



# Portugal



Portugal is one of the smallest economies and one the least prosperous countries of the Eurozone.

Portuguese population (2009 est.): 10.7 M.

Portuguese 2008 GDP: €166 B., estimated at \$235 B. corrected for Purchasing Power parity, yielding a GDP per capita of approximately \$22,000 (corrected for Purchasing Power Parity), ranking Portugal at the bottom of the Eurozone countries, at the level of newcomer Slovakia.

Portugal economic performances in the past few years have been rather poor. GDP growth in 2006, at 1.4%, was the lowest not just in the Eurozone but in all of Europe. In 2007 it was better, at 1.9%, but was nil in 2008, in both years lower than the European average. Since 2000, the Czech Republic, Greece, Malta and Slovenia have all overtaken Portugal in terms of GDP per head, while Slovakia is catching up with Portugal. Portuguese GDP per head has fallen from just over 80% of the average of the European Union countries in 1999 to less than 75% in 2008.

## **Background:**

Portugal has had its heyday as a world power during the 15th and 16th centuries, but the country has since lost much of its wealth and status. Its entry into the EU in 1986, together with Spain, has coincided with a period of growth, well above the EU average, that lasted until the late 1990's. During that period, Portuguese GDP per capita jumped from 51% of the EU average in 1985 to 80% in 1999.

Public and private investments as well as reforms, mainly the privatization of many state-controlled firms and the liberalization of key areas of the economy, including the financial and telecommunication sectors, have been the major fuels of growth. As a result, Portugal has become a diversified and increasingly service-based economy and has qualified for the European Monetary Union (EMU) in 1998 to begin circulating the Euro on 1 January 2002 along with eleven other EU member economies.

Ambitious public investments, partly financed by European solidarity (structural and cohesion funds), had given a strong impetus to the Portuguese economy and had been amplified by private investments, mostly from large European firms attracted by Portuguese lower manufacturing costs. But in the past few years the situation has changed and now Portugal faces difficulties.

## **Portugal's challenges and advantages:**

Portugal main challenges are the following:

- Lower-cost producers in Central Europe and Asia are increasingly overshadowing Portugal as a target for foreign direct investment.
- The entry of eight former Eastern bloc countries into the EU in 2004, plus, in 2007, of Romania and Bulgaria, has caused a decrease in the amount of EU funds available to Portugal, as these funds have to be shared with the new entrants.
- A relatively (in comparison with other Eurozone countries) poor educational system has been an obstacle to greater productivity and growth. Labor productivity is the lowest of the Eurozone and its growth has been half the Eurozone average in recent years.
- Political instability has taken its toll. On average, Portuguese governments have lasted just two years since the return of democracy in 1974. The governments, until very recently, have not been able or willing to seriously reform the public sector and to discipline the public finances. When interest rates fell and released a surge of growth in the late 1990s, Portugal responded with an expansionary fiscal policy instead of taming its deficit. This was Portugal's big missed opportunity before its entry into the Eurozone.
- The geographical location of Portugal, far from Europe's main economic centers, increases transportation costs and is a disadvantage.

To compensate for these negative features the factors of hope for Portugal are the following:

- Mostly and foremost, Portugal's membership in the European Union and in the Eurozone: This is the single force that compels, and will compel, Portugal, to make the structural and political changes that are necessary to insure its future. Thus, the government of Socialist José Sócrates, in power since March 2005, was forced to break some of its popular election pledges. It had to raise value-added taxes, to attack public-sector privileges and to streamline the public administration, which costs more as a share of public spending than in any other Eurozone country. Doctors, nurses, teachers, police and other public-sector workers have all taken to the streets in protest, but Mr. Sócrates has resisted and its tough approach is starting to bear fruit.
- A still comparatively low-cost environment: Although unit labor costs have risen sharply in the past 10 years, this rise has abated recently. For the near future, Portuguese unit labor costs are forecasted to increase less than in the central European countries that are Portugal's main competitors for European "cheap" labor. Real estate costs are still very competitive when compared to the ones of other Eurozone countries: Top grade office rental costs average \$400 per sq m per year, industrial facility rental costs \$100 per sq m per year.
- An up-to-date infrastructure: The investments of the past two decades have transformed the country from a backwater place to a modern country. The transportation network (airports, roads, railways, seaports) has improved

considerably. The privatized telecommunications systems are on par with the most advanced in Europe. They notably offer wireless, mobile phone and internet, coverage over the whole country. The energy sector has been liberalized and opened to competition. Portugal is one of the world's most advanced countries in the area of renewable energy (solar, wind and wave power).

### **Challenge and opportunities - Renewable energies in Portugal**

A total lack of indigenous traditional energy sources (oil, gas or coal), and the higher cost of oil, has compelled Portugal to find creative and original solutions to meet its energy needs. The E4 (Energy Efficiency and Endogenous Energies) program was launched in 2001. Renewable energies (hydro, wind and solar notably) are favored, with a goal of 50% of all electricity generated by such sources within 10 years. The program provides for grid interconnections, preferential feed-in tariffs, financial and tax incentives (reduced VAT, income tax exemptions etc). Portugal is inching its way toward that goal: In 2008 renewable sources accounted for 35% of electricity production and 40% is forecasted for 2010.

Portugal has long depended upon **hydropower** to provide a large part of its electricity needs. The biggest hydroelectric power station is in the Alto Lindoso dam, completed in 1992, with a capacity of 630 MW. However, due to Portugal's tremendous growth in the 1980's and 1990's, hydropower's share of total electricity generation had declined from 53 percent in 1980 to 16 percent in 2005. To slow down that trend, new large hydroelectric projects have been undertaken. The Alqueva dam, in Alentejo, was decided upon in the 1990s and started to produce electricity in 2004. It has a capacity of 240 Megawatts (MW) and its reservoir, with a surface area of 250 km<sup>2</sup>, is Western Europe's largest. A drive to build 10 new large dams by 2020 will boost water-powered energy output from the present 4,950 MW to 7,000 MW. At the other end of the scale, about 100 small hydro power plants offer a global capacity of 260 MW.

In addition to the generation of electricity, several of these dams, with large reservoirs, are the source of major irrigation projects that enhance, and will enhance in the future, Portugal's agricultural potential and the development of agro-industries.

As of December 2008, **wind power** turbines in Portugal have a generating capacity of about 2,830 MW, satisfying about 13% of the country's electricity needs, with another 750 MW under construction. The turbines are being supplied by German, Danish or Spanish manufacturers.

A large photovoltaic **solar power** project, the Serpa solar power plant, in the Alentejo region, has started operations in March 2007. With a capacity of 11 MW it is one of the largest photovoltaic power plants in the world. Two much larger similar plants are under construction in the same region: one by Spanish firm Acciona Energia with a final capacity of 62 MW and the other by a German consortium with a final capacity of 116 MW.

Still in the sector of renewable energy, Portugal is the site of the world's first commercial **wave power** farm, off its northern coast. Officially opened in September 2008, it has a

starting capacity of 2.25 MW, which could be expanded to 21 MW, subject to successful operation.

### **Social / Labor relations:**

The boom years of the 1980s and 1990s, with almost full employment, created in Portugal an environment favorable to militant and aggressive trade-unionism. Legislation was labor-friendly, the important weight of the public sector, shielded from competition, contributed to a feeling in the labor ranks that competitiveness was not essential. As a result, strikes became frequent, wages increased much more than in other European countries and Portugal lost some of its attractiveness to business interests.

That trend had to be reversed and in recent years the labor movement has become much more moderate and reasonable. The introduction of a new labor code by a center-right government in 2003, and its approval at the end of that year, completed in 2004 by new regulations, has produced a more flexible and more balanced labor market. The Socialist government in power since 2005 has had the courage of not reversing these measures and has been able to convince the unions, major traditional allies and support of the Socialist party, to moderate their stand.

The base wages are among the lowest of the Eurozone, but high social costs, as well as traditionally generous severance packages, increase the real labor costs. The average hourly all-inclusive cost was, in 2008, about €11.00 in industry, €14.00 in services (tourism excluded) and €9.00 in tourism.

### **An illustration: The Portuguese automotive industry:**

The automotive industry was the leading Portuguese industrial sector until recently, representing up to 8% of the GDP and 25% of all exports (the largest single sector). In the 1980s and 1990s, most European automobile manufacturers (including the European units of GM and Ford) opened plants in Portugal, followed by a large number of automotive components and parts manufacturers, to take advantage of the lower production costs. But, in the past few years, most of the automobile manufacturing plants have closed, one by one, with the production transferred to other countries. The last plant to close was a GM Opel plant in the outskirts of Lisbon at the end of 2006.

There is only one car manufacturing plant left in Portugal, the VW Autoeuropa plant in the Setubal area, south of Lisbon. That plant was started in 1995 with a capacity of 180,000 vehicles per year that was never reached. The maximum output was 139,000 vehicles in 1998 and in 2005 less than 80,000 MPVs (VW Sharan and SEAT Alhambra minivans) were produced. These models were to be replaced and the closure of the plant looked inevitable.

But pressures from the new Sócrates government have forced the labor unions to be flexible and have encouraged VW to persevere in Portugal. A new labor agreement has been reached and ratified, in October 2006, by 62% of the workers. Flexibility in the scheduling of working

hours has been implemented. Workers can work more than the standard 40 hours a week without additional pay above the standard rate. Temporary contracts have been introduced. In exchange, guaranteed, but very moderate, wage increases have been scheduled over the following two years, an adaptability bonus has been granted to the workers at the onset of the period and continuous employment is guaranteed over at least three years.

As a consequence of this agreement VW has decided to locate the production of new models at the plant: the VW Eos retractable-hard-top convertible and the new VW Scirocco coupé. A new generation of the MPVs is also planned for the plant as well as a revolutionary mid-engined roadster. Production has risen well above the 80,000 per year mark. In addition, Webasto, a German producer of retractable hard tops has also opened a new plant in the vicinity.

The Portuguese automotive industry, which was in jeopardy three years ago, appears now to be revived as the labor moderation and flexibility shown to VW has been extended to other firms of the sector, at least in the Setubal area. There, an automotive cluster of parts and components manufacturers, that is ideal for small batch production lines with specific and highly technical requirements and with fast turnaround time, is developing.

### **Opportunities:**

Portugal is a small country, therefore a small market, and is located far from Europe's main business centers. Nevertheless it offers some opportunities to American exporters and investors.

Exporters can find opportunities as in many sectors there are few strong local companies with a tight grip on the market. Quite often the competition will come from a European-based company whose business costs (in Spain, Germany, France, etc.) are higher than the ones of the American exporter due to the depreciation of the Dollar in relation to the Euro. US companies should then aggressively use their price advantage.

Major infrastructure investments have already been made but investments are still being planned, notably in the fields of transportation, health care, education, renewable energy, environmental protection and conservation. Some EU structural and cohesion funds are still available. American firms can find good outlets for their goods or services in participating in some of these projects. In a number of cases, the private sector has taken over from the public sector and is bringing a competitive outlook that can be of benefit.

In addition or complement to these infrastructure projects, exporters will find the following business sectors of particular interest:

- Educational products and training services;
- Laboratory and scientific instruments as well as medical equipment;
- Pollution control equipment;
- Renewable energy equipment and services;
- Agro-industries.

Regarding the distribution of consumer goods and services, one area of high potential is in franchising, which, as a business concept, has not yet reached full maturity in Portugal. There is no barrier to foreign-owned franchise companies in Portugal. Services, in general, are the “new needs” of Portuguese consumers and franchising of services would be a winning combination.

To find more about these opportunities and to make sure that the products and services offered meet EU mandated standards, regulations and practices, as well as the requirements and preferences of Portuguese customers, the best way is to visit, in person, Portuguese trade fairs. Lisbon and Porto, the two largest cities, are the main venues. English is widely spoken in the business circles of Portugal and help is available from many sources. During these visits, the American visitor will notice that Portugal is a country where business customs are more conservative, formal and “old fashioned” than in most other Eurozone countries, including neighboring Spain. As a consequence, business dealings seem to be more time-consuming than in other European countries.

For a potential American investor, the main advantage of Portugal is to offer one of the lowest industrial and commercial cost environments of Europe. Some Central or Eastern European countries may presently have lower costs but, in those countries, these costs are increasing faster than in Portugal.

From Portugal, one can access the whole EU but also over 200 M. people speaking Portuguese worldwide. Former Portuguese colonies, including Macau, Mozambique, Angola and, of course, Brazil, have close business ties with Portugal. US companies can readily find avenues to these other markets through Portugal.

Regarding Brazil, it is to be noted that the relationship does not work the other way. One can sell to Brazil from Portugal using Portuguese documentation but a US firm would not be welcome in Portugal using “Brazilian Portuguese” documentation or operating through its Brazilian affiliate. Portuguese customers or partners would prefer to deal directly with the US firm and communicate in English. Moreover, the Brazilian operation will probably not be familiar with EU practices, regulations and standards that are to be respected when doing business in Portugal.

One must also note that, although Spain and Portugal share the Iberian Peninsula, they are two very different countries, with different languages and customs. The evolution of their respective economic development of the past 10 years has accentuated these differences. To try to do business in Portugal through one’s Spanish distributor or affiliate would yield very little result, unless the distributor or affiliate is already very well implanted in Portugal.