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Institutions and economic growth in Portugal: a quantitative exploration*

José Tavares

Faculdade de Economia, Universidade Nova de Lisboa, Campus de Campolide, 1099-032 Lisboa, Portugal (e-mail: jtavares@fe.unl.pt)

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Abstract. This paper presents a broad diagnostic of the level of institutional development in Portugal in the legal, corporate governance and financial systems. A comparative assessment suggests that Portuguese institutions are less developed than their European Union and East Asian counterparts, more developed than Greek institutions and on a level similar to that of Spanish institutions. We use data for a wide cross-section of countries since 1960 and correlate indicators of institutional development with the long-term average growth rate, identifying issues where reform is likely to significantly affect economic growth. We construct three new indices that measure the potential of institutional reform – the impact of reform on growth, the required reform effort and the efficiency of reform index – by taking into consideration the institutional "distance" between Portugal and the European Union. These indices measure, respectively, which reforms have the most payoff in terms of growth, which are "less costly" to undertake and which deliver the most growth per required effort. Our results strongly suggest that in a large number of issues, institutional reform may translate into substantially higher rates of economic growth. Of the ten most promising reforms, six are in the legal area, irrespective of which of the indices is considered. Whereas legal reform is promising at the aggregate and the microeconomic levels, in the financial sector aggregate indicators offer the wider scope for productive reform, while in the corporate governance area it is indices at the micro level that hold the most promise. These results support the view that a comprehensive reform effort is likely to deliver higher rates of growth in Portugal, allowing faster real convergence with the rest of the European Union.

Key words Economic growth – Portugal – Legal system – Corporate governance – Financial system

JEL Classification: O0, O5, K00, K4, G2, G3

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