



ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

# *Portugal and the Challenges of Globalization*

*Ministry of Economy and  
Innovation, Lisbon, 5  
November, 2007*

## **Growth and the Regulatory Framework**

**Stefano Scarpetta**

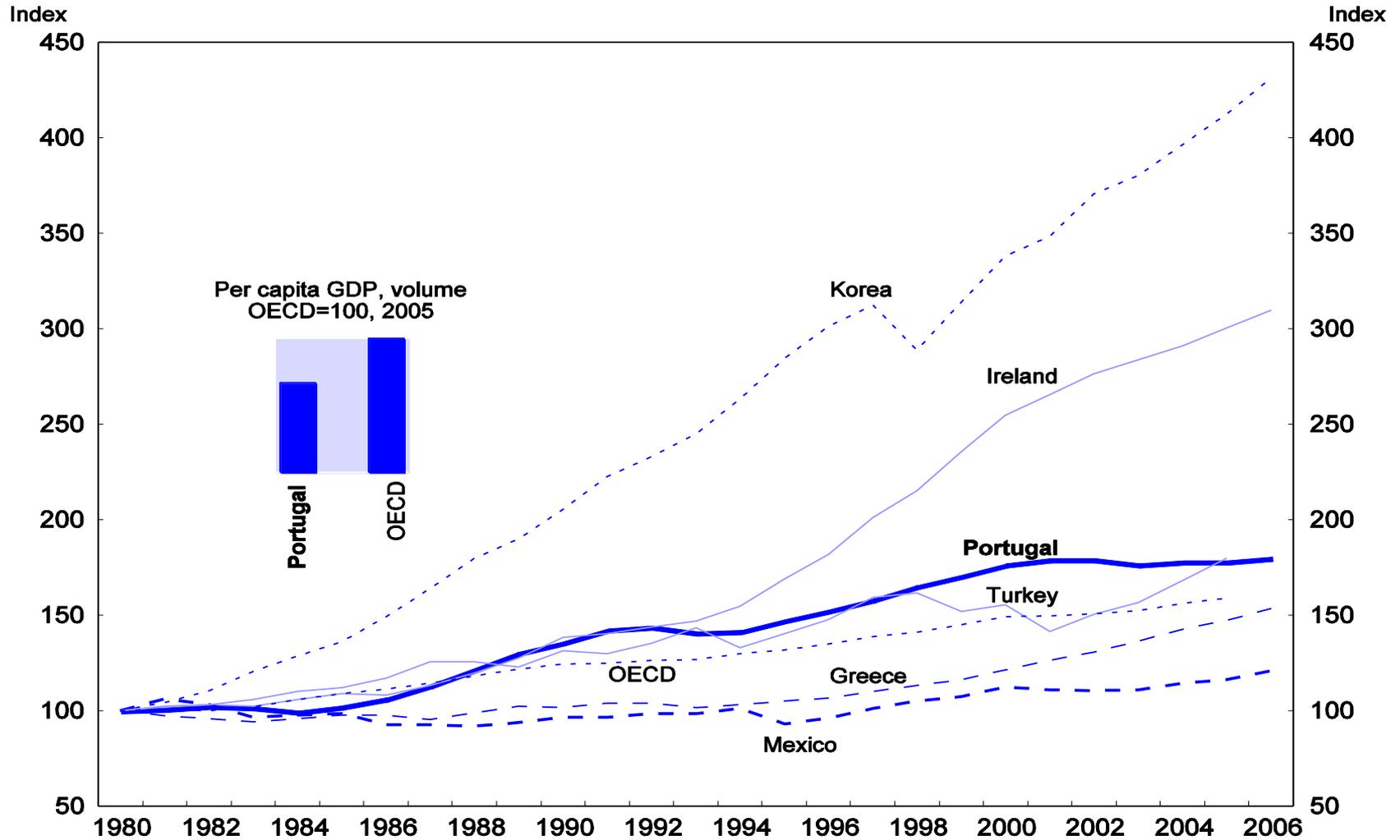
**OECD, Economics Department**

*Based on preliminary material for the OECD 2008 Economic survey of  
Portugal*

# Road Map

- After the boom
  - Recent trends in output and productivity growth and the challenges ahead
- The regulatory framework and changes therein
  - Significant reforms in goods and service markets but more remains to be done
  - Limited progress on labour market reforms
- Regulatory reforms and their impact on productivity, exports and FDI
  - Evidence from simulations of regulatory reforms in product markets

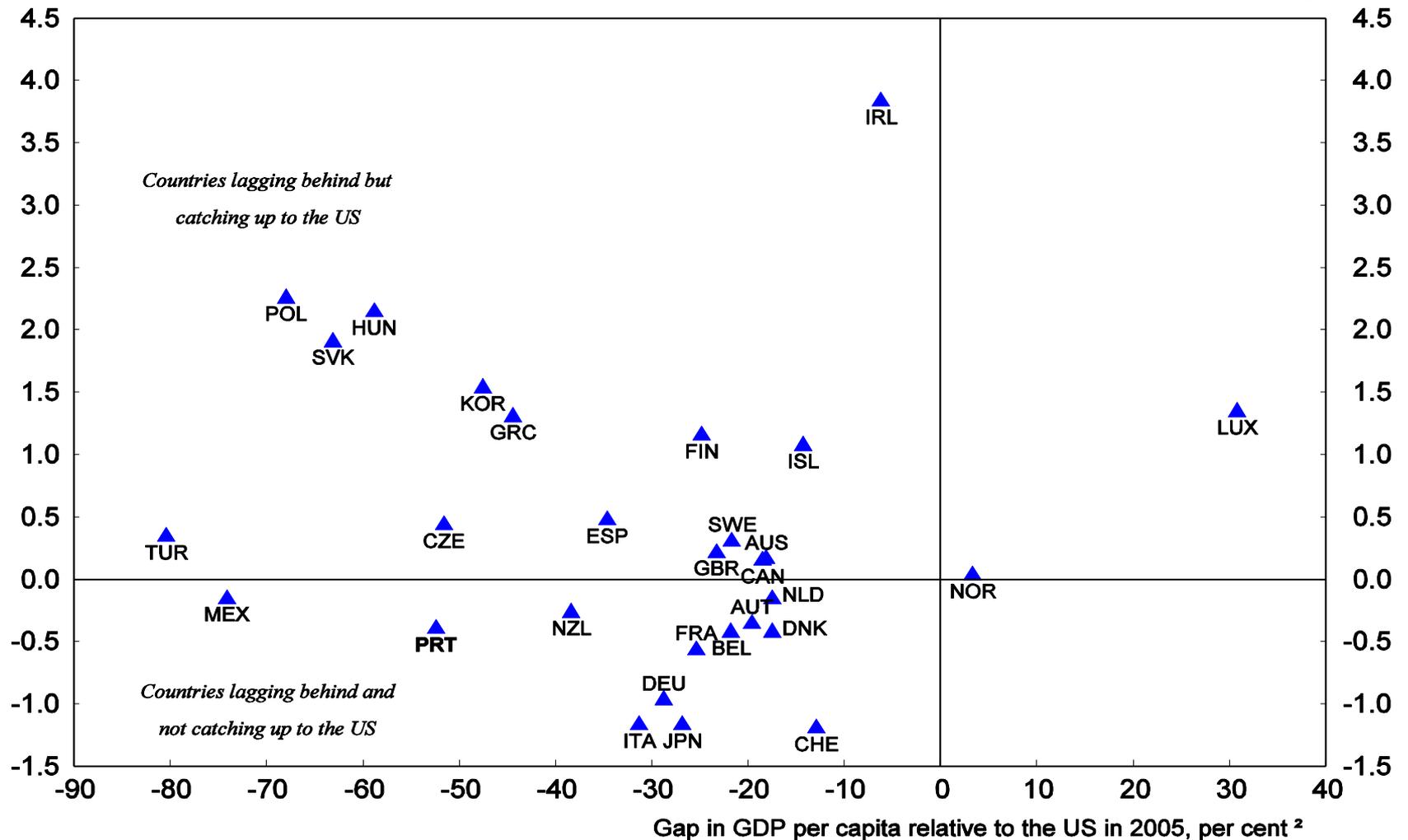
# Growth has remained anaemic since 2000...



# ... and the convergence process reversed

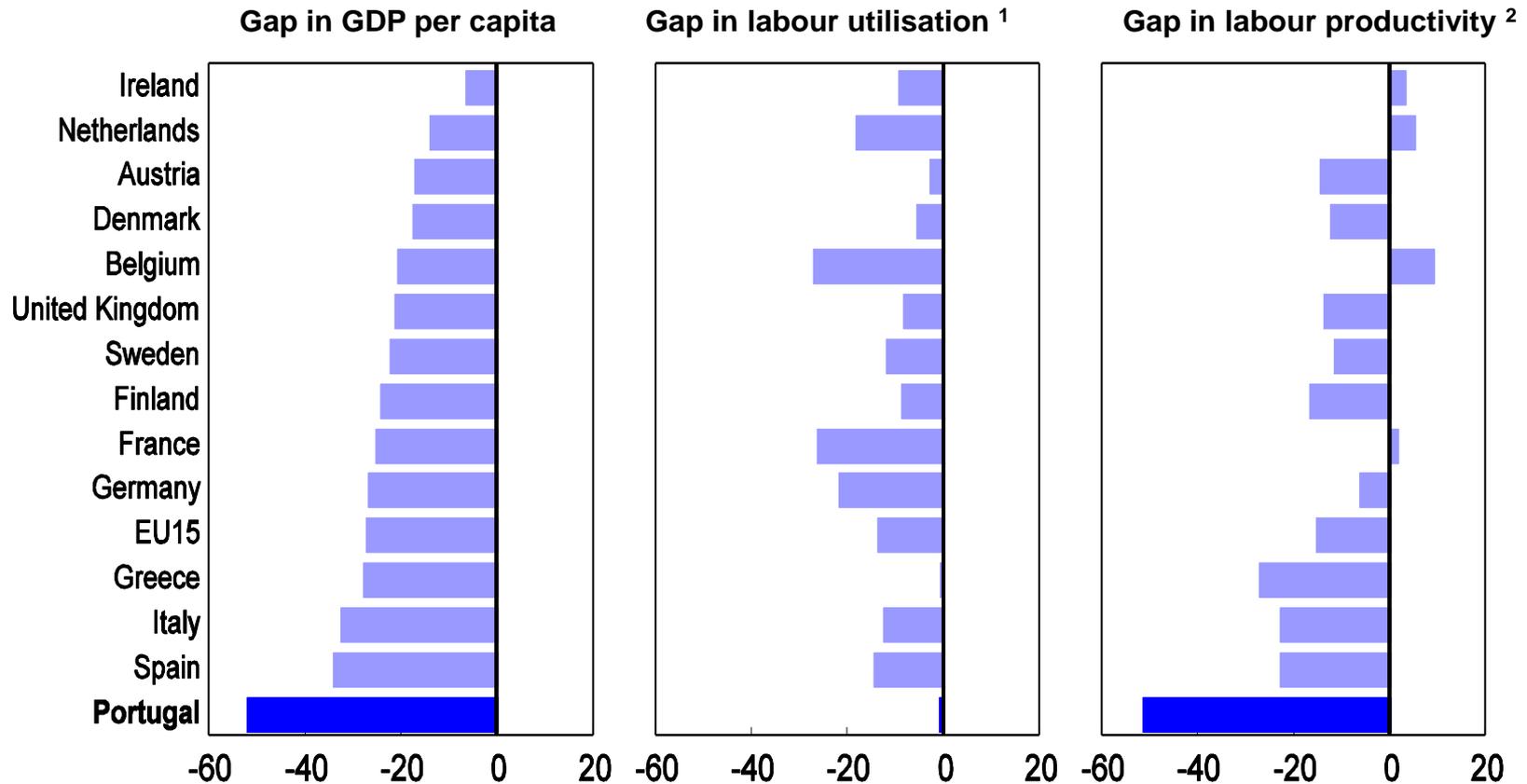
Gap in the average growth rate 1995-05, per cent <sup>1</sup>

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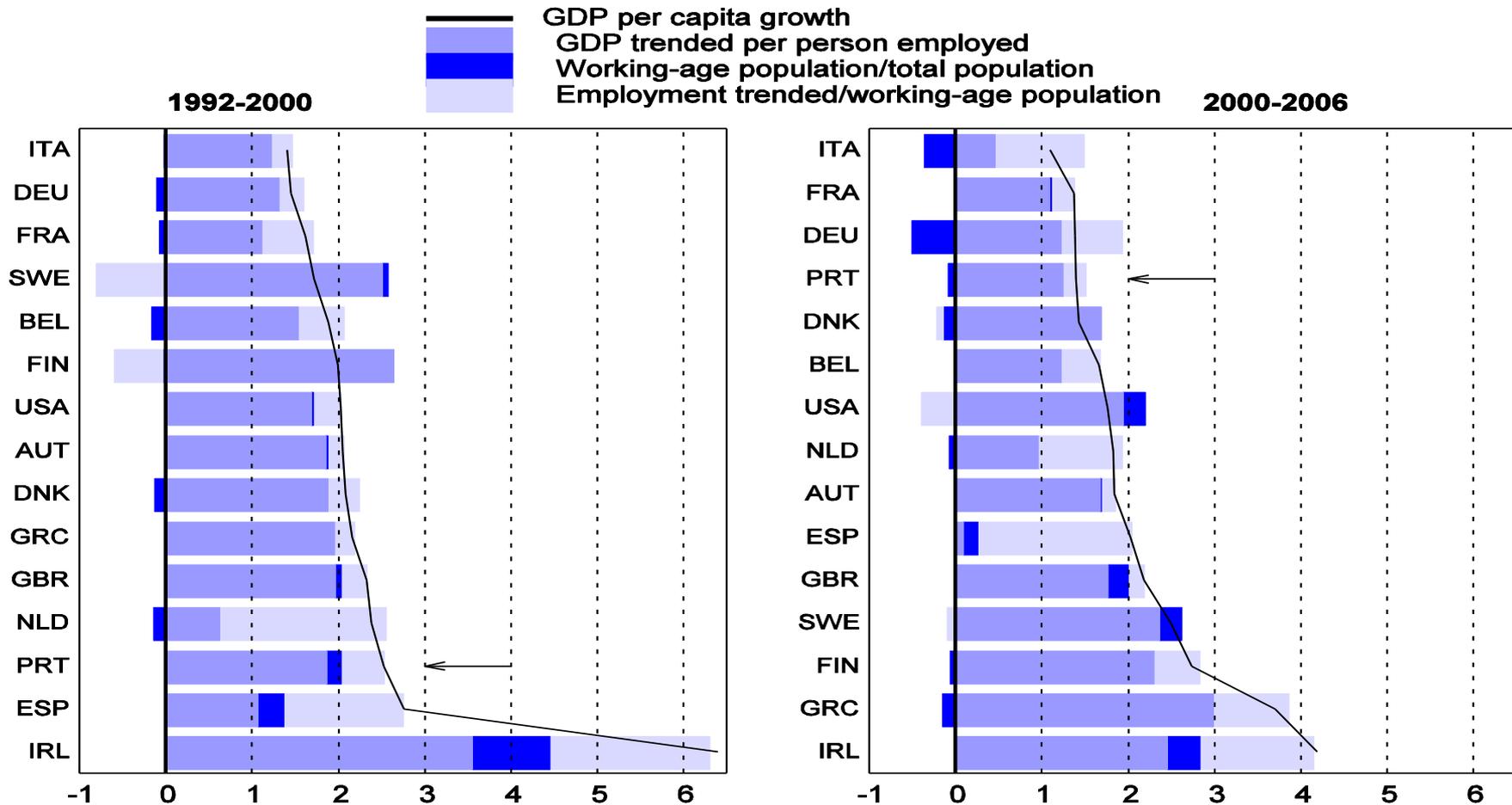
# Difference in GDP per capita

Percentage point differences in PPP-based GDP per capita relative to the United States -- Selected countries in 2006



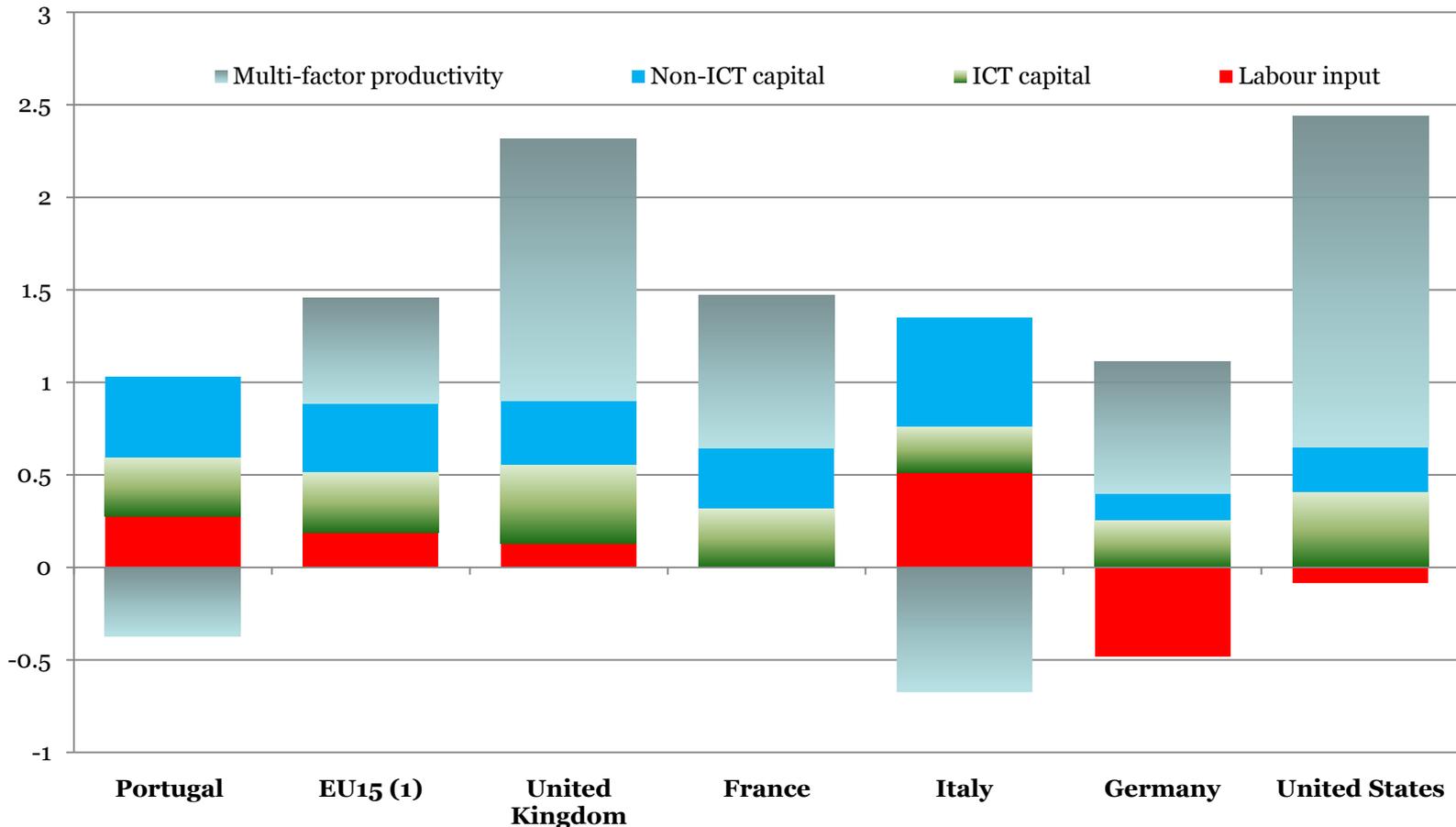
1. Hours worked per capita
2. GDP per hour worked

# The driving forces of GDP pc growth



# Limited role of ICT and MFP to output growth...

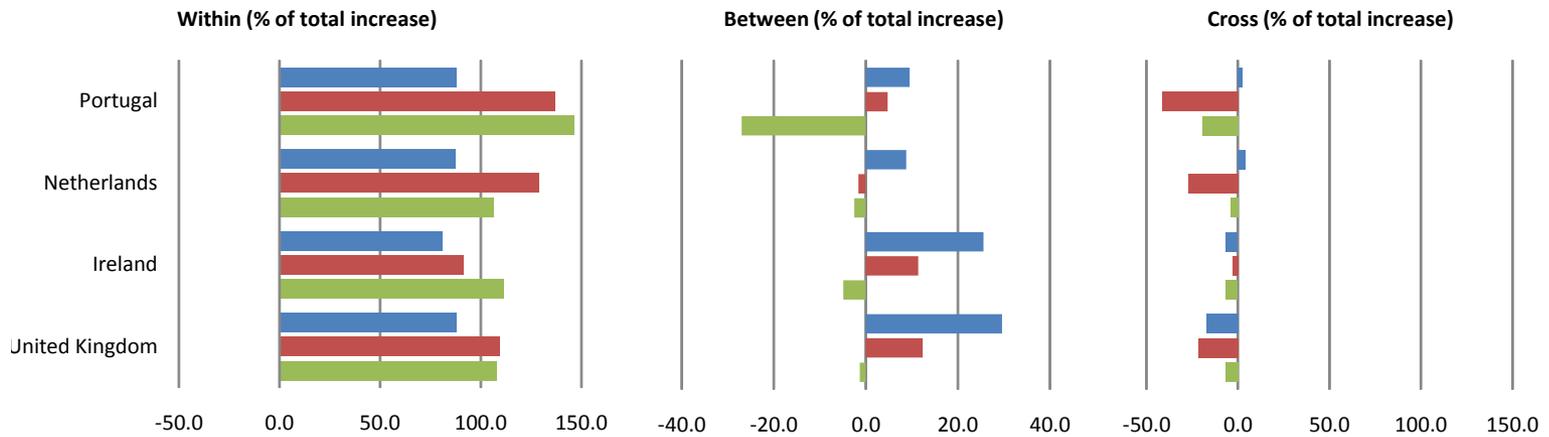
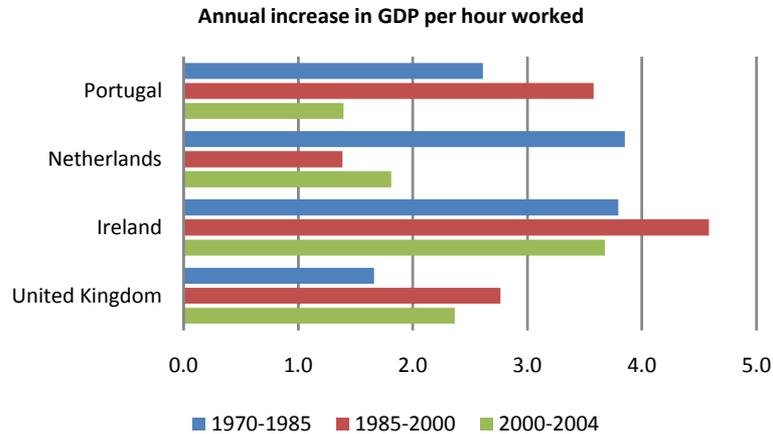
Somewhat weaker contribution of ICT capital but in particular negative contribution from MFP growth, 2000-2005



... with reallocation of employment going to

# low productivity activities

## Shift and share analysis of labour productivity



**Within:** within industry labour productivity growth.

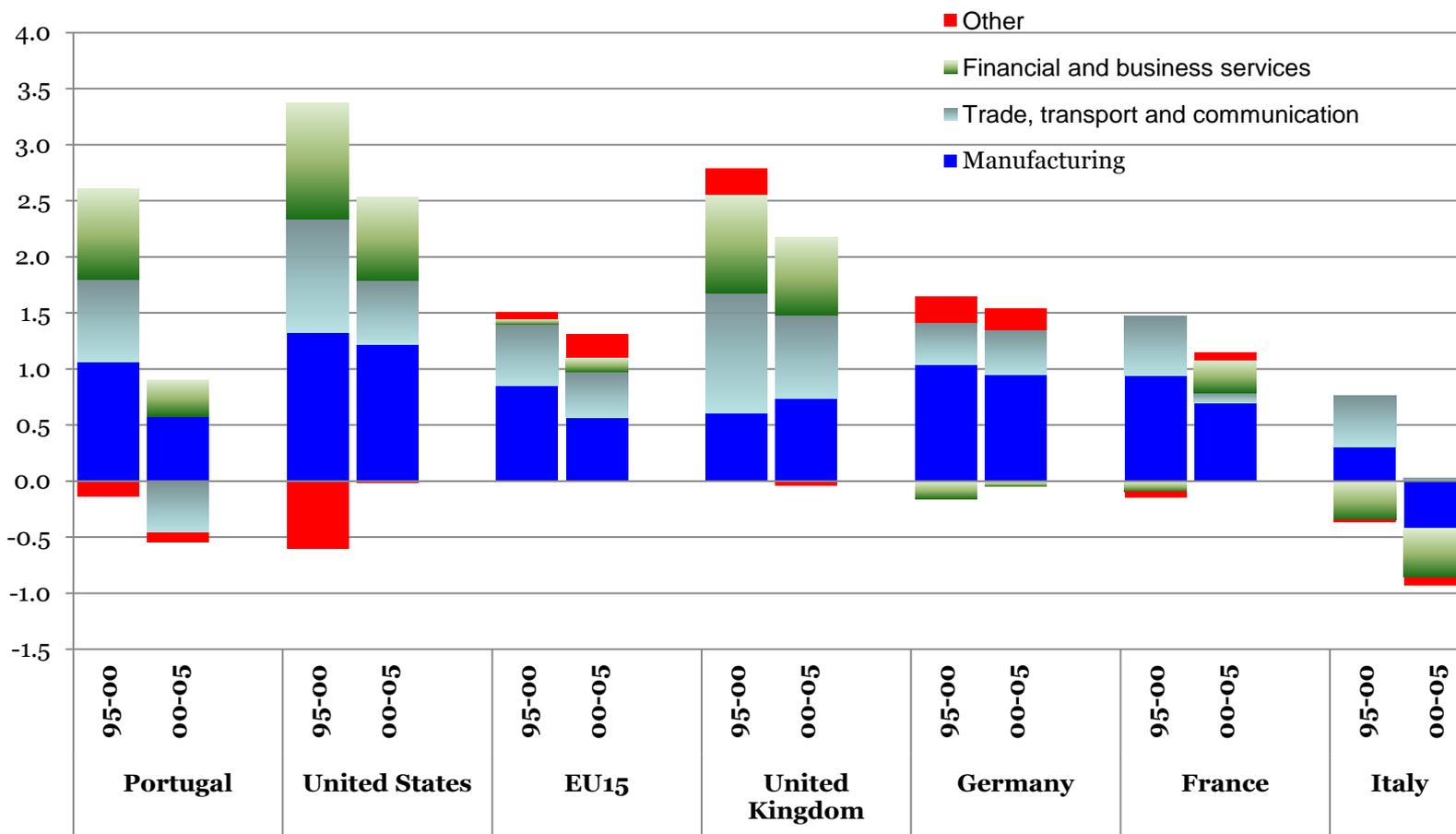
**Between:** productivity growth due to reallocation of labour across industries with different levels of productivity.

**Cross:** productivity growth from shifts of employment across industries with different productivity growth rates.

# ...and limited role of ICT-intensive industries

Market services have contributed relatively little to growth

(Sectoral contributions to business sector productivity growth)

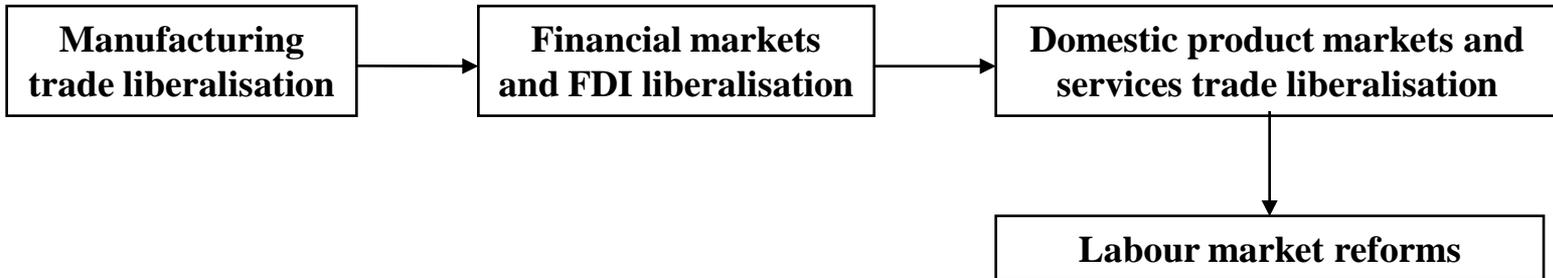


# Why looking at regulation?

- **Recent growth theory and empirics have related growth to policies and institutions...**
- **...especially those that promote or hinder product market competition and facilitate efficient allocation of resources (e.g. Aghion and Howitt, '06; OECD '03)**
- **We now have a better grasp of how such policies and institutions may affect productivity (see e.g. Nicoletti and Scarpetta '05 for a review)**
  - **Domestic investment:** entry liberalization tends to raise long run investment rate. But non-linearity: small changes in heavily regulated environment have insignificant effect
  - **FDI:** Lowering FDI restrictions boosts bilateral and total FDI; Easing host country regulations (relative to investor country ones) boosts bilateral and total inward FDI
  - **MFP growth:** MFP growth rises as overall regulatory environment is eased; The lower entry barriers and state control, the faster is catch-up to best practice; Long run costs of regulation are higher where MFP is farther from the technology frontier
  - **Labor regulations,** by raising adjustment costs affect optimal allocation of resources, especially in labour intensive industries
  - **Trade in services:** heterogeneity in regulations across countries raises trade and investment costs of service providers that operate in different countries (e.g. is Kox and Kyvik-Nordas, 2007)

# Reform patterns

- Stylised sequencing of structural reform in EU countries

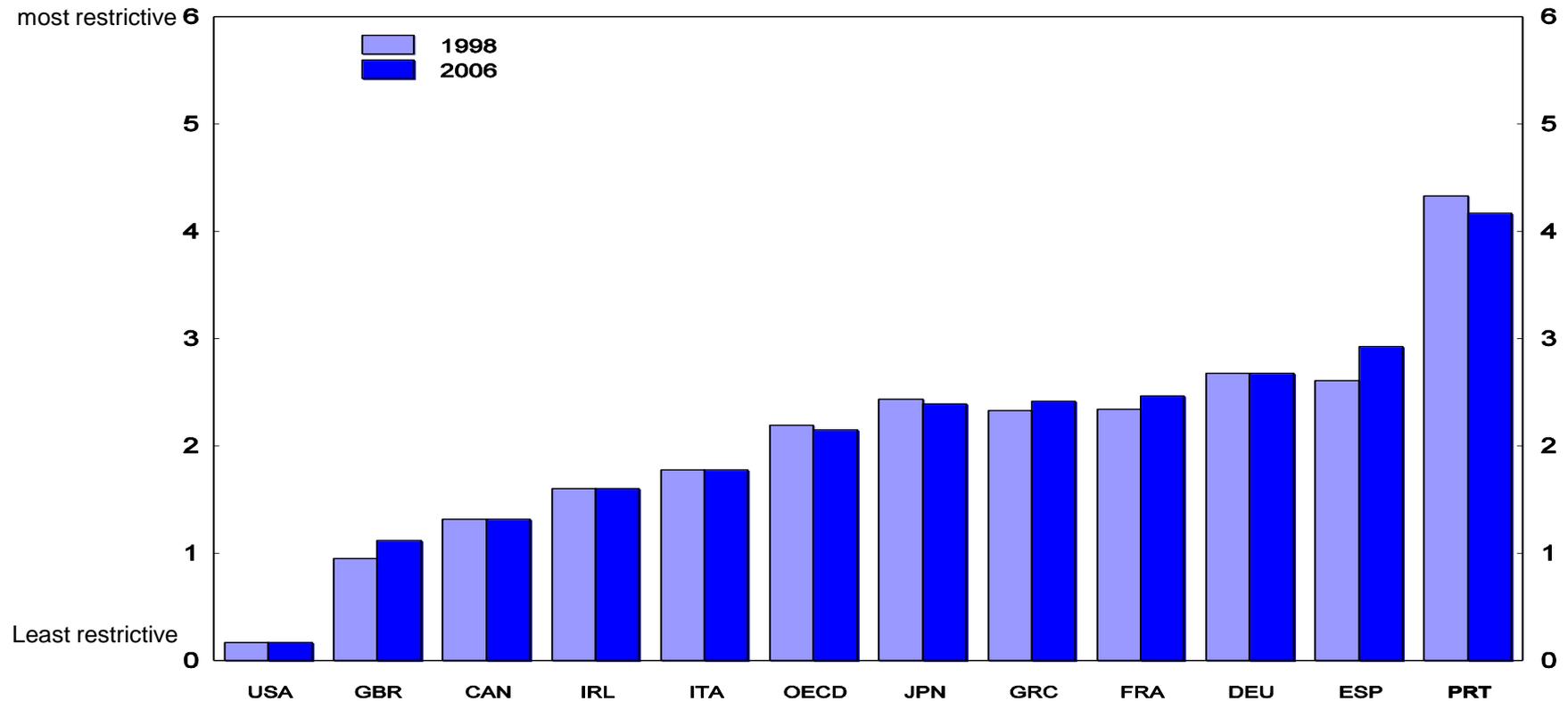


- Extensive product market liberalisation, but much fewer changes in labour markets on average
- Timing and intensity of **product market reform** very different across countries and areas
  - Bell shaped convergence profile
  - Fewer reforms on entry restrictions
- Timing and intensity of **labour market reforms** very different across time and areas
- Large differences in financial market regulations

# Some, limited, progress in labour market

## Employment protection legislation – Regular contracts

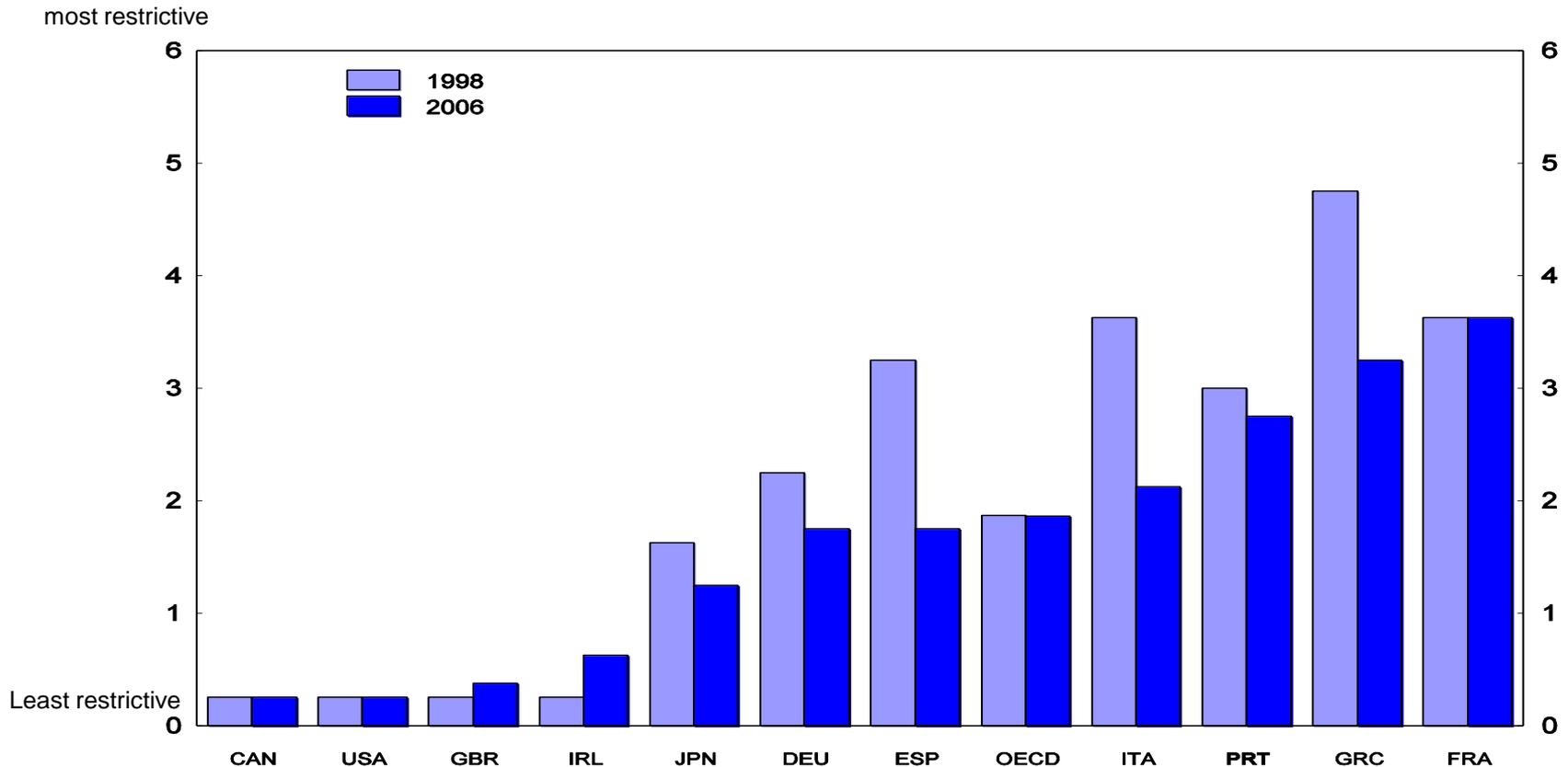
(synthetic indicators of stringency of EPL)



# Some limited progress in labour market regulations

## Employment protection legislation – Temporary contracts

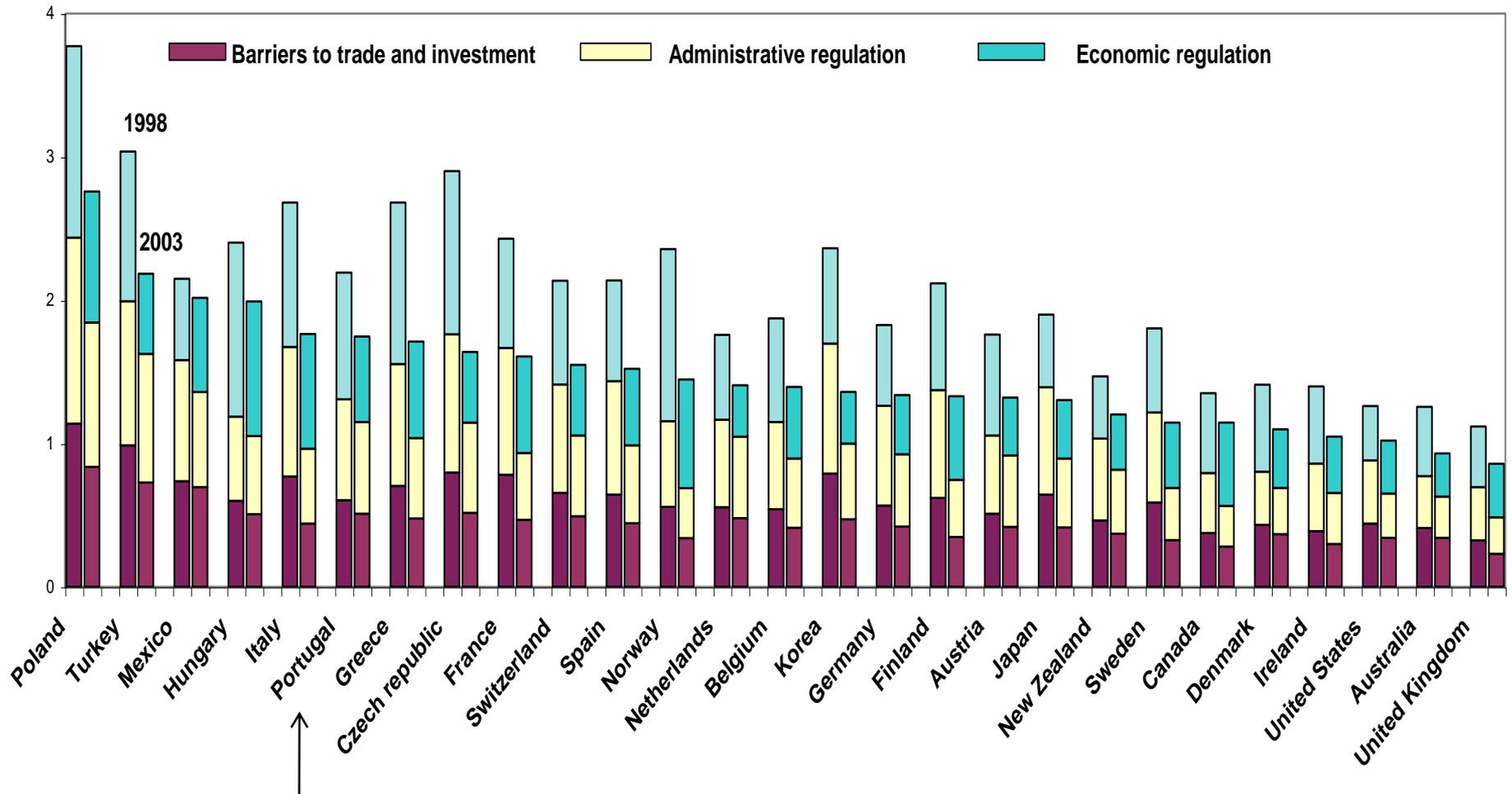
(synthetic indicators of stringency of EPL)



# Product market regulations: Overall regulatory approaches, 1998-2003

By area of regulation

0-6 scale from least to most restrictive

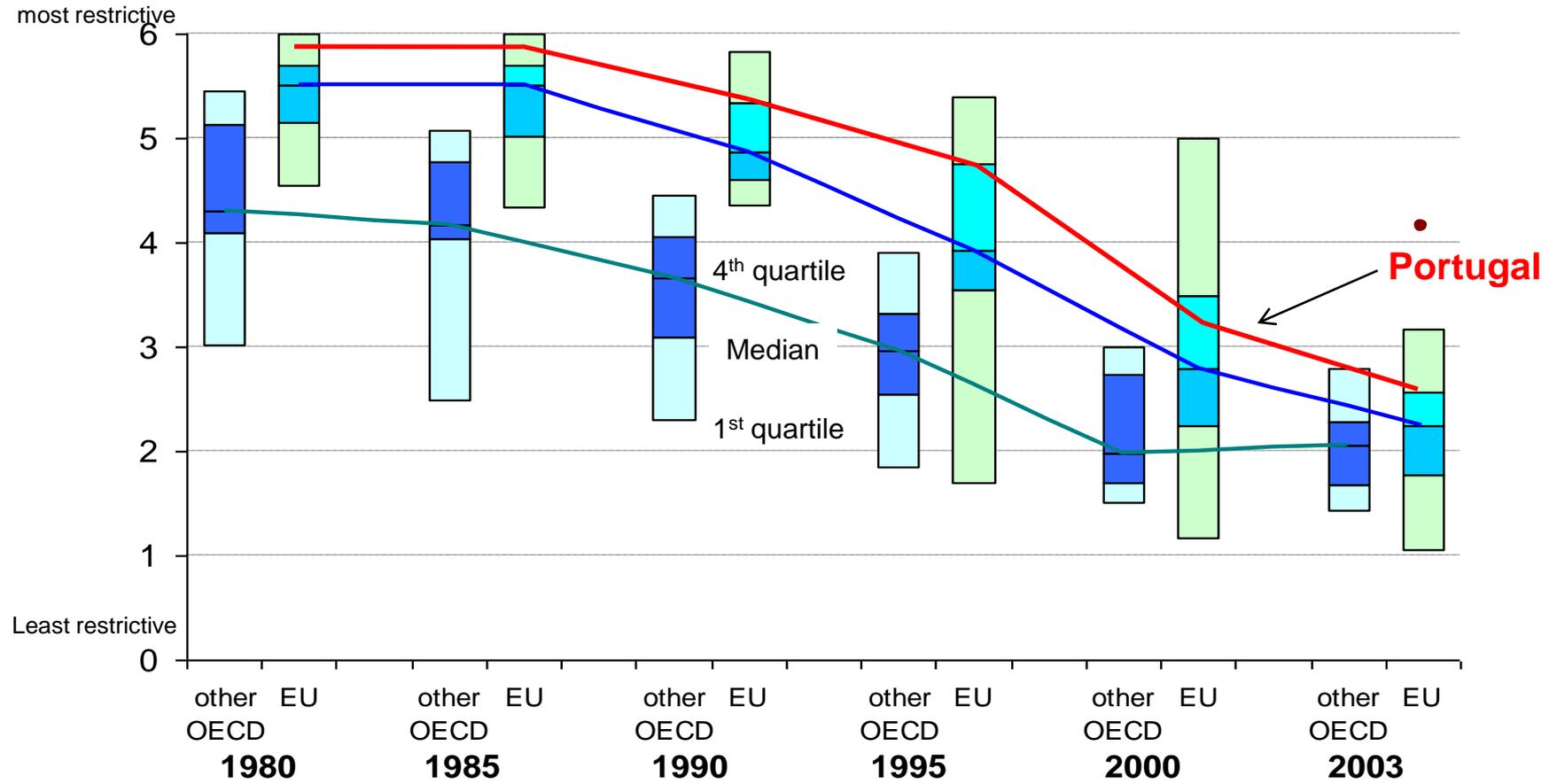


# Further progress in product market regulations

- A number of reforms have recently been implemented or are in the pipeline in the SIMPLEX framework
  - Including quantitative targets in programmes to reduce administrative burdens (e.g., one hour to create a firm)
  - Streamlining government process requirements (e.g., the sharing of information between public services, eliminating the need to provide the same information to multiple services).
  - Reducing the time to create a firm, the number of bodies to contact, and the global cost of the start-up process.
  - Eliminating a number of public announcements in the Official Journal.
  - Eliminating several formal deeds drawn up by notaries.
  - Setting up online services (e.g., Online Firm, Online Brand, Online Patent, Permanent Certificate)
  - Some simplification of the process for the dissolution of firms is already implemented.

# Product market regulations (PMR): convergence over time

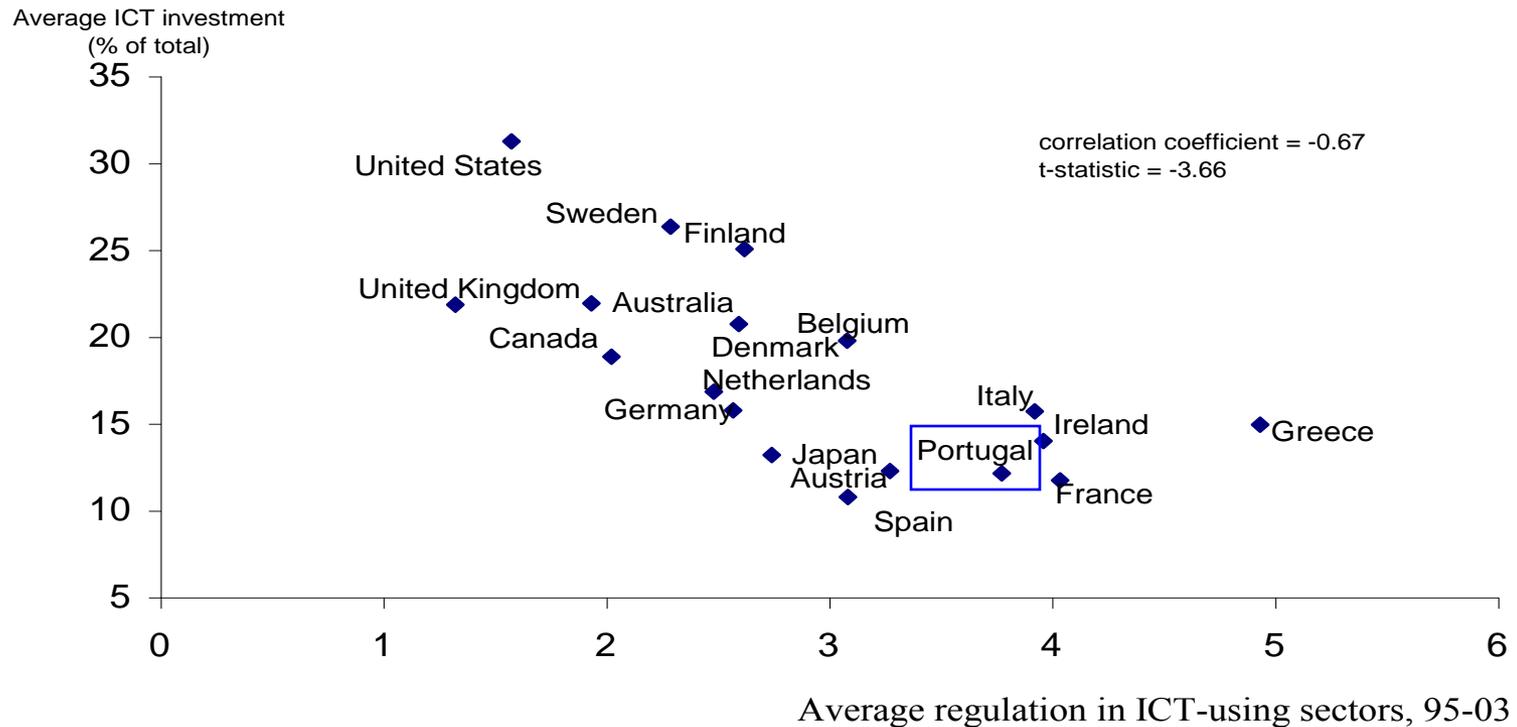
(network industries, index scale of 0-6 from least to most restrictive)



Other OECD countries = AUS, CAN, JPN, NZL, NOR, CHE, US. Source: OECD, product market regulation database.

# Does it matter? Light PMR encourages ICT investment...

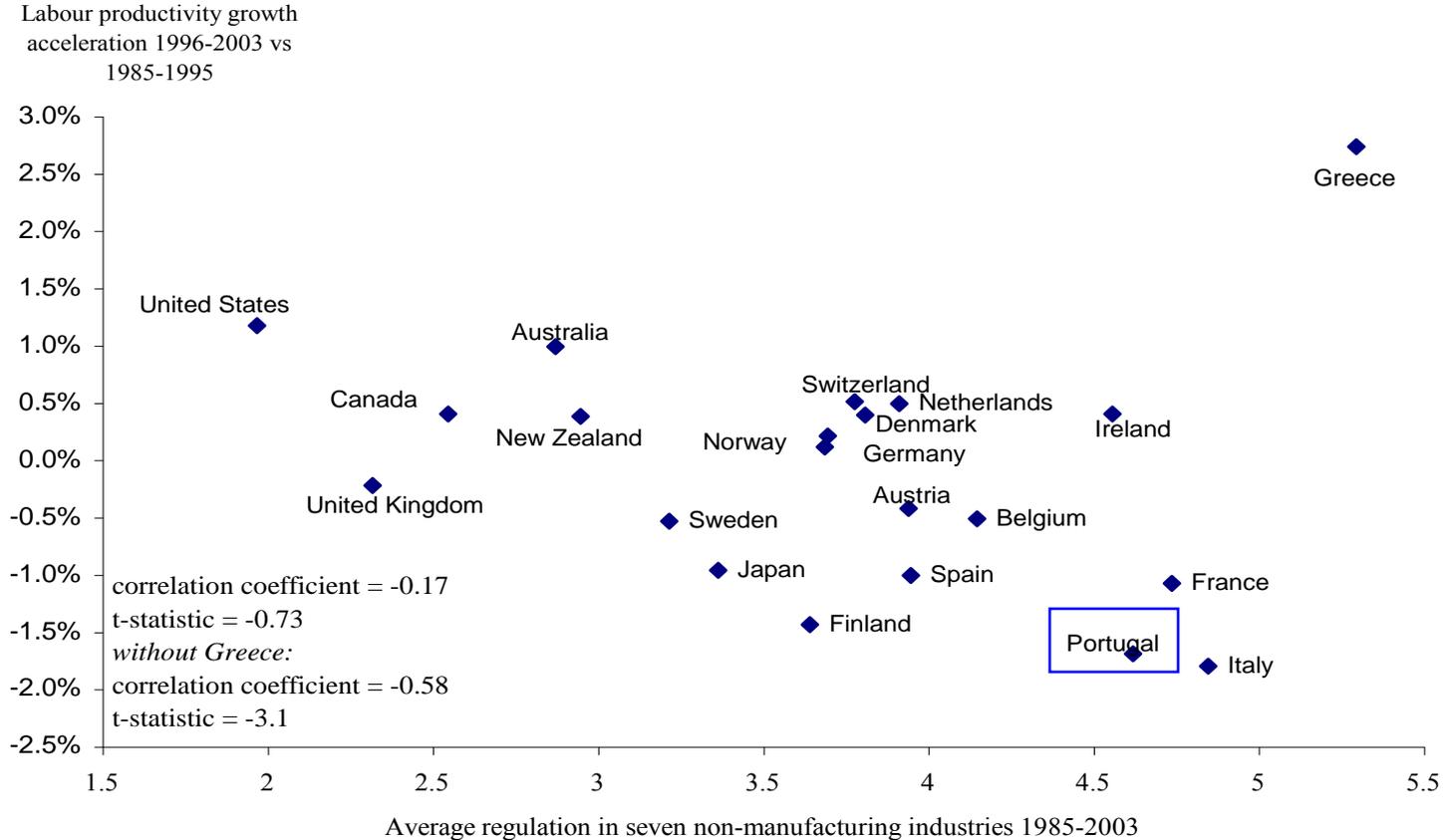
The scale of the indicators is 0-6 from least to most restrictive



1 The indicator of regulation in ICT-using sectors is the simple average of the 'regulation impact' indicators for the individual industries included in these sectors.

# ...and it is associated with stronger productivity dynamics

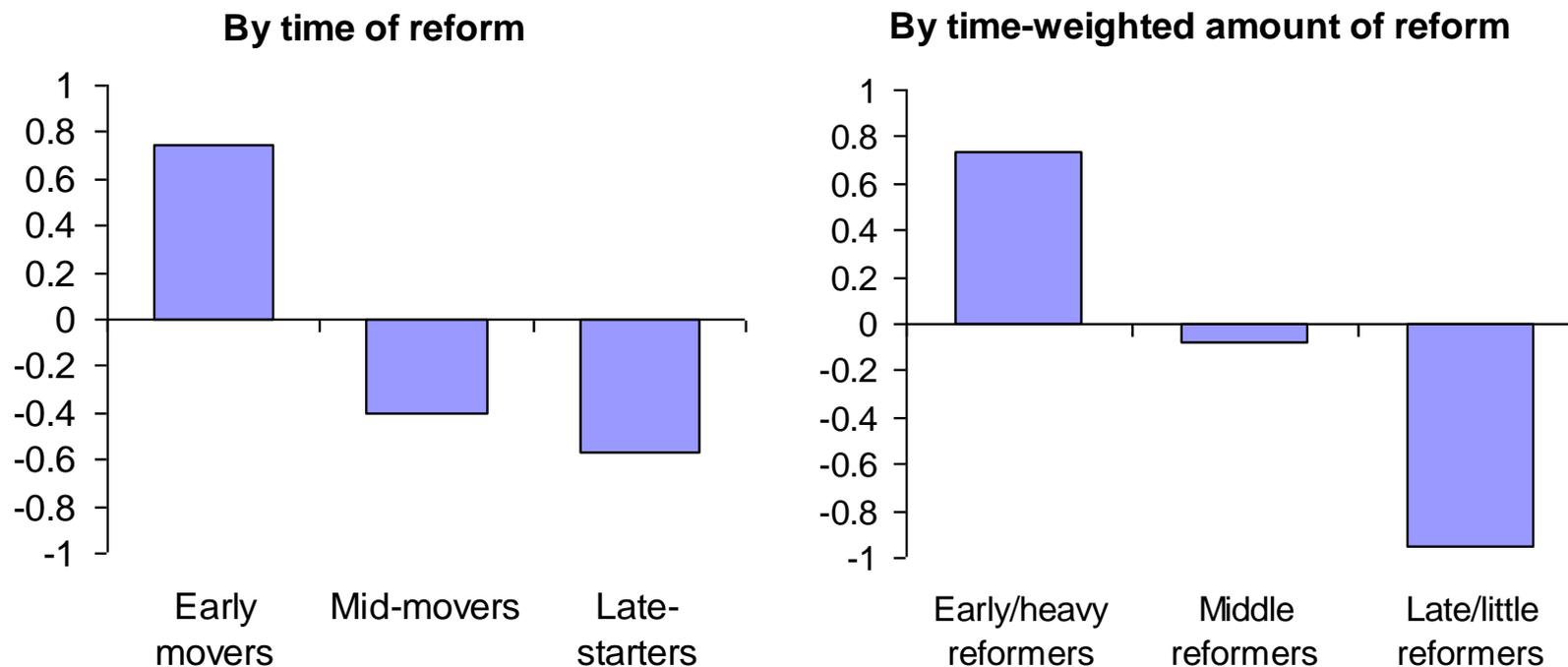
The scale of the indicators is 0-6 from least to most restrictive



Source: OECD Productivity Database and OECD International regulation database

# It takes time for reforms to pay off

Change in labour productivity growth, per cent per annum relative to OECD average



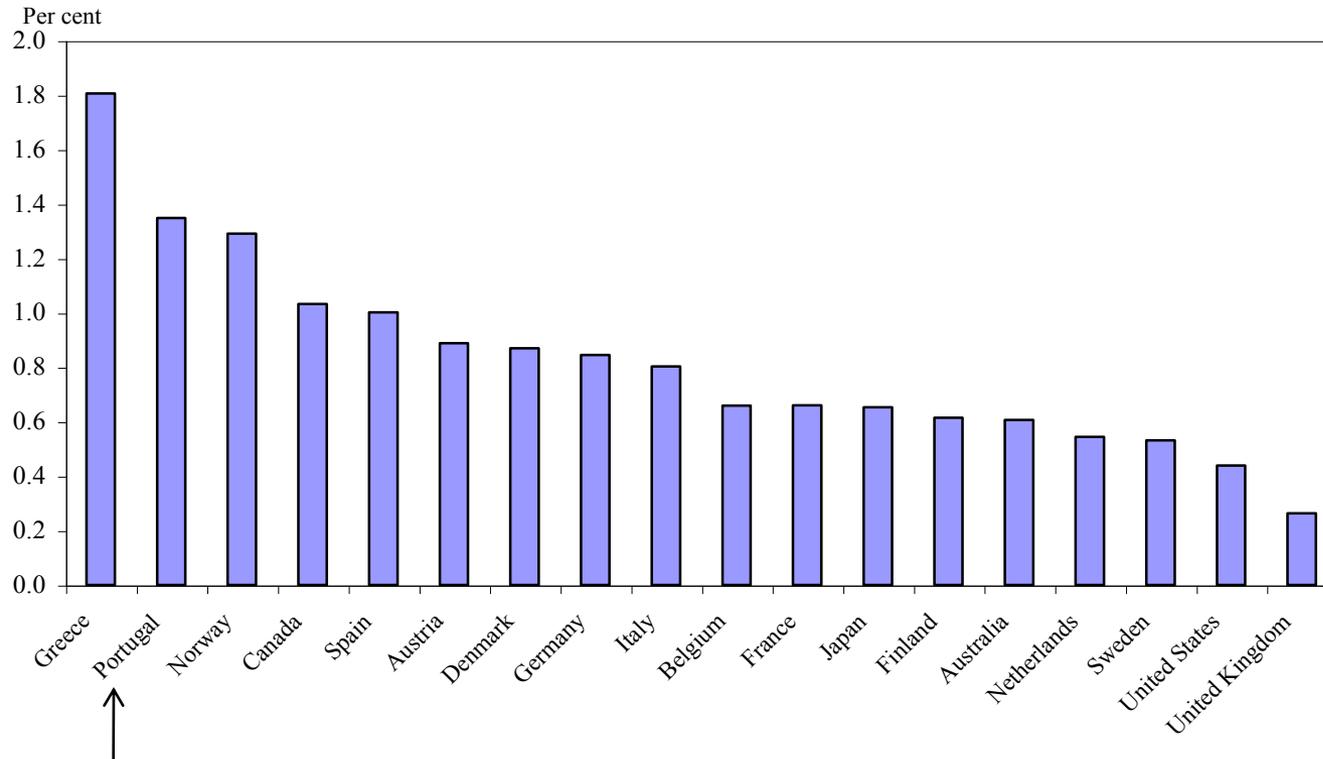
21 OECD countries; labour productivity growth in 2000-05 minus labour productivity growth in 1970-80; proportion of the change in PMR in 1975-85; 85-95; 95-03; in right panel early reforms get higher weight (4, 2, 1, respectively).

# Regulatory reforms and their effects on productivity: *Had you been braver*

Simulations from cross-country/cross-industry regressions

Increase in average annual business sector productivity growth over the period 1995

to 2003 given a move to sectoral regulations that are least restrictive of competition in 1995<sup>1</sup>



1. Simulations from cross-country/cross-industry regressions. Data are the average increase in annual business-sector productivity over the period 1995 to 2003 given an easing in regulation to the least restrictive of competition in non-manufacturing sectors in OECD countries in 1995. Productivity in the productivity leader in each sector is assumed to grow at 1.6% per year. The business-sector results are calculated as weighted averages of the sectoral productivity increases using value added weights.

Source: Conway et al. (2006), OECD Economics Department Working Paper No. 509.

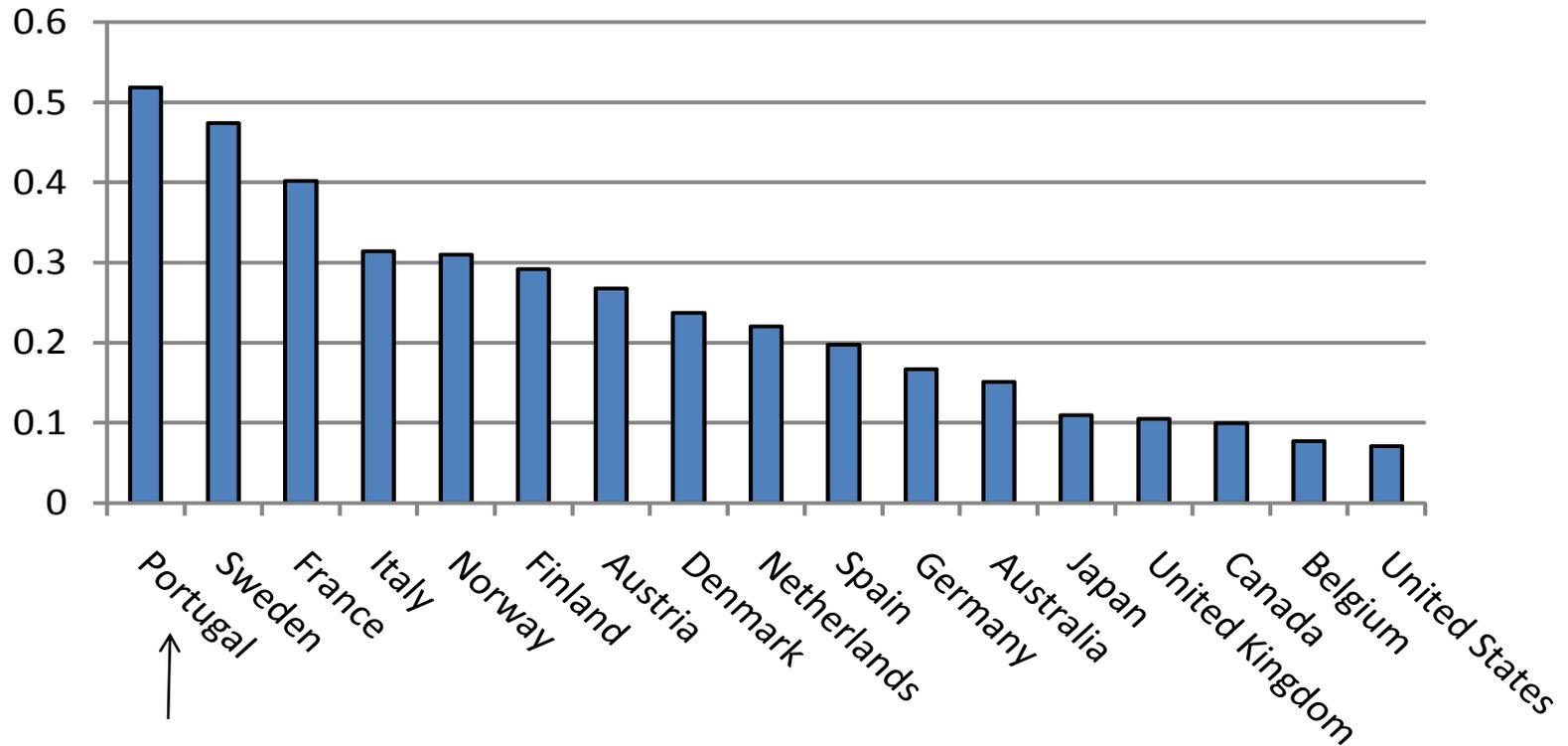
Lisbon, 5 November, 2007

# Regulatory reforms and their effects on productivity: *Had you been quicker*

Simulations from cross-country/cross-industry regressions

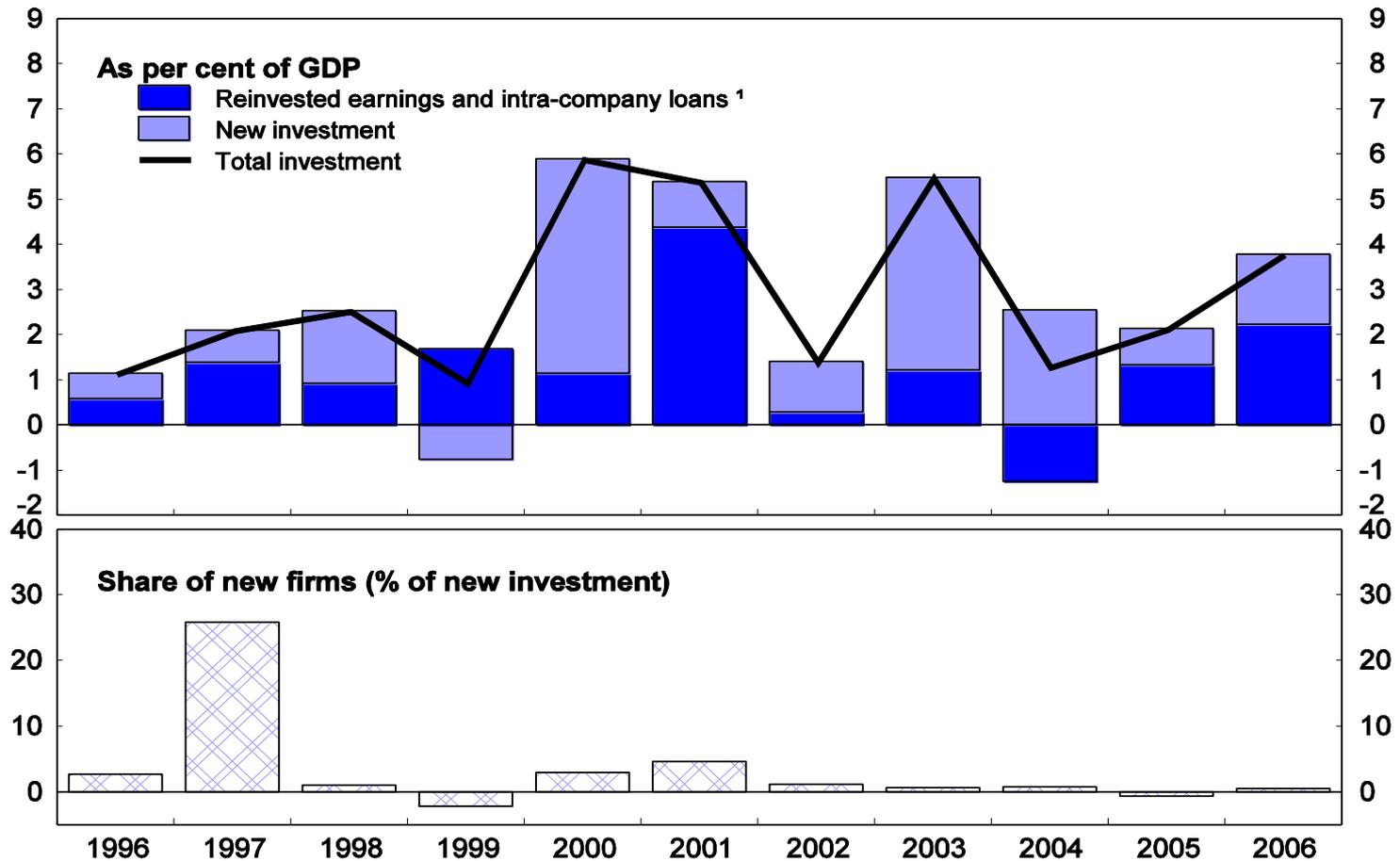
**Increase in average annual business sector productivity growth over the period 1995-2003 given a move to the regulatory setting of 2003 in 1995**

per cent



# FDI in Portugal

Significant magnitude, but limited new investment

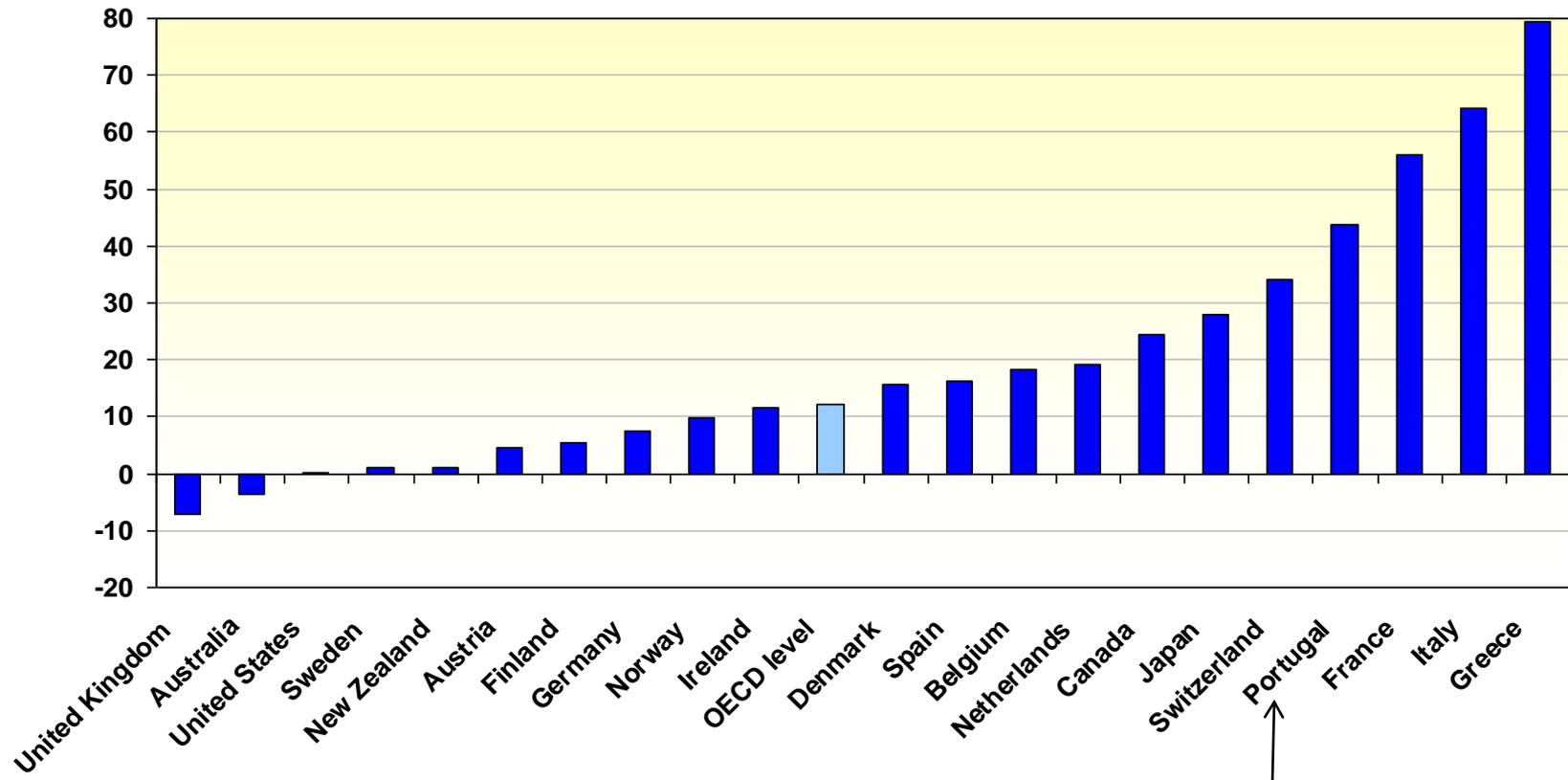


# Regulatory reforms and their effects on FDI:

*Had you been more attractive to FDI*

Estimated impact on FDI of setting product market regulations  
to best practice

Percentage change as a proportion of the average FDI positions over the 1990s



# Summing up

- After solid growth in the second half of the 1990s and convergence towards living standards in richer OECD countries, economic growth stalled in Portugal in the early 2000s
  - Slowdown in productivity largely responsible for the weak economic performance
  - ...this is resulting from weak investment in new technologies (ICT)...
  - ... and because resources dismissed from more productive activities (e.g. manufacturing) have been absorbed by activities with lower productivity (low productivity services)
- Understanding the regulatory framework in which firms operate, and the competitive pressure they face, is important to assess key challenges to promote higher and more sustainable growth.
  - Labour regulations in Portugal: some limited progress, with an easing of employment protection legislation (EPL) in 2006
  - Much progress in product market regulations, including administrative burden to start up and business operation as well as improvements in sector-specific regulations
  - Much of the regulatory reform took place in the recent past, and the experience of “early” OECD reformers suggests that it takes time for reforms to fully display their effects
  - Despite the significant effort over the recent past, much remains to be done to align product market regulations in Portugal to the best practice
  - Simulations suggest that there is scope to promote greater efficiency and a better allocation of resources through regulatory reforms. These have the potential to boost significantly productivity and output growth over time.