International Competitiveness: is the reduction of wages a solution? An evaluation of the Portuguese case[1,2]

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Abstract

The purpose of this paper is to analyse, for the case of Portugal, the effectiveness of a wage reduction - a current proposal since 2011 to help the country to reverse the high public and external debts - in promoting the efficiency and the international competitiveness of the economy. A static multi-sector and single-country general equilibrium model is used and data is collected from GTAP7 Data Base. The model allows the measurement of changes by sector. The simulations performed show that extending the reduction of wages already deployed by the government in the public sector to the private one leads to a positive impact on employment (both skilled and unskilled labour), production and volume of exports in all sectors except those that are R&D intensive, characterized by a low weight in the Portuguese economy. However it is possible that the positive results in terms of external competitiveness are not sustainable as the impact on productivity is negative, albeit small, for most sectors. There is also reasons for concern regarding the observed deterioration of the trade balance of most sectors, the exception being the traditional labour intensive sectors that show good prospects in this respect.

KEYWORDS: Competitiveness, wages, Stability and Growth Pact; General Equilibrium Model, Portugal.

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