those receiving the guaranteed minimum income benefit (*rendimento social de inserção*).<sup>160</sup> Those in receipt of unemployment insurance receive a top-up equivalent to 20% of their unemployment benefits, while those in receipt of unemployment assistance receive a top-up equivalent to 20% of the IAS. In both these cases, and for private, not-for-profit organisations, the PES would cover 50% of these costs. Finally, those in receipt of just guaranteed minimum income benefit would receive a bursary equal to the IAS, covered 90% by the IEFP if the host institution is a private, not-for-profit organisation, and 80% if the host is a public entity (increased by an additional 10 percentage points in case the intern has a disability).

During the crisis, a few small changes were introduced to these programmes, primarily aimed at widening access to them:

- 1 June 2010: priority for participation in the programme is given to unemployed individuals whose income is equal or less than the minimum wage.<sup>161</sup>
- 19 April 2011: the bursary for unemployment insurance recipients is capped at 20% of the IAS.<sup>162</sup>
- 1 January 2014: prioritised groups now include those aged 45+ (as opposed to 55+); and the Contrato Emprego-Inserção+ is extended to those who do not receive either unemployment or guaranteed minimum income benefits, and who fulfil one of the following conditions: are long-term unemployed; or live in a workless household.<sup>163</sup>
- 31 January 2014: victims of domestic violence are included in the priority target group and, in case the individual receives unemployment benefit and is disabled, the PES covers 100% of the costs.<sup>164</sup>

### **Training programmes**

Two new, short-duration training programmes were introduced in 2013: *formação transversal* (a 25-hours training programme aimed at improving personal, communication, entrepreneurial and job search skills) and *Vida Ativa*.

159. Decree 128/2009 of 30 January.

160. Those that are simultaneously in receipt of unemployment benefits and the guaranteed minimum income benefit are eligible for the *Contrato Emprego-Inserção*.

161. Decree 294/2010 of 31 May.

162. Decree 164/2011 of 18 April.

163. Decree 378-H/2013 of 31 December.

164. Decree 20-B/2014 of 30 January.

## ***Formação transversal***

*Formação Transversal – Ativação e Técnicas de Procura de Emprego* is a short module (25 hours) provided by the Public Employment Service which aims to boost the employability of job seekers by developing their personal, communication and job search skills.

## ***Vida Ativa***

*Vida Ativa*<sup>165</sup> is targeted at: those who have been unemployed for six months or more; low-skilled unemployed (whose qualifications are below levels 1 or 2 of the QNQ); and those in jobless households. The intervention consists of part-time, short, modular training courses (lasting between 25 and 300 hours) during which the participant is expected to continue actively looking for work. Where possible, these training courses are supplemented with practical, work-based training for a period of 3-6 months (extended exceptionally to a period of 12 months). Where appropriate, the intervention may consist instead in the validation of existing skills. Participation in *Vida Ativa* should start no later than three months after registration with the Public Employment Service.

## **Youth**

### ***Impulso Jovem***

In June 2012,<sup>166</sup> the government launches its strategic plan to tackle youth unemployment, *Impulso Jovem* (which would later turn into the Youth Guarantee), built on four pillars: internships (*Estágios Emprego*), hiring incentives (*Apoios à Contratação*), vocational training (*Formação Profissional*) and entrepreneurship support (*Empreendedorismo*). More specifically, the measures announced as part of this plan include:

- *Passaporte Emprego*: internships for unemployed youth, combined with a hiring incentive should the employer subsequently hire the young person on an open-ended contract.
- Incentives for hiring long-term unemployed youth through reductions in social security contributions.
- *Passaporte para o Empreendedorismo* and *Portugal Empreendedor*: covering a range of interventions to promote youth entrepreneurship and firms hiring highly-skilled youth who have been unemployed for four months or more.
- *COOP Jovem*: supporting the creation of co-operatives through direct financial support to each worker aged between 18 and 30 years, and who have completed the first cycle of basic education.
- Development of a national microcredit programme which provides technical support and training of the entrepreneur during the first years of operation, giving priority to individuals aged between 16 and 34 and who have been registered as unemployed for at least four months.<sup>167</sup>
- Investment support, including a component to facilitate access to finance for small- and medium-sized enterprises.

165. Decree 203/2013 of 17 June.

166. Cabinet Resolution 51-A/2012 of 14 June.

167. The microcredit programme already existed (Ministerial Ordinance 985/2009 of 4 September). The Ministerial Ordinance 95/2012 of 4 April amended it to give priority to those aged 16-34 enrolled as unemployed in the PES for at least four months (the target group of the first edition of the *Impulso Jovem*).

One year later, the strategic plan was revised in an attempt to rationalise and simplify the various policy instruments.<sup>168</sup> In particular, with respect to hiring incentives, the link was made with *Estímulo 2013* and the *Apoio à Contratação via Reembolso da TSU*.

### ***Youth Guarantee***

At the end of 2013, the Portuguese Government announced the *Youth Guarantee*, which encompasses all measures cited above aimed at young people, as well as others.<sup>169</sup>

### ***Emprego Jovem Ativo***

The programme *Emprego Jovem Ativo* was introduced in September 2014<sup>170</sup> and is a six-months-long work experience/group apprenticeship programme which involves a co-ordinator, a highly-skilled unemployed youth (with a university degree) as well as 2-3 low-skilled unemployed youths (who have not completed basic education). Participants need to be aged between 18 and 29 and registered with the Public Employment Service. For low-skilled youth, the programme provides an opportunity to acquire a range of professional as well as soft skills. For high-skilled youth, the programme aims to provide an opportunity to gain management skills. For the duration of the programme, participants receive a monthly bursary (0.7 x IAS for low-skilled youths and 1.3 x IAS for high-skilled youths), covered entirely by the PES and there is no need for employers to contribute to social security.

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168. Cabinet Resolution 36/2013 of 4 June.

169. Cabinet Resolution 104/2013 of 31 December.

170. Ministerial Ordinance 150-2014 of 30 July.

## ANNEX B

### TIMELINE OF REFORMS

2011 January	1 January - increase in the MW from EUR 475 to EUR 485
February	
March	
April	
May	17 May - Government signs the Memorandum with the Troika
June	
July	
August	
September	
October	
November	1st reduction in severance pay (cut-off: 1 November) - Law 53/2011 of 14 October
December	
2012 January	11 January - first exceptional extension of temporary contracts - Law 3/2012 of 10 January (applying to contracts expiring by the end of June 2013)
February	14 February - Launch of Estímulo 2012 hiring subsidy - Ministerial Ordinance No. 45/2012 of 13 February
March	Launch of the Modernisation of the Public Employment Service - Cabinet Resolution No. 20/2012 of 9 March
April	1 April - changes to unemployment benefits - Decree-Law 64/2012 of 15 March
May	
June	
July	1 July - introduction of a contributory system of unemployment protection for the dependent self-employed - Decree-Law 65/2012 of 15 March
August	1 August - Changes in reasons for dismissal - Law 23/2012 of 25 June 1 August - Extension of duration of contracts of very short duration Reduction in compensation for overtime - Law 23/2012 of 25 June Speeding up the procedures for implementing short-time working arrangements 4 August - Launch of Apoio à Contratação via Reembolso da TSU subsidy - Ministerial Ordinance 229/2012 of 3 August 5 August - UB recipients can keep part of their unemployment benefit if they accept a low-paid job - Decree-Law 207/2012 of 6 July
September	
October	
November	2nd reduction in severance pay (cut-off: 1 November) - Law 23/2012 of 25 June 1 November - introduction of criteria for the extension of collective bargaining agreements - Cabinet Resolution 90/2012 of 31 October 2012
December	
2013 January	
February	14 February - revision of Apoio à Contratação via Reembolso da TSU - Ministerial Ordinance 65-A/2013 of 13 February 14 February - launch of Apoio à contratação de desempregados com idade igual ou superior a 45 anos via reembolso da TSU - Ministerial Ordinance 3-A/2013 of 4 January
March	
April	15 April - Introduction of Estímulo 2013 - 106/2013 of 14 March
May	
June	
July	18 July - Apoio à contratação via Reembolso da TSU - Ministerial Ordinance 204-A/2013 of 18 June
August	1 August - workers' councils in firms with at least 150 employees can negotiate plant-level agreements - Decree-Law 189/2012 of 22 August
September	Constitutional Court rules unconstitutional the new criteria for selecting workers to be dismissed in case of extinction of a work post - Decision nº 602/2013 of 20 September 2013 Constitutional Court rules unconstitutional the removal of the requirement to find another suitable job for a worker before being dismissed - Decision nº 602/2013 of 20 September 2013 1 September - strengthened enforcement of laws around dependent self-employment - Law 63/2013 of 27 August
October	3rd reduction in severance pay (cut-off: 1 October) - Law 69/2013 of 30 August Introduction of dismissal funds - Law 70/2013 of 30 August Incentivo Emprego - Ordinance nº 286-A/2013 of 16 September
November	8 November - second exceptional extension of temporary contracts - Law 76/2013 of 7 November (applying to contracts expiring 7 November 2015)
December	
2014 January	
February	Relaxation of rules to set up private employment and temporary work agencies - Law 5/2014 of 12 February
March	
April	
May	
June	Re-revised criteria for selecting worker to be dismissed in case of extinction of a work post - Law 27/2014 of 8 May Reintroduction of requirement to find another suitable job for a worker before being dismissed - Law 27/2014 of 8 May Criteria for the extension of collective bargaining agreements revised - Cabinet Resolution 43/2014 of 27 June 2014
July	25 July - Medida Estímulo Emprego - Ministerial Ordinance 204-A/2013 of 18 June - Ministerial Ordinance 149-A/2014 of 24 July
August	
September	1 September - validity period of cessation clauses in collective bargaining agreements reduced - Law 55/2014 of 25 August 1 September - introduction of possibility to temporarily suspend collective agreements in times of crisis - Law 55/2014 of 25 August
October	1 October - increase in the MW from EUR 485 to EUR 505 1 October - Temporary decrease of 0.75 percentage points in employer social security contributions on minimum-wage workers who were hired no later than May 2014
November	
December	
2015 January	
February	
March	21 March: introduction of a financial incentive for the "Promotion of Gender Equality in the Labour Market" - Decree 84/2015 of 20 March 21 March: introduction of financial support to promote geographical mobility - Decree 85/2015 of 20 March 21 March: introduction of REATIVAR - Decree 86/2015 of 20 March
April	
May	
June	
July	
August	
September	
October	Revision of dismissal funds (limit contributions to 50% of SP) - Decree-Law 210/2015 of 25 September
November	
December	

## ANNEX C

### THE IMPACT OF SEVERANCE PAY REFORMS IN PORTUGAL ON ON-THE-JOB SEARCH AND WORKER FLOWS

#### Introduction

As part of the labour market reforms, Portugal significantly reduced the severance pay entitlements of workers (and of new hires in particular – see Chapter 1 and Annex A for further detail). The primary objective of these reforms was to encourage a more efficient re-allocation of labour resources. With lower severance pay entitlements, workers might be less reluctant to switch jobs, resulting in increased on-the-job search and job-to-job flows. For employers, lower severance pay could increase both hiring and firing rates. However, as a result of grandfathering<sup>171</sup>, accumulated severance pay entitlements were preserved by the reform. One would therefore expect the largest (short-run) effects of the reform to be on hiring only (and possibly on the firing/job-to-job moves of new hires). In addition, because the reduction in severance pay was larger for permanent than for temporary contracts, one might expect to see an increase in the share of hiring that is on permanent contracts. At the same time, it is important to remember that severance pay was cut for both types of contract, and so the reform should have encouraged hiring on temporary as well as on permanent contracts.

Table C1 shows the implications of the reforms in terms of the average severance pay entitlements of existing and new workers, respectively, as well as by type of contract. For each of these breakdowns, the table shows three different severance pay estimates:

1. What severance pay would have been like under the old rules (“old”);
2. Actual severance pay the worker is currently entitled to (“actual”); and
3. What severance pay would be like if the new rules applied fully – i.e. without any grandfathering (“new”).

Box C1 provides further detail on how these severance pay indicators are derived, and some of the assumptions that needed to be made in the process.

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171. Grandfathering refers to the exemption of some individuals from a new regulation that prohibits or restricts something. In the present case, many of the new severance pay rules applied to new hires only, and not to existing workers.

### Box C1. Construction of the severance pay variables for the analysis

Quarterly European Labour Force Survey (EU-LFS) data on start date, contract type and duration of temporary contracts were used to calculate the number of months of severance pay each individual is entitled to under the current/actual rules, as well as what they would be entitled to under the old and new rules, respectively. As the EU-LFS does not contain information on wages, the rules concerning the maximum base wage for the calculation of the severance pay entitlement (i.e. 20 times the minimum wage) could not be taken into account (although severance pay was still capped at 12 months). Given that only a very small fraction of employees have wages higher than 20 times the minimum wage, the severance pay calculation will not be strongly affected by this simplification.

The same methodology was applied to the annual *Quadros de Pessoal* (QP) data, which have the advantage that the exact survey and starting dates are known, making the calculation more precise. However, the QP data contain no information on the duration of temporary contracts, which made it necessary to assume that all temporary workers had contracts of less than six months.

Table C1 confirms that the first reform (1 November 2011) had no impact on the actual severance pay entitlements of existing workers, but did change the entitlements of newly hired workers substantially compared to what they would have received under the old rules (primarily as a result of the removal of the 3-month minimum severance pay entitlement). While the second reform (1 November 2012) did not change anything else for new hires, it lowered the rate at which severance pay entitlements of existing workers would be accumulated, and also introduced a cap. This explains the small drop in actual severance pay of existing workers compared to what they would have received under the old rules. Finally, the third reform (1 October 2013) had an impact on both new and existing workers by further reducing the rate at which severance pay would be accumulated. For existing workers, this led to another small reduction in average severance pay. For new hires, the average after the third reform is much lower than that observed after the previous two reforms because it reflects severance pay accumulated over a maximum of three months only.<sup>172</sup>

Table C1. **Average severance pay entitlements (number of days) after each reform, by type of worker and contract type: Old, new and actual rules**

		Permanent contracts			Temporary contracts		
		1 <sup>st</sup> reform	2 <sup>nd</sup> reform	3 <sup>rd</sup> reform	1 <sup>st</sup> reform	2 <sup>nd</sup> reform	3 <sup>rd</sup> reform
Existing employees	Old	363.93	371.26	365.14	73.92	76.5	60.65
	Actual	363.93	361.04	342.97	73.92	60.57	44.21
	New	202.97	207.08	140.58	53.15	53.79	38.62
New hires	Old	90	90	90	7.39	6.45	1.44
	Actual	5.60	5.01	0.35	4.46	4.01	0.83
	New	5.60	5.01	0.35	4.46	4.01	0.83

*Note:* Estimates are based on the European Labour Force Survey Q1 2011-Q4 2013. The averages in each column are calculated based on all individuals observed after the relevant reform, but before the next reform (or end of sample). For example, for the calculation of the values of the second reform, all individuals surveyed over the period 11/2012 to 9/2013 are included. New hires are defined as workers with tenure shorter than three months.

*Source:* OECD analysis based on the EU-LFS.

172. This is because the data used for these estimates stop in Q4 2013. Note that this will not matter for the regressions that are run later in this section because the explanatory variable used measures the percentage difference with what an individual would have received under the old rules (which will be equally low).

This annex presents some initial evidence on the impact that these changes in severance pay might have had on on-the-job search and worker flows. The results obtained here need to be interpreted with care because: i) the reforms were implemented very recently and their full impact on the labour market might not be observable yet; ii) the nature of the reforms means that it was not possible to identify clear treatment and control groups, and therefore the causality of the observed effects cannot be established with full certainty. That being said, three separate approaches are presented below, and the findings are surprisingly consistent with one another (as well as robust to a falsification exercise): the severance pay reforms appear to have had only a small effect on firing (which appears to be concentrated on new hires only); a positive effect on hiring (although this finding is less robust to the falsification test); and a positive effect on the share of hiring that is permanent. All these effects appear larger for small firms (with fewer than 50 employees). The estimates also suggest that workers most affected by the reforms are more likely to be engaged in on-the-job search. At the same time, there is some indication that workers in firms most affected by the reforms experienced lower wage growth. Overall, these results indicate that the reforms of severance pay in Portugal were beneficial for both worker reallocation and labour market duality. However, the findings are only preliminary and further research will be required to confirm them.

### **The impact of the severance pay reforms on on-the-job search and worker flows: Evidence from the European Labour Force Survey**

Table C1 summarised the estimated effects of the new severance pay rules on the average entitlements of different types of worker (existing employees and new hires) as well as by type of contract. The basic idea behind the analysis in this section is to exploit variation in the depth of these reforms (i.e. the percentage difference between the old and actual/new severance pay) and estimate its impact on the labour market outcomes of different individuals/occupations. For example, one would expect to observe a higher probability of on-the-job search for those individuals for whom the difference between actual severance pay and that which they would have received under the old rules is greatest. Similarly, employers might be more likely to fire workers for whom the reforms have meant the greatest reduction in severance pay (as measured by the difference between actual severance pay and what they would have been entitled to under the old rules). As far as hiring is concerned, employers will be more forward-looking and interested in the new rules (applying to new hires) rather than the actual rules (applying to existing workers). In this case, therefore, one would expect to see more hiring among employers where the difference in severance pay between the old and new rules is the greatest. Finally, one might expect to see an increase in the share of hiring that is on permanent contracts amongst those employers who saw a larger fall in severance pay for permanent workers than for temporary ones.

This section uses the EU-LFS to test the above hypotheses. The advantage of the EU-LFS (compared to the *Quadros de Pessoal* data discussed in the next section) is that observations are available on a quarterly basis (i.e. relatively frequently). On the downside, the data are not longitudinal so that individuals and employers cannot be followed over time. In addition (and as explained below), most of the analysis needs to be done at the more aggregated occupational level (as opposed to the firm as in the *Quadros de Pessoal*).

To analyse the impact of severance pay on the probability of on-the-job search, the following individual-level regression model is used:

$$Y_{it} = \beta_0 + \beta_1 \Delta \log(SP_{it}) + \sum_{c>1} \beta_c X_{cit} + \gamma_t + \mu_q + \varepsilon_{it} \quad (1)$$

Where  $Y_{it}$  is a dummy variable indicating whether individual  $i$  is engaged in on-the-job search at time  $t$ , and  $\Delta \log(SP_{it})$  is the percentage difference between the old and actual severance pay. The regression further controls for individual characteristics,  $X_{it}$  (age, gender, country of birth, region, educational

attainment, industry, occupation, tenure and contract type<sup>173,174,175</sup>), as well year ( $\gamma_t$ ) and quarter ( $\mu_q$ ) fixed effects.

While the on-the-job search analysis is run at the individual level, this is not possible for the regressions looking at hiring (the percentage of workers at time  $t$  with tenure less than three months) and employment outflows (the percentage of individuals who, at time  $t$ , had been unemployed or inactive for less than three months).<sup>176</sup> This is because, by definition, severance pay cannot be calculated when the individual is unemployed/inactive (i.e. tenure is non-existent/missing). For these outcome variables, the analysis is run at the occupation level (30 groups)<sup>177</sup> and the model becomes:

$$Y_{gt} = \beta_0 + \beta_1 \Delta \log(SP_{gt}) + \sum_{c>1} \beta_c X_{cgt} + \gamma_t + \delta_g + \mu_q + \delta_g \cdot \mu_q + \varepsilon_{it} \quad (2)$$

Where the explanatory variable,  $\Delta \log(SP_{it})$ , and the control variables are all transformed into within-group averages, and group fixed effects,  $\delta_g$ , as well as group-specific seasonal effects,  $\delta_g \cdot \mu_q$ , are added to the equation. In the case of hiring, the explanatory variable is defined as the percentage difference between the old and *new* severance pay (as opposed to the difference between old and *actual* severance pay used in the case of employment outflows).

The final model looks at the impact of the reforms on the share of hires that are permanent. The set-up is identical to the one in equation (2) and is run at the group-level, except that the explanatory variable now becomes the difference between the average  $\Delta \log(SP_{gt})$  for permanent workers and the average  $\Delta \log(SP_{gt})$  for temporary workers within an occupation. This is because, in making decisions about

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173. Controls for tenure and contract type are included to correct for composition effects. Without these, one concern might be that the occupation-level results are biased due to reverse causality (i.e. changes in the outcome variable having an impact on the explanatory variable  $\Delta \log(SP_{it})$ ). Indeed, given that  $\Delta \log(SP_{it})$  is defined as a within-group average, its value is determined not only by the severance pay rules, but also by the composition of employment. While the conclusions remain essentially unchanged when controlling for composition effects, the size of the coefficients is always smaller, suggesting that there may indeed be some reverse causality. Adding in an interaction between tenure and contract type has little effect on the results. In alternative models (not shown here) the composition effect was addressed by reweighting the data so that the composition remains constant at the average level throughout the time period analysed. These results were qualitatively very similar to the ones presented here.
174. The tenure groups are defined as: < 3 months, 3-6 months, 6-12 months, 1-2 years, 2-4 years, 4-6 years, 6-8 years, 8-10 years, 10-15 years, 15-20 years, 20-25 years, 25-30 years, and 30+ years. The contract type groups are defined as: permanent; temporary with a duration of less than six months; and temporary with a duration of six months or more.
175. Also controlling for the level of severance pay makes little difference to the results. This is not surprising given that both tenure and contract type (which jointly determine severance pay) are already included in the regression.
176. With the EU-LFS data, one can look at hiring (i.e. whether an individual has tenure shorter than three months). In this case, flows from all previous states are included (i.e. inactive, unemployed, or employed in another job). The EU-LFS also allows one to look at employment outflows. In this case, only moves into either inactivity or unemployment can be observed. So outflows are defined as individuals who have moved from employment into either inactivity or unemployment in the past three months. Note that, because these variables are defined at the occupation level, they can be interpreted as hiring and employment outflow rates.
177. Occupations are defined at the 2-digit ISCO level. Some 2-digit occupations are clustered (within the same 1-digit occupation) to ensure a sufficient number of observations. The occupation of a non-employed person is defined as the occupation of his/her last job.



whether to take on permanent or temporary workers, employers are likely to consider by how much severance pay under the new rules fell for permanent contracts compared to temporary ones.

Table C2 reports the estimated coefficients on the severance pay variable,  $\beta_1$ , for each different outcome using EU-LFS data for the period Q1 2011-Q4 2013.<sup>178</sup> The results can be interpreted as the percentage point change in the outcome of interest for a 1-percentage point increase in the difference in severance pay before and after the reform (or, in the case of the last column, of a 1-percentage point increase in the difference in severance pay reduction between permanent and temporary contracts). The results in Table C2 confirm the expected impact of a reduction in severance pay: i) on-the-job search increases; ii) hiring increases; and iii) the fraction of hiring on permanent contracts increases (although the coefficient is only marginally significant). By contrast, the impact on flows out of employment is insignificant.<sup>179,180</sup>

**Table C2. The impact of the severance pay reforms on on-the-job search and worker flows: Evidence from the EU-LFS**

	Individual level	Group level		
	On-the-job search	Employment outflows	Hiring	Share permanent hiring
$\Delta \log(\text{SP}_{gt})$ : old v. actual rules	0.075***	-0.037		
$\Delta \log(\text{SP}_{gt})$ : old v. new rules			0.131**	
$\Delta \log(\text{SP}_{gt}^{\text{perm}}) - \Delta \log(\text{SP}_{gt}^{\text{temp}})$ : old v. new rules				1.077*

Note: \*\*\* Significant at the 1% level, \*\* significant at the 5% level, \* significant at the 10% level. Robust standard errors clustered at the occupation-year level. Agricultural and public sectors excluded.

Source: OECD analysis based on the EU-LFS.

178. While earlier data is available, the analysis only starts in Q1 2011 because of a methodological break in the Portuguese Labour Force Survey.
179. The analysis presented in Table C2 considers all the reforms of severance pay simultaneously. Regressions have also been run on each of the reforms separately. While excluding the first or third reform has no substantial impact on the coefficients for on-the-job search and employment outflows, the exclusion of the first reform leads to a slightly lower and less significant coefficient on hiring. This confirms the importance of the first reform in encouraging hiring. The impact of the difference between permanent and temporary severance pay entitlement on the share of permanent workers becomes insignificant when excluding the third reform, which is consistent with the fact that severance pay entitlement for new workers became higher for temporary workers than for permanent workers following this last reform.
180. The interpretation of the size of these coefficients is not straightforward, but providing some population averages may help. The average difference between old and actual severance pay is 5.3%, while 6.6% of workers are engaged in on-the-job search. Against this background information, lowering severance pay by 1 percentage point would increase on-the-job search by 0.075 percentage points. Turning to hiring, 3.8% in each quarter are new hires. The average difference between old and new severance pay is 29.6% and the results indicate that a 1-percentage point increase in this gap results in a 0.13-percentage point increase in the hiring rate. This is a relatively large effect, but may be consistent with the fact that unemployment in Portugal in the recovery has been falling considerably faster than what would have been predicted based on the past relationship between unemployment and GDP growth (see Chapter 3). In addition, this coefficient should be seen as an upper bound on the possible effect of the reform. More realistically, assuming that there is no effect on the occupation with the smallest change in severance pay and anchoring all estimates on this occupation, the reform would expect to result in a 0.23-percentage point increase in the hiring rate on average. Finally, 17.7% of hires are on permanent contracts, and the average difference between the reduction in permanent and temporary severance pay is 8.8 percentage points. The results show that a 1-percentage point increase in this difference would result in 1-percentage point increase in hiring on permanent contracts.

While there is no clear identification strategy which would allow these results to be interpreted as causal, a robustness check is run which does provide additional confidence that they may be attributed to the reform. More specifically, as a falsification exercise, the same regressions are run again, but tenure levels and contract type are randomised for each individual (while keeping their labour market outcomes unchanged).<sup>181</sup> Using these random tenure levels and contract types, a new explanatory variable measuring the difference between the pre- and post-reform severance pay systems is estimated. If the relationships observed in Table C2 persist despite the randomisation, then one should worry that those effects are not truly caused by the reform. Table C3 shows that, with the randomised severance pay variable, all the coefficients that were significant in Table C2 turn insignificant, while the insignificant coefficient on outflows becomes significant, the sign is the opposite of what the theory would predict. Perhaps the only coefficient for which the falsification exercise is less convincing is the one on hiring: while the estimate turns insignificant, the size of the coefficient is very similar (even slightly larger) to the one obtained in Table C2. Overall, however, the results from this falsification exercise support the argument that the effects observed are linked to the reform.

Table C3. **The impact of the severance pay reforms on on-the-job search and worker flows: Falsification exercise with randomised tenure and contract type (EU-LFS)**

	Individual level	Group level		
	On-the-job search	Employment outflows	Hiring	Share permanent hiring
$\Delta \log(SP_{gt})$ : old v. actual rules	0.001	-0.109*		
$\Delta \log(SP_{gt})$ : old v. new rules			0.148	
$\Delta \log(SP_{gt}^{perm}) - \Delta \log(SP_{gt}^{temp})$ : old v. new rules				-0.01

Note: \*\*\* Significant at the 1% level, \*\* significant at the 5% level, \* significant at the 10% level. Robust standard errors clustered at the occupation-year level. Agricultural and public sectors excluded.

Source: OECD analysis based on the EU-LFS.

### The impact of the severance pay reforms on hiring and separations: Evidence from the *Quadros de Pessoal*

As an additional robustness check on the findings presented in the previous section, the analysis is re-run on the *Quadros de Pessoal* (QP) data, a matched employer-employee administrative dataset. The advantages of this dataset compared to the EU-LFS are that it covers all non-public sector employees (it is a census, not a survey) and allows for the analysis to be carried out at the firm-level rather than at the more aggregate occupation-level. The disadvantages, however, are that the dataset is annual and that only the individuals working on October 31<sup>st</sup> of each year are observed. This implies that flows during the year (e.g. individuals hired and fired between October 31<sup>st</sup> of year  $t$  and October 31<sup>st</sup> of year  $t-1$ ) will not be captured. This is a problem for temporary contracts in particular. In addition, for reasons further explained below, the effect of the 1 November 2011 reform on separations cannot be estimated.

181. The randomisation works as follows. First, individuals are ordered randomly within time periods (i.e. quarter and year) and contract type groups, and are given the tenure level of the individual ranked one position below them (within the same time/contract group). In the next step, individuals are ordered by tenure within time periods, and the individual are given the contract type (temporary or permanent) of the individual ranked one position below them (within the same time period). By first assigning tenure (within contract type groups) and then only contract type, situations are avoided where, for example, individuals on temporary contracts might have very high tenure.

The outcomes that one is able to investigate using the QP data are slightly different from those in the EU-LFS.<sup>182</sup>

- Separations (i.e. the share of employees who were employed by the firm in year  $t-1$  but not in year  $t$ );
- Hiring (the share of employees who were employed by the firm in year  $t$  but not in year  $t-1$ );
- Share of hires that are permanent.

The basic model is re-defined at the firm-level:

$$Y_{jt} = \beta_0 + \beta_1 \Delta \log(SP_{jt}) + \sum_{c>1} \beta_c Z_{cjt} + \gamma_t + \delta_j + \varepsilon_{it} \quad (3)$$

Where  $Y_{jt}$  is the employment outcome for firm  $j$  at time  $t$  and  $\Delta \log(SP_{jt})$  is the average percentage difference in severance pay between the pre- and post-reform systems. As in the EU-LFS analysis, the difference between old and actual severance pay is used in the separations regressions, while the difference between old and new severance pay is used in the hiring regressions.<sup>183</sup> Just as before, the impact of the share of hiring that is permanent is analysed using the difference in severance pay reductions between permanent and temporary contracts. The regression further controls for time-varying firm characteristics,  $Z_{jt}$ , (such as the type of collective bargaining coverage<sup>184</sup> and productivity<sup>185</sup>), as well as firm and year fixed effects.

Table C4 reports the estimated coefficients on the severance pay variable,  $\beta_1$ , for each different outcome for the period 2010-2013. As before, the results can be interpreted as the percentage point change in the outcome of interest of a 1-percentage point increase in the difference in severance pay before and after the reform (or of a 1-percentage point increase in the difference in severance pay reductions between permanent and temporary for the last column). The results show that firms that experience a larger fall in the severance pay level of their employees exhibit a higher separation rate. Although significant, the value of the coefficient is relatively small and will partly reflect the higher tendency of on-the-job search found in the LFS analysis (and therefore increased job-to-job flows). The results in Table C4 further show that firms that anticipate a bigger drop in severance pay levels for their future employees have a higher hiring rate. Finally, the results indicate that the severance pay reforms may have had a positive impact on the share of permanent workers. Overall, these results are remarkably similar to the ones obtained using the LFS data.<sup>186</sup>

182. Note that, while the definition of hiring is similar to the EU-LFS definition, the separations definition is broader as it also refers to individuals moving to another job. The separations and hiring rates on the QP data are therefore more comparable to one another, and the results clearly show that the effect of the reforms on hiring is significantly larger than the effect on separations. This may be a result of grandfathering.

183. The first reform had no impact on the severance pay of existing workers. Any effect of the reform on separations would therefore only occur on individuals who are hired after the reform. However, because the QP only records individuals in employment in October of each year, anyone who joins a firm and leaves again during the year will not be captured. As such, the QP data cannot be used to estimate the effect of the 2011 reforms on separations.

184. Share of uncovered workers, share of workers covered by firm-level agreements, and share of workers covered by sector/national agreements (base category).

185. Productivity is defined as the firm's turnover divided by the number of employees.

186. Again, it is not straightforward to interpret the magnitude of these effects. Starting with separations, 14.2% of workers separate from their employer each year. At the same time, the average difference between old and

**Table C4. The impact of the severance pay reforms on hiring and separations: Evidence from the *Quadros de Pessoal***

	Employment outflows	Hiring	Share permanent hiring
$\Delta \log(SP_{gt})$ : old v. actual rules	0.043***		
$\Delta \log(SP_{gt})$ : old v. new rules		0.292***	
$\Delta \log(SP_{gt}^{perm}) - \Delta \log(SP_{gt}^{temp})$ : old v. new rules			0.624***

Note: \*\*\* Significant at the 1% level, \*\* significant at the 5% level, \* significant at the 10% level. Robust standard errors clustered at the firm level. Agricultural and public sectors excluded.

Source: OECD analysis based on the *Quadros de Pessoal*.

To test the robustness of these results, a falsification exercise similar to that run on the EU-LFS data is also run on the QP. Randomising the tenure levels and contract types of employees leads to strongly different results, with all coefficients changing sign (Table C5). As before, this strengthens the case for ascribing the effects observed in Table C4 to the severance pay reforms. Even the coefficient on hiring is now much smaller, and changes sign.

**Table C5. The impact of the severance pay reforms on hiring and separations: Falsification exercise with randomised tenure and contract type (*Quadros de Pessoal*)**

	Employment outflows	Hiring	Share permanent hiring
$\Delta \log(SP_{gt})$ : old v. actual rules	0.043***		
$\Delta \log(SP_{gt})$ : old v. new rules		-0.054***	
$\Delta \log(SP_{gt}^{perm}) - \Delta \log(SP_{gt}^{temp})$ : old v. new rules			-0.015

Note: \*\*\* Significant at the 1% level, \*\* significant at the 5% level, \* significant at the 10% level. Robust standard errors clustered at the firm level. Agricultural and public sectors excluded.

Source: OECD analysis based on the *Quadros de Pessoal*.

The model was also run separately for small firms (fewer than 50 employees) and large ones (50 employees or more). The results, presented in Table C6, show that most of the effect of separations occurs in small firms – which suggests that these firms might be particularly constrained by high firing costs, which could impede their productivity and growth. The impact of the reform on hiring and the share of hiring that is permanent is significant in both types of firms, although the effects are larger for small ones.

actual severance pay in the QP data is 5.6%, and the results show that 1-percentage point increase in this difference results in a 0.04-percentage point increase in the separation rate. Turning to hiring, 16.2% of workers are new hires each year, while the average difference between old and new severance pay is 25.6%. The results show that a 1-percentage point increase in this difference is associated with a 0.29-percentage point increase in the hiring rate. Finally, the average share of hiring that is permanent is 46.9%, while the difference in severance pay reduction for permanent and temporary contracts is 3.4 percentage points. A 1-percentage point increase in this difference would increase the share of hiring that is permanent by 0.6 percentage points.

Table C6. The impact of the severance pay reforms on hiring and separations, by firm size (*Quadros de Pessoal*)

	Small firms (<50)			Medium and large firms (≥50)		
	Employment outflows	Hiring	Share permanent hiring	Employment outflows	Hiring	Share permanent hiring
$\Delta \log(SP_{gt})$ : old v. actual rules	0.044***			-0.073		
$\Delta \log(SP_{gt})$ : old v. new rules		0.293***			0.172***	
$\Delta \log(SP_{gt}^{perm}) - \Delta \log(SP_{gt}^{temp})$ : old v. new rules			0.658***			0.300***

Note: \*\*\* Significant at the 1% level, \*\* significant at the 5% level, \* significant at the 10% level. Robust standard errors clustered at the firm level. Agricultural and public sectors excluded.

Source: OECD analysis based on the *Quadros de Pessoal*.

Finally, the model was used to test whether the severance pay reforms affected wage growth at the firm-level. One can imagine that workers in firms most affected by the severance pay reforms would lose in bargaining power over wages as their likelihood of being fired has increased. Indeed, the results presented in Table C7 indicate that firms with a larger average gap between old and actual severance pay have lower wage growth. By contrast, the average firm-level gap between old and new severance pay has no effect on wage growth – as might be expected.

Table C7. The impact of the severance pay reforms on wage growth (*Quadros de Pessoal*)

	Hourly wage growth	Hourly wage growth
$\Delta \log(SP_{gt})$ : old v. actual rules	-0.030**	
$\Delta \log(SP_{gt})$ : old v. new rules		0.016

Note: \*\*\* Significant at the 1% level, \*\* significant at the 5% level, \* significant at the 10% level. Robust standard errors clustered at the firm level. Agricultural and public sectors excluded. Hourly wage calculated as the sum of base wages, overtime wages and other payments, divided by the sum of normal and overtime hours.

Source: OECD analysis based on the *Quadros de Pessoal*.

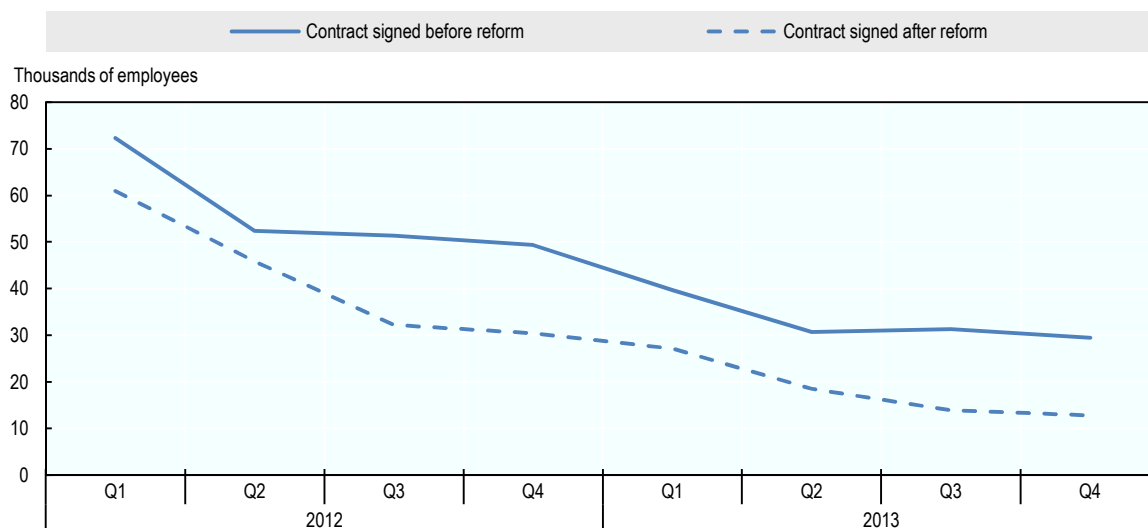
### The impact of the severance pay reforms on individual employment survival: Evidence from the European Labour Force Survey

This final section hones in on the question of whether lower severance pay results in higher job separations. It does this by exploring detailed information from the EU-LFS on the starting date of contracts to analyse differences in employment survival between employees who signed their contract just before the 1 November 2011 reforms and those who signed just after. Employees who signed a contract on or after that date would accumulate severance pay entitlements at a slower rate than those who signed their contract before that date, and also no longer have an entitlement to a minimum of three months' severance pay. As such, one would expect to see higher separation rates for workers hired after 1 November 2011 because: i) employers would be more likely to fire them; and ii) the workers themselves may be less reluctant to leave their job.

To make sure that the “treated” individuals (i.e. those who signed their contract after the reform) in the analysis are as similar as possible to the “control” individuals (i.e. those who signed their contract before the reform), a short time window around the reform date is chosen. More specifically, the sample is restricted to employees who signed their contract in the two months prior to the reform and in the two months after (i.e. it includes any contract signed over the period September to December 2011). Figure C1 shows the evolution of the number of employed people in both the control and the treatment groups. As expected, both groups reduce in size as time passes. However, Figure C1 also suggests that the gap

between the two groups of employees may have widened slightly over time and that the line for “treated” individuals is slightly steeper – which indicates that the workers hired under the new severance pay system are fired or leave their job more easily.

Figure C1. **Evolution of the number of workers who signed their contract just before or just after the 1 November 2011 severance pay reform**



Source: OECD analysis based on the EU-LFS.

To test this hypothesis more formally the following regression setup is used:

$$Y_{it} = \beta_0 + \beta_1 t + \sum_{c>2} \beta_c X_{cit} + \varepsilon_{it} \quad (4)$$

Where  $Y_{it}$  is a dummy variable equal to one if an employee belongs to the treatment group and zero when he/she belongs to the control group. The variable of interest,  $t$ , is a simple linear time trend, and the regression also controls for individual characteristics (age, skills, gender, contract type and region). As such, this model tests whether the share of employees who signed their contract after 1 November 2011 increases or decreases over time. The estimated coefficient ( $\beta_1 = -0.023$ ) is significant at the 1% level, suggesting that employees covered by the new severance pay system have a lower probability of survival than employees under the old system.

One can also test whether employees who signed their contract just after the reform have a higher probability of on-the-job search than those who signed their contract just before the reform. This is done by estimating the following model:

$$S_{it} = \beta_0 + \beta_1 Y_{it} + \sum_{c>2} \beta_c X_{cit} + \varepsilon_{it} \quad (5)$$

Where  $S_{it}$  equals one if an employee engages in on-the-job search (zero otherwise), and  $Y_{it}$  is, as before, a dummy variable equal to one when an employee belongs to the treatment group (zero otherwise). The other explanatory variables remain as in equation (4), and the regression is run on the same restricted sample as before (i.e. individuals who signed their contract over the period September-December 2011).

The estimated coefficient ( $\beta_1=0.045$ ) is positive and significant at the 5% level, indicating that the severance pay reforms have led to relatively higher on-the-job search for those affected by the reform.

### The impact of the severance pay reforms on individual employment survival: Evidence from social security data

The same analysis can be repeated using social security data which contain details on the employment spells of individuals with different employers, the reasons for ending an employment spell, as well as a range of personal characteristics. The time span covered by the data extends from January 2010 to September 2015. More details on the structure and content of these data can be found in Annex D.

As in the previous analysis, a difference-in-difference model is estimated to compare the outcomes of individuals who signed their contract in the two months after the reform (treatment group) to those who signed their contract in the two months before the reform (control group):

$$Y_i = \beta_0 + \beta_1 T_i + \sum_{c>0} \gamma_c X_{ci} + \sum_{c>0} \mu_c Z_{ci} + \varepsilon_{it} \quad (6)$$

Where the treatment dummy,  $T_i$ , equals one for all employment spells  $i$  of the treatment group and zero for the spells of the control group. The regression further controls for individual characteristics,  $X_{ci}$  (age, gender, region, migrant status), and firm level characteristics,  $Z_{ci}$  (sector, and size at the end date of employment). The outcome variable,  $Y_i$ , is defined as the hazard rate of employment, i.e. the probability of leaving a job, given that the individual has been employed in the job for a duration  $d$ .

Given that the dependent variable is expressed as a hazard rate, the regression is estimated using a Cox proportional hazard model. The estimated hazard ratio equals 1.082 (significant at the 5% level), implying that individuals hired in the two months after the reform are 8.2% more likely to leave employment than the individuals hired just before the reform (Table C8).

Table C8. The impact of the severance pay reforms on individual employment survival (*Social Security data*)

	All	Employer initiative	Employee initiative
$\beta_1$	1.082**	1.129***	0.919
	-0.036	-0.043	-0.069
Observations	6168	5389	2473

Note: \*\*\* Significant at the 1% level, \*\* significant at the 5% level, \* significant at the 10% level. Robust standard errors clustered at the firm level.

Source: OECD analysis based on social security data.

The data also contain information on the reason for the end of the employment spell. When the dependent variable in the model is redefined to include exits from employment that occurred on the initiative of the employer only, the estimated hazard ratio increases to 1.129 (significant at the 1% level). On the other hand, when the dependent variable covers only exits that occurred on the initiative of the employee, no significant difference is found between the treatment and control groups. These results suggest that the reason why individuals who signed their contract under the new rules are more likely to separate from their jobs is that they are more likely to get fired.

## Concluding remarks

Several conclusions may be drawn from the analysis presented above. First, that the reform appears to have been successful in promoting greater worker re-allocation as well as hiring, particularly among small firms. Second, that the preservation of accumulated severance pay rights for existing workers has mitigated the impact of the reform on their probability of job separation. And, third, that the same grandfathering rules have introduced some inequalities in the labour market depending on when someone signed their contract. Indeed, the analysis showed that individuals hired under the new rules were more likely to separate from their jobs (being fired) than individuals who were still hired under the old rules. These inequalities were primarily a result of the November 2011 reforms, and later reforms tried to reduce these inequalities (or at least the rate at which they would increase) by imposing a cap on the severance pay of existing workers and reducing the rate at which further severance pay entitlements would be accumulated.



## ANNEX D

### THE IMPACT OF REDUCTIONS IN UNEMPLOYMENT BENEFIT LEVELS ON FLOWS FROM UNEMPLOYMENT TO EMPLOYMENT: EVIDENCE FROM ADMINISTRATIVE DATA

The reforms of the Portuguese unemployment benefit system reduced the generosity of benefits for unemployment spells starting after April 1<sup>st</sup> 2012. The reforms entailed: i) a reduction in the maximum amount of unemployment insurance (from 3 to 2.5 times the social support index<sup>187</sup>), and ii) a 10% reduction in the unemployment insurance level after six months of unemployment (i.e. a declining replacement rate). The primary goal of these reforms was to encourage recipients to look more actively for a job and reduce the length of unemployment spells. It is important to note that the reduction in the level of unemployment benefits was only a small part of the total unemployment benefit reform package, and that the biggest effect is to be expected from the reduction in the maximum duration of unemployment insurance. However, because the latter will not apply to the first spell of unemployment after the reform, it is too early to assess its impact on unemployment duration.

This annex analyses the impact of the reduction in unemployment benefit levels on the probability of moving from unemployment to employment using social security data for the period January 2010 to September 2015 (see Box D1 for more details on the data). These data contain detailed monthly information for a sample of labour markets participants, such as labour market status, social security benefits and contributions, as well as a range of personal characteristics. To isolate the impact of the reduction in benefit levels from the reduction in unemployment benefit duration, only the first spells of unemployment after the reform are taken into account.<sup>188,189,190</sup>

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187. Since 2009, the social support index (IAS) has been equal to EUR 419.22, which implies that the maximum monthly level of unemployment insurance was lowered from EUR 1 257.66 to EUR 1 048.05.

188. In the dataset made available for the purposes of this report, only 643 unemployment spells could be identified which were covered by the new rules on maximum unemployment benefit duration. These spells represent about 1% of the total monthly observations for unemployed individuals.

189. The reforms also changed the unemployment benefit eligibility rules by lowering the threshold for access from 450 to 360 days of contributions over the past 24 months. This will have changed the composition of both the treatment and control groups. As it is impossible to identify the persons with 360 to 450 days of contributions, the results of the analysis presented in this annex might be contaminated by this increased eligibility. Therefore, a key (but not unreasonable) assumption is that these newly eligible individuals do not have a significantly different outflow probability from individuals who were already eligible under the old rules. Either way, the difference-in-differences setup used in this annex will remove this possible bias – as long as the widened eligibility affected the treatment and control groups in the same way.

190. In the same period, unemployment benefit levels for jobless households were temporarily raised by 10% (although the new maximum benefit level and the 10% reduction after six months would still apply). While these individuals would ideally be excluded from the analysis, the lack of household information in the administrative data makes it difficult to identify them.

**Box D1. Social Security data used for unemployment insurance analysis**

The impact of the unemployment benefit reforms are analysed using a 2% social security sample on all individuals registered with Social Security on December 31<sup>st</sup> 2012. For these individuals, all monthly information between January 2010 and September 2015 is matched on. The information includes:

- Personal characteristics (age, gender and country of birth);
- Information on the employer for employed individuals (firm size and sector);
- Information on remuneration (level and taxes);
- Information on unemployment benefit (start date, type of benefit and level).

On December 31<sup>st</sup> 2012, the sample consists of 61 169 individuals, of whom 11.72% are unemployed. The number of individuals decreases with time as some individuals disappear from the social security system. A total of 11 225 individuals have one or more unemployment spells starting after the reform. About 64% of them have spells longer than six months and are therefore affected by the new declining replacement rate. Only about 4.7% of individuals who become unemployed after the reform are affected by the reduction in the cap (or 534 individuals).

To test the impact of the reduction in the maximum unemployment insurance level, a difference-in-differences model is estimated which compares the difference in outcomes before and after the reform between those who were affected by the cap and those who were not:

$$Y_i = \beta R_i + \gamma T_i + \delta(R_i T_i) + \sum \mu X_i + \varepsilon_i$$

The reform dummy,  $R_i$ , equals one for all unemployment spells starting after April 2012, and zero for all spells starting before. The treatment dummy,  $T_i$ , equals one for all individuals with unemployment benefits at or above 2.5 times the social support index (i.e. for all individuals affected by the reduction in the cap).<sup>191</sup> In order to make the control group ( $T_i=0$ ) as comparable as possible to the treatment group, only those people with unemployment benefits just below the maximum are selected (i.e. with benefits between 90% and 100% of the new cap).<sup>192</sup> The coefficient on the interaction term,  $\delta$ , measures the impact of the reform. It shows whether the difference between the pre- and post- reform outcomes of the treatment group is different from that for the control group. The outcome variable,  $Y_i$ , is defined as the hazard rate (or exit rate) from unemployment, i.e. the probability of moving from unemployment to employment conditional on having been unemployed for a duration  $d$ . The regression further controls for a set of personal characteristics,  $X_i$  (migrant status, age, gender, region and maximum unemployment benefit duration)<sup>193,194</sup>

A similar regression setup is used to test the impact of the 10% reduction in unemployment benefit levels after six months of unemployment. This time, however, the treatment and control groups are constructed on the basis of when the individual became unemployed. To be more precise, the impact of the reform is estimated by comparing individuals who became unemployed just before the reform to those who became unemployed just after, and the regression model becomes:

$$Y_i = \beta R_i + \sum \mu X_i + \varepsilon_i$$

- 
191. The reduction of the maximum amount by 10% after six months (for spells starting after the reform) is taken into account in the definition of the treatment and control groups.
192. Expanding this group to those with benefit levels between 80% and 100% of the cap does not affect the results obtained.
193. All personal characteristics are entered into the regression as dummy variables (two migrant statuses, five age groups, two genders, seven regions, three benefits duration levels).
194. In a robustness check using discrete duration models monthly dummies are added to control for possible seasonality in the hazard rate. Their inclusion does not, however, alter the result.

Where the reform dummy,  $R_i$ , equals one for all individuals whose employment spell started in the two months following the reform (April and May 2012) and zero for the individuals with an unemployment spell starting in the two months before the reform (February and March 2012). To make the treatment and control groups more comparable, they are further limited to having a level of initial unemployment benefits (before the 10% reduction) of between EUR 15 and EUR 34 per day. These levels are chosen as to not include individuals subject to the minimum or maximum benefit level, given that the minimum level hides large difference in previous wage levels and that the maximum was subject to an additional reform. The outcome variable,  $Y_i$ , and the control variables,  $X_i$ , remain as before.

Given that the outcome variable in both models is defined as a hazard rate, the regressions are estimated using a Cox proportional hazard model.<sup>195</sup> Table D1 shows the hazard ratios for the variables of interest for both regressions, as well as the number of unemployment spells per person.<sup>196</sup> The hazard ratio for the maximum level regression is larger than one, which implies that the probability of exiting to employment has increased more after the reform for the treatment group than for the control group. Similarly, the estimated hazard ratio for the 10% reduction model is larger than one, which suggests that the individuals who became unemployed just after the reform have a higher probability of moving to employment than the individuals who became unemployed just before the reform. However, neither of the coefficients are significantly different from one, meaning that no definite conclusions can be drawn about the effect of the reform.<sup>197</sup>

**Table D1. The impact of unemployment benefit level reductions on unemployment outflows:  
Regression results**

	Maximum level	10% reduction
$R_i T_i$	0.995	
	-0.122	
$R_t$		1.115
		-0.112
Number of spells	1391	702

Note: Robust standard errors displayed in parentheses.

Source: OECD analysis based on social security data.

To test the robustness of these results, the models are re-estimated using control groups obtained by propensity score matching. This ensures an even greater degree of comparability between the treatment and control groups. More specifically, each individual from the treatment group is matched to a non-treated individual with similar observable characteristics (based on age, gender, region, migrant status and maximum unemployment benefit duration).<sup>198</sup> For the first model (maximum benefit level), the new

195. A critical assumption of this Cox model is that the difference between the hazard rates of two groups is independent of the unemployment duration. While this assumption is unlikely to be violated in the maximum level regressions, it might be problematic for the 10% reduction given that the difference between the two groups only starts after six months of benefits. However, allowing for a different coefficient before and after six months of unemployment duration did not significantly improve the model. This does not change when anticipation is taken into account (i.e. setting the threshold at four or five months of unemployment duration).

196. The number of spells is very close to the number of individuals, given that there are only few individuals with multiple unemployment spells.

197. The impact of the 10% reduction in benefit level after six months could be greater for individuals with greater liquidity constraints. To test for this, the analysis was re-run separately on two different groups with varying levels of unemployment benefit (one with unemployment benefit ranging between EUR 15 and EUR 20 per day, the other with benefit levels between EUR 20 and EUR 34 per day). The reform did not have a statistically significant impact on the flows from unemployment to employment for either group.

198. Individuals at the minimum or maximum benefit level are excluded from the treatment and control groups.

control group consists of the nearest neighbours of the treated individuals, both before and after the reform.<sup>199</sup> For the second model, all individuals starting their unemployment spell in the two months after the reform are matched to their nearest neighbour in the group of individuals who became unemployed in the two months before the reform.<sup>200,201</sup> Using these new control groups, the same duration models as above are estimated, but standard errors are clustered at the match level. The results in Table D2 confirm the earlier estimates, with both hazard ratios remaining insignificantly different from one. This could be due to small sample sizes, and future research should use larger extracts from the social security data to verify the results obtained here.<sup>202</sup>

**Table D2. The impact of unemployment benefit level reductions on unemployment outflows:  
Regression results using propensity score matching**

	Maximum level	10% reduction
$R_t T_i$	1.015	
	-0.162	
$R_t$		1.145
		-0.164
Number of spells	1446	400

*Note:* Robust standard errors clustered at match level displayed in parenthesis.

*Source:* OECD analysis based on social security data.

While this preliminary assessment could not detect any significant effect of the unemployment benefit level reforms on unemployment outflows, the benefit reductions will still have had an impact on the government budget. An estimated 4.8% of beneficiaries were affected by the reduction in the cap over the period April 2012 to September 2015, with an average saving in UB of almost EUR 185 per beneficiary per month – resulting in a total saving of around EUR 70 million over the entire period. The saving associated with the 10% reduction was even greater: EUR 200 million over the period April 2012 to September 2015.<sup>203</sup> It is important to note that these estimates only represent a rough approximation of the actual savings from the reforms, as the calculations are based on a 2% random sample of the Social Security records. The calculations therefore assume that the sample is representative of the wider population.

199. The group from which the nearest neighbours for the maximum level treatment group are selected is restricted to individuals with unemployment benefits between 80% and 100% of the maximum benefit level.
200. Both for the maximum level control group, as for the 10% reduction control group, propensity score matching is done using a k-nearest neighbour matching method with  $k = 2$ .
201. While limiting the treatment group to individuals with employment benefit levels between EUR 20 to EUR 34 does not alter the results, the estimated coefficient for the treatment group limited to benefits between EUR 15 and EUR 20 becomes significantly larger than 1 (indicating that the reform may have had an effect on exits from unemployment to unemployment), albeit only at the 10% significance level.
202. As an additional robustness check the models have been re-estimated in a discrete setup (i.e. transforming the data from spells to monthly observations), using both a standard logistic estimator and a proportional hazard model. As expected, the estimated coefficients are very close to the ones reported in tables D1 and D2.
203. Whereas unemployment benefits without the 10% reduction can easily be identified in the social security data from the actual unemployment benefit level, the benefit level in the absence of the new lower cap is more difficult to estimate. Based on the observed wage in the previous job, it is nevertheless possible to calculate approximately what the benefit would have been in the absence of the new cap. Comparing this level to the current cap provides an estimate of the reduction caused by lowering the cap. To estimate an upper bound on the savings from this reform, one can alternatively assume that the saving for each individual affected is simply the difference between the old and the new cap. This leads to a total saving of EUR 79 million.

## ANNEX E

# THE IMPACT OF ACTIVE LABOUR MARKET PROGRAMMES ON EMPLOYMENT OUTCOMES: EVIDENCE FROM ADMINISTRATIVE DATA

The Portuguese public employment service (PES) provides a range of active labour market programmes (ALMPs), such as internships, hiring subsidies and training programmes. As documented in Chapter 1, some of these programmes have been revised substantially over the last few years, and new programmes have been introduced.

In this annex, the impact of a set of ALMPs on individual employment outcomes is analysed using administrative data from the Portuguese PES for the period 2010-2015. These data contain information on the programmes that each unemployed individual registered at the PES participated in. Additionally, registration dates as well as dates and reasons for exit are documented, together with a set of personal characteristics (Box E1).

## Box E1. Public Employment Service data used for the evaluation of ALMPs

The extract of administrative data from the Portuguese PES used for the present analysis contains information for all individuals who were registered with the PES on December 31st 2011 as well as for all new entrants to the PES until the end of 2014. The dataset therefore contains all registered unemployed over the period 2012-2014, and information for these individuals pre-2012 and post-2014. In total, the dataset contains information on 1 846 393 unemployed individuals.

Information is available on date of registration at the PES, interventions by the PES (e.g. ALMPs), placements, annulments and a range of personal characteristics. An individual leaves the dataset following placement by the PES (12% of exits) or annulment (88%). In total, 44 different reasons for annulment are present in the dataset. These consist of five broad categories: self-placement (27%), refusal of activation measures (26%), absence for controls (30%), leaving the labour market (6%), dropout from intervention (2%), and other (6%).

The PES data contain information on 220 different interventions, varying strongly in number of participants. The most common interventions are “placement interview”, “personal development plan”, and “active job search” – i.e. standard PES services. The programmes evaluated in this report cover around 7% of all registered interventions and 45% of all ALMPs (71% excluding *formação contínua*). Table A shows that Vida Ativa (a short-duration training programme) is by far the largest among the evaluated programmes, while the reported number of participants in the hiring subsidy programme is relatively low. The average age, schooling level and unemployment duration at the start of participation (proxied by the number of months since registration) reflect the eligibility criteria of the different programmes (see Annex A).

Table A. Characteristics of ALMP participants

	Number of participants	Average age	Average years of schooling	Average months registered with PES
Subsidised internships	116 834	26.1	14.4	7.3
Hiring subsidies	15 826	33.9	11	13.5
Vida Ativa	564 599	40.2	9.6	12.9
Socially useful work	200 388	42.2	8	11.1

Note: Subsidised internships include *Passaportes emprego*, *Estágios profissionais*, *Estágios emprego*; hiring subsidies includes *Estímulo 2012*, *Incentivo à contratação*; socially useful work includes *Contrato emprego-inserção*, *Contrato emprego-inserção+*.

Source: OECD analysis based on PES administrative data.

The goal of this analysis is to see whether individuals who participated in an activation programme had a higher probability of being employed, compared to similar individuals who did not participate in the same activation programmes. More specifically, individuals starting a programme at time  $t$  are compared to individuals unemployed at time  $t$ , but who never participated in that programme. The probability of employment for these two types of individuals is compared at times  $t+6$ ,  $t+12$ ,  $t+18$  and  $t+24$ .

To make the control group (i.e. the individuals who did not participate in a specific ALMP) as comparable as possible to the treatment group (i.e. the participants), propensity score matching is used.<sup>204,205</sup> Everyone from the treatment group is matched to a similar person in the control group based on age, gender, marital status, whether or not the individual has children, years of schooling, date of registration with the PES, and whether or not the individual has already been employed. This matching process is done separately for each month in which the ALMPs are started.<sup>206</sup> As it is possible that individuals participate in multiple ALMPs, the analysis is repeated for a treatment group of individuals who only participated in the ALMP of interest and a control group of individuals who did not participate in any ALMP at all.<sup>207</sup>

Given that the matching process is limited to observable characteristics of the individuals, there might still be a significant difference between the treatment and control group in terms of unobservable characteristics, such as motivation and innate ability. These unobservable characteristics might, in turn, affect the outcome of interest and therefore bias the estimates of the impact of the programme. However, given the lack of natural experiment, it is impossible to take these unobserved characteristics into account. That being said, the wide range of observed characteristics included in the matching process should reduce the extent of such bias.

The focus of the analysis is on four different types of ALMPs that are all substantial in terms of number of participants, and were introduced or reformed during the crisis period:

- Subsidised internships (*Passaportes emprego, Estágios profissionais, Estágios emprego*)
- Hiring subsidies (*Estímulo 2012, Incentivo à contratação*)<sup>208</sup>
- Short-duration training programmes (*Vida Ativa*)
- Socially useful work (*Contrato emprego-inserção, Contrato emprego-inserção+*)

More details on these ALMPS can be found in Annex A.

204. Propensity score matching is done on a one-to-one basis without replacements

205. Another option would have been to run a basic OLS regression of the outcome variable (employment) on a treatment dummy (1 if treated, 0 if control) and individual characteristics. The advantages of PSM are that it is non-parametric, and therefore more flexible, and that it only looks at comparable observations (common support).

206. Individuals starting an internship at time  $t$  can only be matched to individuals who were unemployed at time  $t$ . When an individual is included in the control group for the treatment group with starting date  $t$ , he or she is excluded from potential matching with treatment groups with starting dates  $t' > t$ .

207. The restriction does not apply to some very standard PES interventions, such as information sessions or the personal development plans (*Sessão de informação colectiva, Plano Pessoal de Emprego*)

208. The PES data do not allow the identification of *Estímulo 2013* and *Apoio a contratação via reembolso da TSU* participants.

Table E1 shows the probability of employment after 6, 12, 18 and 24 months for the treatment and control groups, and for the four different types of ALMPs. An individual is considered to be employed when he or she has permanently left the PES database and when the reason for exiting is either placement by the PES or self-placement. Unemployment is defined as being registered in the PES database. The main drawback of these definitions is that they ignore individuals who left the PES dataset for other reasons than (self-)placement. This is because the PES data do not allow the identification of the labour market status of these individuals, and they can therefore not be classified as either employed or unemployed.

Individuals participating in a subsidised internship programme have a higher probability of being employed than comparable individuals not participating, except six months after the start of the programme (Panel A). This latter finding is not surprising, given that the majority of the treated individuals are by definition still unemployed after six months since internship programmes normally last for more than six months. The fact that the employment probabilities of the treatment group after finishing the internship are higher than the probabilities of the control group suggests that participating in an internship has a positive impact on the probability of finding a job (and staying employed) – assuming that there was no selection into the programme based on observable characteristics. This is consistent with the fact that many internships are transformed into normal contracts at the end of the internship programme (42% of all internships starting in 2012-2014).

An even more pronounced difference in employment probabilities is found for the hiring subsidies (Panel B). Because individuals participating in a subsidised job are registered as employed and *Estímulo 2012* subsidies lasted for six months, the employment probability of the treatment group after six months is very high by definition. However, even after ending the subsidised job, the employment probabilities for the treatment group remain substantially higher than for the control group. After two years, those who benefited from a hiring subsidy are still 70% more likely to be in employment than similar individuals who did not.

By contrast, *Vida Ativa* appears to have very little impact on the employment outcomes of participants (Panel C). It is not clear why this is but possibilities include the broad nature of the programme (it covers modular training as well as validation of existing skills), the fact that the intensity of the programme can differ strongly across participants, and also that the programme is modular so that the full effect of the programme may not be captured in the present analysis, but only part of it.<sup>209</sup>

Finally, the employment probabilities of individuals participating in a socially useful work programme are slightly higher after 12 and 18 months than those of similar individuals in the control group. However, there does not seem to be a long-run effect of these programmes, as the employment probabilities of the treatment and control groups are almost equal after 24 months. Compared to the individuals participating in the subsidised internships from Panel A, the individuals participating in a socially useful work programme have a much lower probability of being offered a job by the employer where their socially useful internship was done (only 3.2% of all individuals starting such a programme over the period 2012-2014).

209. The PES data do not provide detailed information on the exact content of the *Vida Ativa* measures for each individual. The intensity of the programme can, however, be proxied by its duration. When excluding participants who participated in *Vida Ativa* for less than five days, the difference in employment probabilities between the treatment and control groups becomes bigger, but remains limited to 4 percentage points after 24 months.

Table E1. The impact of unemployment benefit level reductions on unemployment outflows: Regression results using propensity score matching

All					No other ALMP				
Panel A: Subsidised internships									
	Treatment		Control			Treatment		Control	
	Obs.	Mean	Obs.	Mean		Obs.	Mean	Obs.	Mean
Employed after 6 months	49 931	6.31%	35 183	25.28%	Employed after 6 months	24 385	5.62%	16 511	24.02%
Employed after 12 months	46 836	46.89%	23 666	43.57%	Employed after 12 months	22 502	45.00%	11 151	38.38%
Employed after 18 months	33 035	75.85%	15 504	57.95%	Employed after 18 months	15 345	70.45%	7 941	49.58%
Employed after 24 months	19 625	82.29%	8 358	66.27%	Employed after 24 months	10 370	75.83%	5 251	53.95%
Panel B: Hiring subsidies									
	Treatment		Control			Treatment		Control	
	Obs.	Mean	Obs.	Mean		Obs.	Mean	Obs.	Mean
Employed after 6 months	7 385	82.17%	5 496	18.03%	Employed after 6 months	4 118	81.84%	2 316	20.64%
Employed after 12 months	7 058	79.13%	4 804	27.75%	Employed after 12 months	3 934	78.14%	1 971	30.04%
Employed after 18 months	6 807	77.29%	4 256	36.98%	Employed after 18 months	3 811	74.57%	1 758	36.92%
Employed after 24 months	6 461	80.05%	3 710	46.85%	Employed after 24 months	3 611	76.54%	1 544	43.52%
Panel C: Vida Ativa									
	Treatment		Control			Treatment		Control	
	Obs.	Mean	Obs.	Mean		Obs.	Mean	Obs.	Mean
Employed after 6 months	133 041	30.88%	106 991	28.78%	Employed after 6 months	20 950	39.60%	17 561	32.28%
Employed after 12 months	103 545	46.58%	79 193	45.46%	Employed after 12 months	16 602	49.45%	13 027	45.86%
Employed after 18 months	85 875	62.85% <sup>a</sup>	62 653	62.45% <sup>a</sup>	Employed after 18 months	13 862	63.47% <sup>c</sup>	10 430	62.34% <sup>c</sup>
Employed after 24 months	73 503	75.21%	51 870	77.43%	Employed after 24 months	11 947	73.07% <sup>a</sup>	8 798	73.85% <sup>a</sup>
Panel D: Socially useful work									
	Treatment		Control			Treatment		Control	
	Obs.	Mean	Obs.	Mean		Obs.	Mean	Obs.	Mean
Employed after 6 months	53 780	24.80% <sup>a</sup>	39 844	25.17% <sup>a</sup>	Employed after 6 months	27 359	26.69% <sup>a</sup>	18 214	26.53% <sup>a</sup>
Employed after 12 months	46 953	45.09%	30 209	39.47%	Employed after 12 months	23 422	43.89%	13 962	36.94%
Employed after 18 months	39 677	61.57%	24 029	54.63%	Employed after 18 months	19 297	59.61%	11 349	49.26%
Employed after 24 months	35 369	69.89%	19 704	67.24%	Employed after 24 months	17 129	64.85%	9 553	57.11%

Note: All differences between means are significant at the 1% level, with the exception of (a) insignificant, (b) significant at the 5% level, and (c) significant at the 10% level.

Source: OECD analysis based on administrative data from the Portuguese PES.