On the wage bargaining system in Portugal

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Like in many other countries of continental Europe, in Portugal the instruments of collective regulation (IRC) constitute the main structural element of labour relations. Given that the Portuguese Constitution guarantees unions the monopoly of collective representation of workers in the bargaining process (Article 56), the various existing IRC are distinguished above all by how employers are represented in the negotiations. In Sector-level Collective Agreements (Contratos Coletivos de Trabalho, CCT), which up to 2011 were clearly dominant (about 60 per cent of agreements and 90 per cent of all covered workers), firms are represented through employers associations; in Multi-firm Collective Agreements (Acordos Coletivos de Trabalho, ACT), negotiations take place with a group of non-associated firms; finally in Firm-level Collective Agreements (Acordos de Empresa, AE) bargaining involves only a single employer.[1]

Except for the firm-level agreements, the remaining IRC are only binding for workers complying with the so-called double affiliation principle, *i.e.*, workers that are simultaneously members of the subscribing union(s) and that are employed by firms that are members of one of the subscribing employer associations. In the Portuguese case, the combination of these two dimensions would determine a very small coverage of collective agreements due to low union and employer associations' density rates. For instance, Portugal and Vilares (2013) report that only 11 per cent of private sector workers are unionized. In such a scenario, most workers would have their employment relationships determined by individual agreements negotiated directly with their respective employers. In this regard it is interesting to note that even

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1. In 2010, the number of published CCT was 141, *i.e.* substantially above the number of ACT (25) and AE (64) signed the same year. From 2011, in the context of the adjustment program, these numbers were reduced dramatically, particularly in relation to CCT (93 in 2011, 36 in 2012 and 27 in 2013). In 2014, the number of new collective agreements significantly increased compared to 2013 (from 94 to 152) but much of this increase was due to the growth of AE (49 to 80).

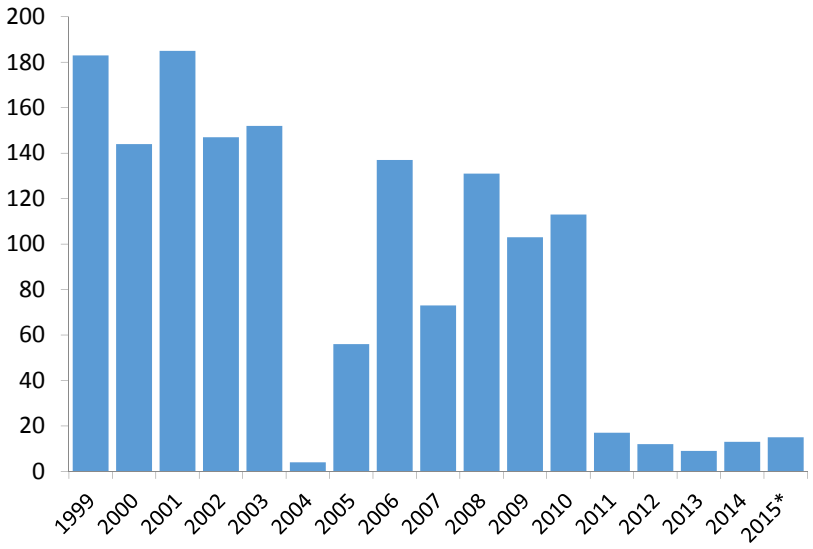

FIGURE 1: Extension Clauses: number of issues between 1999 and 2015

*Up to June 2015.
Source: Ministry of Employment, Solidarity and Social Security.

though the agreements are only binding to workers who comply with the principle of double affiliation, there are no mechanisms in Portuguese law that oblige unions and employers to reveal their constituency.

This legal conundrum has been resolved by various governments through the extension of collective regulations, in particular the CCT, to all the firms in each sector using the so-called Extension Clauses.[2] This mechanism has contributed to accentuate the discrepancy between, on the one hand, the low union density (about 11 per cent) and, secondly, the high coverage rate of IRCs (about 90 per cent). If it is true that the existence of extension mechanisms may act as an incentive for membership of employer associations, so that they can more directly influence the outcome of negotiations, from the workers' point of view incentives to become union members are tiny because the non-unionised workers would benefit from the same contractual conditions of their unionized colleagues without bearing the cost of the union fees.

Until 2004 – the year when the Labour Code entered into force – the number of extension clauses was quite high. After a short-duration decline,

2. Mostly extensions apply only to the CCT, as the AE and the ACT involve, respectively, only one firm or a limited group of firms.

this number increased again until it suffered a drastic reduction from 2011 onwards (Figure) in the context of the economic adjustment program, which initially froze the extensions and then change the criteria for their application more restrictive, as we shall see.

The use of extension clauses has been advocated based on several arguments. One of the most common is that their absence would lead inevitably to the blocking of collective bargaining in that it would promote a scenario of unfair competition by non-subscribing firms. These firms would be able to pay lower wages than those agreed under the IRC of their sector and hence secure lower prices for their products than those of its most direct competitors, which would be subject to the more generous conditions for workers arising from the IRC. In this context, the extension clauses would be an instrument that would ensure greater equity among firms in the sectors concerned, levelling working conditions and render labour inequality and unfair competition.

However, it must be remembered that regulatory instruments are traditionally negotiated by employer associations and trade unions that represent only a small number of workers. These instruments define a number of aspects of labour relations (minimum wages for each professional category, work schedules, holiday schemes, tenure bonuses,…) that may not fit all firms and workers in a particular sector. In particular, the setting of minimum levels of pay for each professional category without the involvement (direct or indirect) of a large part of the firms creates a type of friction that in nature is similar to that resulting from setting a fully-binding national minimum wage in that all firms are required to adjust their wages to the new agreed tables.

This effect is potentially more devastating when those wage minimum levels result from the issuing of extension clauses, which extend the range of their application beyond the subscribing unions and employer associations.[3] In this context, the number of minimum wages actually existing in the economy is quite extensive, being as many as the existing professional categories (about 30,000). Further, the impact of imposing indiscriminately to all firms in an sector such minimum wage levels is also more far-reaching than what results from setting a national minimum wage, which typically affects only a fringe of less skilled workers.

Equally relevant is the fact that the imposition of minimum wage levels contributes to exacerbate the effects of nominal downward nominal rigidity by limiting the ability of firms to adjust to a recession, particularly in an environment of low inflation. This aspect is particularly relevant in the

3. According to Article 514 of the Labour Code, "the collective agreement in force can be applied, in whole or in part, by an extension clause to the employers and employees integrated into the scope of activity of the agreement". This extension "is possible after weighting the social and economic circumstances that may justify it, in particular the identity or similarity of the economic and social situations within the extension and the collective agreement referred to."

Portuguese case, where from the legal point of view firms cannot reduce bargained wages, including other monetary and non-monetary components paid on a permanent basis, unless this is provided for in the IRC (see Dias *et al.* (2013)).

Recent empirical evidence for Portugal indicates that extensions may have considerable negative effects on net job creation. Martins (2014) estimates that in 2007-2012 formal employment in Portugal falls on average by about 2 per cent in the four-month period following the publication of an extension clause, the impact being large on smaller firms, *i.e.* those less likely to be represented in wage negotiations. The results also show that the greatest impact is observed in the reduction of hiring rates, since the impact on the separations is almost negligible. In contrast, informal employment (service providers), which is not subject to extension clauses, increases by about 1.4 per cent.

Guimarães *et al.* (2015) estimate for each Portuguese firm the wage bill increase implied by each new collective agreement (excluding AE) and analyse how these external shocks affect the net job creation and firms' failure rate. The results for the 1986-2013 period show that firms that are more heavily affected by the change in bargained wage floors decrease their hiring rates and, more importantly, significantly increase their separation rates leading to considerable destruction of jobs among continuing firms. Their results show that an increase of 10 per cent in contracted wages translates into a reduction in the hiring rate of 0,5 percentage points and an increase in the separation rate of 2,1 percentage points. Some studies carried out in other countries in which the extensions are equally relevant show similar effects.[4]

It is important to note that if the working conditions defined under the collective agreement, in particular the new pay scales, are not appropriate for some firms, they can adjust by reducing hirings or increasing separations, but in the limit they can simply decide to close down. Guimarães *et al.* (2015) show a positive impact of increases in bargained wages on firms' failure rate (an increase of 10 per cent of bargained wages increases by 2,2 percentage points the probability of closing a business). This result is consistent with the evidence presented by Martins (2014), which points to an increase of 4 per cent of firms' closing rate in the four months following the entry into force of an extension clause.

The performance of the labour market in Portugal since the turn of the century has been deeply disappointing. In addition to the low growth rates of economic activity, the dysfunctionality of the labour market has also contributed to the unprecedented levels reached by the unemployment rate. Between 2000 and 2014, the unemployment rate rose from 3.9 per cent to 13.9

4. Catalán and Villanueva (2015) show that automatic extensions in Spain in the period that surrounded the onset of the financial crisis (end of 2008) contributed to an increase of 36 per cent in the separation probability for the less skilled workers.

per cent (from 8.6 to 34.8 per cent, considering only the labour force under 25 years). Despite the reduction in the most recent period, the unemployment rate remains at historically high levels. Simultaneously, also revealing is the significant increases of both the share of long-term unemployment (45 per cent in 2000 to 66 per cent in 2014) and the average duration of unemployment (21 months in 2000 to 31 months in 2014).

The disappointing performance of the labour market and the recent empirical evidence should lead us to question the functionality of the current architecture of the wage bargaining system in Portugal. One element that has certainly contributed to the fact that the adjustment of the labour market in recent years has processed mainly through increases in unemployment and reductions in employment lies in the very strong rigidity of nominal wages in Portugal. Apart from the rigidity that results resulting from the prohibition of reducing contracted wages set in Portuguese labour law, the nominal wage rigidity is exacerbated by the widespread use of mechanisms that ensure the extension of agreements to the entire sector. This scenario has contributed to the misalignment between actual and feasible wages, which has translated into increasing structural unemployment.

In particular, in the context of the current low inflation environment the architecture of the wage formation system is unable to ensure the necessary flexibility in real wages. In this sense, following the example of some European countries,[5] it would be appropriate to consider the possibility of introducing more decentralized wage-bargaining mechanisms that foresaw the possibility of firms voluntarily adhere ("opting-in") to a sector agreement or exclude themselves from that agreement ("opting-out"). Simultaneously, a more decentralized bargaining system would have to necessarily go through a more active role by the works councils, whose participation is currently limited by the monopoly that the legislative system assigns to trade unions on worker representation. In the bargaining processes is also essential to create mechanisms to make mandatory the disclosure of representation of unions and employers in order to identify the universe effectively linked to each agreement.

Finally, on the extension clauses it seems justified to limit its use to criteria based on representativeness. The low membership rates of both trade unions

5. Between 1993 and 2008, Denmark recorded a significant drop in the unemployment rate (6.4 percentage points), which was much higher than that observed throughout the European Union (2.2 percentage points). Among the various measures taken there is the decentralization of wage negotiations that allowed 85 percent of the negotiations to be directly established between employees and employers. The outstanding performance of the German market in the last decade, even at the peak of the recession, has often been associated with a greater decentralization of the wage bargaining process with more active participation of works councils in safeguarding employment in firms and with trade unions and employers associations agreeing on clauses that allow firms to opt-out from sector-level agreements [Dustmann *et al.* (2014)].

and employer associations may well lead firms with higher wages to adopt a strategic behaviour in order to avoid competition from lower-wage firms. In this regard, it is worth to note that following the commitment made at the signing of Memorandum of Understanding in May 2011, a Resolution of the Council of Ministers (October 2012) defined as a criterion to make an extension that the subscribing employer associations accounted for at least 50 per cent of the workers of the sector. This was a step in the right direction that was later distorted (June 2014) with the introduction of an alternative criterion that is virtually fulfilled by all employer associations. So if they do not meet the most demanding criteria of representing at least half of the workers in a given sector they just have to fill out the alternative criteria of covering a number of associated firms consisting of at least 30 per cent of micro, small and medium enterprises (firms up to 250 employees). In this context, it is not unlikely that the drastic reduction in the number of extension clauses observed recently could increase significantly in the near horizon.

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