



PORTUGUESE REPUBLIC

Stability and Growth Programme

2007 - 2011

December 2007 Update

© MINISTRY OF FINANCE AND PUBLIC ADMINISTRATION

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EXECUTIVE SUMMARY

This document updates the Stability and Growth Programme (SGP) of the Portuguese Republic for the period from 2007 to 2011, thus ensuring compliance with Portugal's obligations under the Stability and Growth Pact. Following its presentation and discussion in the Portuguese Parliament on 13 December 2007, it is sent to the European Commission on 14 December 2007, according to the deadlines established for Portugal in the Pact's Code of Conduct.

The budgetary consolidation effort that has been ongoing since 2005 is essentially based on structural measures to curb expenditure and reduce the weight of expenditure in GDP and improve the efficiency of the tax system, particularly by fighting tax evasion and fraud, as the basis for sustained growth in revenue.

Budgetary policy has ensured that the objectives focused on correcting budgetary imbalance established in the December 2005 update of the SGP have been achieved. As a result, the structural deficit was reduced by 3.0 p.p. of GDP between 2005 and 2007 (2.3 p.p. in 2006 and 0.7 p.p. in 2007). In nominal terms, the consolidation effort that has been conducted to date should ensure that in 2007 Portugal does not exceed the 3% threshold for overall deficit, one year ahead of schedule.

The Portuguese Government will carry on the budget consolidation effort over the Programme's time horizon, particularly in relation to personnel expenditure and social transfers. The end goal of this effort is the reduction of the overall weight of public expenditure in the economy through the broader restructuring of the administration, human resources and public services, through the results generated by the reform of the social security and health systems, and through measures to strengthen the tax system's effectiveness. The structural balance is forecast to improve by 1.7 p.p. of GDP between 2007 and 2011, achieving approximately $-\frac{1}{2}\%$ of GDP in 2010 and sustaining this value in the following year. This target is concurrent with that established by the Portuguese Government in December 2005, as the medium-term objective, and its compliance requires sustained effort to ensure rigour in the budgetary consolidation process.

The budgetary balance developments, particularly that of primary balance, should permit, in a context of economic growth acceleration, a continued reduction of the government debt to GDP ratio. Accordingly, this ratio is forecast to fall from 64.4% in 2007 to 56.7% in 2011.

The reforms already implemented in the social security systems, which provide these systems with the increased capability to absorb adverse alterations in demography, allow the lessening of the long-term sustainability risks of public finances associated to the ageing population. The consolidation strategy contributed to the same end, as it restored confidence in the future of the Portuguese economy, guaranteeing the sustainability of social policies and providing the financial stability required to strengthen wealth-creating conditions.

On the other hand, budgetary policy has been progressively steered towards supporting the recovery and restructuring of economic activity and employment creation currently underway, fostering the competitiveness of the Portuguese economy, and towards supporting citizens and households, seeking to bolster their participation in the collective effort to create wealth, in the modernisation of Portuguese society, and in the sharing of the improvements to well-being.

The renewed Lisbon Strategy comprises a manifest reference mark in fostering the country's growth and development potential, pursuing policies oriented towards the creation of macroeconomic stability likely to stimulate innovation and capacity to adapt among economic agents, creating the necessary conditions for agents to engage in entrepreneurship and develop their activities. The structural reforms of Public Administration, in Social Security, Health, Education and Training, local and regional financing, and administrative and tax simplification, in addition to others, have proven to be decisive in bolstering economic agents' confidence in the soundness of the Portuguese economy and have provided a business environment more tuned towards stimulating initiative, modernisation, qualification, innovation and the consequent strengthening of our competitiveness. This contribution, in addition to the business restructuring effort carried out by the private sector, is reflected in the recovery of economic growth, which shall allow Portugal to again pick up the path of convergence towards the more developed EU countries. The improved net job creation capacity is also indicative of this dynamic.

The importance attributed by the Portuguese Government to the budgetary consolidation process has created the conditions for Portuguese citizens to better understand the importance of the quality of public finances. Better management of public revenue and expenditure, guided by efficiency and effectiveness criteria, ensures the improvement in the quality and in the capacity to deliver public services, without any impact on the tax and contributory burden.

These are the reasons for the implementation of measures such as the modernisation of the Public Administration, the strengthening of planning and control of the State-owned company sector, or the redefinition of the institutions, processes and budgetary rules, including the recent improvements in the Health area, where the use of management information systems and strategic planning have led to the improvement of the health services provided, increased transparency and financial rigour.

I. ECONOMIC OUTLOOK

I.1. World Economy / Technical Assumptions

In the first half of 2007, the international economic environment was marked by the perpetuation of sound growth of most economies, with particular note to the dynamism of emerging economies, while the developed economies showed a slight tendency for slowdown.

The turbulence in international financial markets associated to the reassessment of risk triggered by the crisis in the US sub-prime mortgage market led to an increase in uncertainty in the second half of 2007, contributing to a less favourable international economic environment. The functioning of some segments of global financial markets was affected, more restrictions were placed on access to credit, and a deterioration of expectations in business circles was observed.

Most economies demonstrated imperviousness to the initial impact of these developments. Nevertheless, it is expected that the deceleration impact on economic activity may be stronger in 2008. The US economy should record more moderate growth as the result of less positive performance of consumption and investment. Investment and exports should slow down in the European economies which will, therefore, grow at a slower rate, limiting the growth of external demand for Portuguese exports. The emerging economies will, in contrast, continue to record robust growth.

The oil price should remain high in the short term due to the strong demand growth of the emerging economies and to the existing production capacity limitations. The adverse impact of this situation on the Euro area economies should be partly alleviated by the expected appreciation of the euro against the US dollar.

The following table indicates the external technical assumptions underlying the macroeconomic scenario presented in this update of the Stability and Growth Programme (SGP). For the years 2010 and 2011, most variables are assumed to stabilise at the expected values of 2009.

Table 1. International Environment – Technical Assumptions

	2006	2007(e)	2008(f)	2009(f)	2010(f)	2011(f)
Growth of relevant external demand (%)	8,4	6,8	6,2	5,8	5,8	5,8
Oil price (Brent, USD/bbl)	65,1	72,5	80,8	77,9	77,9	77,9
Short-term interest rate (annual average, %) (a)	3,1	4,3	4,2	4,2	4,0	4,0
Long-term interest rate (annual average, %) (b)	3,9	4,4	4,4	4,4	4,2	4,2
Nominal effective exchange rate for Portugal (c)	0,2	0,8	0,5	0,0	0,0	0,0
USD/Euro exchange rate (annual average)	1,256	1,360	1,420	1,420	1,420	1,420

(e) estimate; (f) forecast.

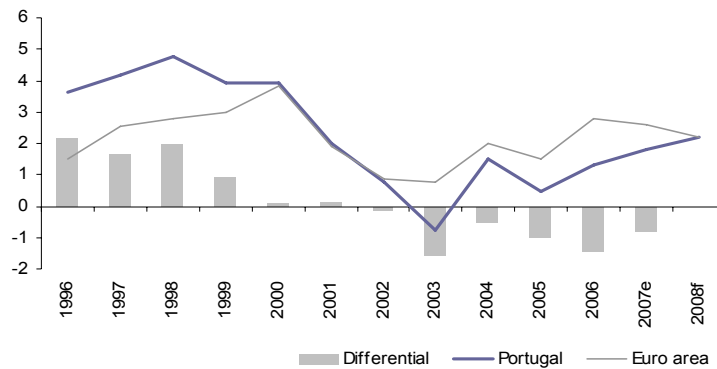
(a) 3-month Euribor rate; (b) 10-year Treasury bonds. (c) Annual average rate of change, as % (positive/negative change means appreciation/depreciation of euro).

Sources: European Commission, *Economic Forecasts Autumn 2007*, and Ministry of Finance and Public Administration.

I.2. Cyclical Developments and Current Prospects

The GDP, following on from the moderate growth recorded in 2005 (0.5%), should accelerate from 1.3% in 2006 to 1.8% and 2.2%, in 2007 and 2008, respectively. Portugal is thus expected to register, after six years of divergence, an economic growth in 2008 that is slightly above the average growth for the Euro area.

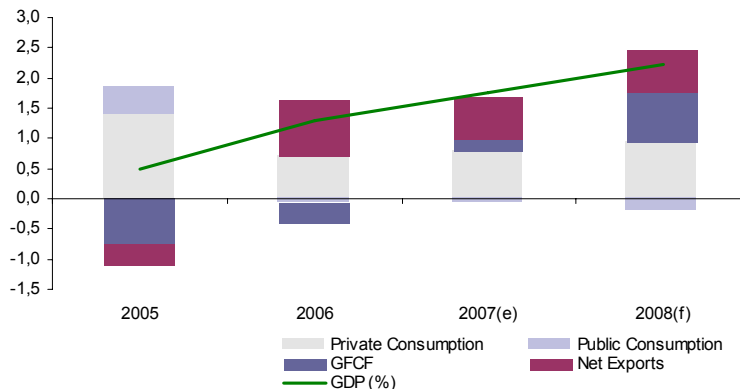
Chart 1. Gross Domestic Product
(real growth rate, %)



(e) estimate; (f) forecast.
Sources: INE and Eurostat.

The Portuguese economy in 2007 and 2008 should be marked by the recovery of investment, with particular focus on private investment, and by continued sound growth in exports. This growth dynamic partly reflects the impact of the structural reforms that have contributed to creating a more favourable environment for investment and economic competitiveness. This economic acceleration should derive primarily from a very favourable growth in productivity. The budgetary consolidation underway and the dynamism of exports project an improvement in the adjustment of structural imbalances in the Portuguese economy over this period, particularly the budget deficit and external deficit.

Chart 2. Contributions to GDP growth
(percentage points)



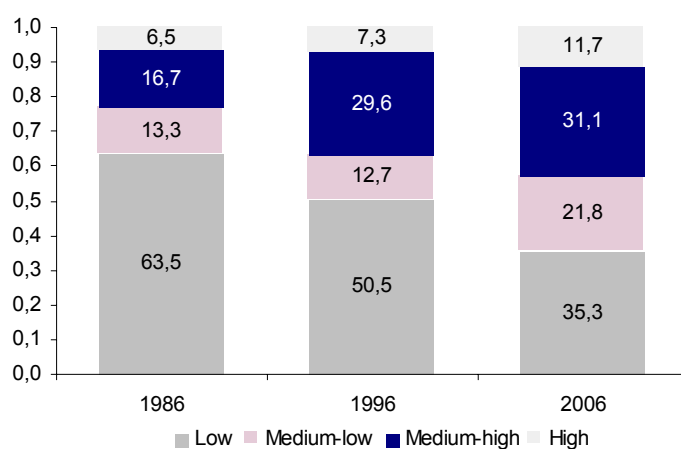
(e) estimate; (f) forecast.
Sources: INE and Eurostat.

Domestic demand should register significant improvement, driven chiefly by the favourable trend followed by investment. Gross fixed capital formation (GFCF) should grow by 1% in 2007 and by 4% in 2008 (-1.6% in 2006), associated to the more favourable performance of private investment, which has benefited from the dynamism of exports and the improved climate of optimism in industry. Investment in capital goods should be the most dynamic component of investment.

Private consumption should, on the other hand, maintain moderate growth, though slightly accelerated, driven by the more favourable prospects in relation to the evolution of employment in 2008 and the expected stabilisation of interest rates, following an upward trend in 2006 and 2007. Public consumption should continue to decline in real terms, due to the budgetary consolidation.

Exports should continue as the most dynamic component of overall demand, though this trend is expected to drop off somewhat, in consequence of the expected slowdown in relevant external demand. This deceleration should be more pronounced in the case of goods, while services will continue to register growth above the overall exports average. Nonetheless, gains in market share should continue due to the geographical diversification of export markets and the redirection of export structure specialisation, which encompasses the gradual decrease in share of low technology sectors (more vulnerable to international competition, particularly from the emerging economies).

Chart 3. Export structure by technological intensity
(percentage share)



Sources: Portuguese Central Bank and Ministry of the Economy and Innovation.

The growth of imports in 2007 should be slightly less than in the previous year but above domestic demand growth, resulting in the continued increase of the import penetration rate in the Portuguese economy. Imports are expected to undergo a slight acceleration in 2008, mainly due to imports of energy goods and services. The reduction of the trade deficit should continue, which, associated to the expected increase of transfers from the European Union to Portugal under the National Strategic Reference Framework, should contribute to the decrease in Portuguese net borrowing position vis-a-vis the rest of the world by 1.8 p.p. of GDP in 2007 and 1.1 p.p. of GDP in 2008.

On the inflation front, the average change of the Consumer Price Index followed a downward trend during 2007, and it should reach around 2.3% by the year's end, 0.8 p.p. down on 2006. This slowdown is largely

due to the deceleration in the price of energy goods and the more moderate growth in prices of imported consumer goods. Consumer prices are forecast to undergo a certain degree of deceleration in 2008.

The unemployment rate in 2007 should remain high, reflecting the usual time lag in the performance of the variable at times of economic recovery. On the other hand, the maintenance of a high proportion of long-term unemployment, in a context of productive profile restructuring, may represent the inadequate adjustment of employment supply and demand and the low human capital provision of the Portuguese economy, which are factors that hinder the more favourable evolution of unemployment. These characteristics prove the urgency of the structural reforms that foster the improvement of workers' professional qualifications and their capacity to use new information and communication technology.

Despite the acceleration of economic activity, employment growth should decelerate in 2007, which indicates quite atypical evolution with employment elasticity with respect to the real growth of GDP being lower than in the ascending phases of previous economic cycles. The continued favourable evolution of economic activity in 2008 should originate improvement in the labour market, with higher growth in employment and a reduction in the unemployment rate, though this may, nonetheless, remain above the NAIRU (Non-Accelerating Inflation Rate of Unemployment).

The acceleration of economic activity in 2007 should reflect a significant improvement in productivity, which should increase by around 1.4%, in other words, 0.8 p.p. up on 2006. Economic acceleration in 2008 should be associated to the rise in the employment growth rate, whereas productivity should register slightly lower growth, though it should remain above the average of the most recent past (around 0.7%, since the start of 2000). Compensation per worker should continue to be underpinned by moderate growth, reflecting the still unfavourable situation of the labour market and increased competition in the world economy.

Table 2. Main macroeconomic indicators
(rate of change, %)

	2006	2007(e)	2008(f)	2009(f)	2010(f)	2011(f)
GDP and Expenditure Components (real terms)						
GDP	1,3	1,8	2,2	2,8	3,0	3,0
Private consumption	1,1	1,2	1,4	2,1	2,3	2,4
Public consumption	-0,3	-0,4	-1,1	-0,6	-0,3	1,1
Investment (GFCF)	-1,6	1,0	4,0	6,7	7,0	7,2
Exports of Goods and Services	8,9	6,9	6,7	6,0	6,3	6,5
Imports of Goods and Services	4,3	3,8	3,9	4,8	5,6	6,6
Prices Developments						
GDP Deflator	2,9	2,9	2,7	2,6	2,6	2,6
CPI (a)	3,1	2,3	2,1	2,1	2,1	2,1
Labour Market Developments						
Employment	0,7	0,4	0,9	1,4	1,5	1,5
Unemployment rate (%)	7,7	7,8	7,6	7,2	6,9	6,6
Apparent labour productivity	0,6	1,4	1,3	1,4	1,5	1,5
Current and Capital Account Balances						
Net lending / borrowing vis-à-vis the rest of the world	-8,8	-7,0	-5,8	-5,6	-4,9	-4,7
-Current account balance	-9,9	-8,3	-7,6	-7,0	-6,2	-5,9
<i>of which</i> Trade balance	-10,0	-9,4	-9,4	-8,9	-8,5	-8,4
-Capital account balance	1,1	1,3	1,8	1,4	1,3	1,2

(e) estimate; (f) forecast.

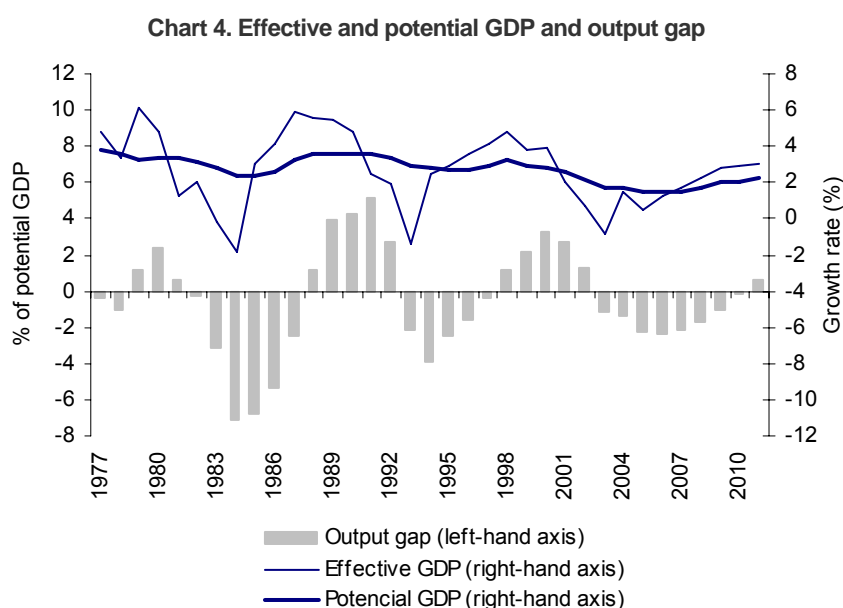
N.B. (a) Consumer Price Index average annual change;

Sources: INE and Ministry of Finance and Public Administration.

I.3. Medium-Term Scenario

The potential Portuguese output has registered a deceleration dynamic since the end of the nineteen nineties up to 2006, primarily due to falling productivity factors. This dynamic was inverted in 2007, and this turnaround should endure to the end of the projection period due to the significant rise in productivity and increase of capital, which more than offset the reduced contribution of labour input, in a context of an ageing population and downward trend in the number of hours worked per worker. These developments should partially reflect the impact of the set of structural reforms implemented as much in the public sector as in the private sector, and which are intended to increase efficiency in the allocation of resources and stimulate productive investment.

It is projected in the medium term, between 2009 and 2011, that the Portuguese economy shall continue to grow at a rate greater than the potential output, stabilising at 3% in 2010 and 2011, approximately the average growth over the last 30 years, which means, therefore, that the output gap should become positive in 2011. A positive growth differential compared to the European average is also projected for that same three-year period.



Sources: INE and Ministry of Finance and Public Administration. Potential GDP estimated in accordance with European Commission methodology.

The extension of the growth pattern forecast up to 2008 is assumed for the medium-term scenario. Hence, the economy should continue to benefit from, in particular, the acceleration of domestic demand, driven by the dynamism of investment (GFCF), notwithstanding the fact that exports are expected to continue to register strong growth. Nonetheless, the contribution of external demand should fall off as imports accelerate.

It is envisaged that investment shall become the most dynamic component of domestic demand from 2009, assuming the continuation of the favourable performance of private investment and also the positive

turnaround in public investment. Private consumption should accelerate, in harmony with the expected improvement of labour market conditions, but that acceleration will be moderate given the restrictions imposed by the high levels of household indebtedness. It is projected that the contribution to domestic demand provided by the growth of public consumption shall recover slightly during the analysed period.

The assumptions underlying the development of exports include the continued tendency for wage restraint and the increase in the Portuguese economy's competitiveness, fruit of the restructuring process focused on the productive fabric and the implementation of structural reform policies. Accordingly, exports should decelerate compared to 2008 growth, in line with the slowdown in foreign markets, although this deceleration should be more moderate, as the result of the expected gains in market share. Imports should, on the other hand, accelerate, reflecting the trend in domestic demand and leading to a contraction of the contribution of net exports to GDP growth. Hence, the reduction of the trade balance deficit should slow up over the period, and a deficit of 8.4% of GDP is forecast for 2011 (-10% of GDP in 2006). The Portuguese economy's net borrowing position vis-à-vis the rest of the world should continue its downward trend, mirroring increased domestic saving and also as the result of budgetary consolidation measures.

Labour market conditions should improve in a more favourable economic context, and the reduction of the unemployment rate to 6.6% is forecast in 2011. Employment should accelerate, and it is assumed that the increase in employment and productivity contribute in identical measure to GDP growth.

In terms of price development, the medium-term scenario envisages the stabilisation of inflation around 2.1%, considering the absence of pressures on productive capacity (the output gap only reaches equilibrium in 2011), as well as the assumptions regarding the cost and profit margin restraints and the technical assumption relative to the stabilisation of the price of raw materials.

1.4. National Action Programme for Growth and Jobs (PNACE)

The second year of implementation of the National Action Programme for Growth and Jobs 2005/2008 (PNACE), which was presented in 2005 as part of the process of implementing the guidelines and priorities of the Renewed Lisbon Strategy, was completed in 2007. The implementation of the Programme, founded on fostering the articulation of a broad set of macroeconomic, microeconomic and employment measures, focused on promoting the potential for economic growth and sustainable development, continues to echo the success of the strategy initially set out for the country's modernisation:

- To give renewed credibility to Portugal through budgetary consolidation and the implementation of strong, accountable and focussed policies;
- To re-establish confidence in Portugal through economic growth, through the improvement of the legal and legislative environment and through public investment in key economic areas, with the aim of attracting more private investment;
- To increase the competitiveness of the Portuguese economy through the implementation of the Technological Plan (PT) and reducing red tape in regard to public procedures;
- To strengthen social, territorial and environmental cohesion through policies orientated to employment, education and qualification, with special focus of life-long learning.

Prominent among the macroeconomic measures in 2007 was the entry into force of the reforms of the general social security scheme and their adaptation to the civil service social protection scheme. These measures are borne out the analysis performed by the Working Group on Ageing that assists the Eco-

conomic Policy Committee, which concluded a significant improvement in the long term sustainability of public finances in the expenditure component that is sensitive to population ageing.

The strengthening of the sustainability of health systems also continued in 2007. Of note in this regard are the improvements achieved in the generation of management information and internal control, which have permitted the quality of the budget process to be improved and ensured an important contribution, through gains in efficiency, to the financial situation of the National Health Service (NHS).

As regards the reform of the Public Administration, the legislative instruments concerning contractual ties, careers and remuneration schemes and the services, management and staff performance assessment systems have already been approved by the Portuguese Parliament. The strong emphasis in the legislation on fostering merit and performance, transparency, flexibility and autonomy in the management of human resources and the reduction of the segmentation of the labour market is worthy of note.

Also in the field of the modernisation of the Public Administration, the results achieved in simplifying citizens' and businesses' lives in their contacts with the Public Administration and improving the quality of public services provided, strengthening the development of a business environment that is favourable to entrepreneurship, innovation and investment, deserve highlight. This type of measures are of fundamental importance in reducing the red tape costs borne by small and medium-size enterprises, which account for a significant part of the national business structure. A significant initiative in this area is the SIMPLEX Programme launched in March 2006, which includes projects such as "On the Spot Firm" and "On the Spot Brand", the Simplified Business Information return, the simplification and elimination of trade register acts and associated notary acts and the dematerialisation of tax acts and procedures using new information technology.

According to the World Bank's recently published Doing Business 2008 report, Portugal holds 37th place in the ranking that evaluates the business environment. This corresponds to a rise of three places in relation to the previous report and eight places compared to the position in 2005. The recognition of the progress achieved in the e-government field is consensual. Portugal recently recorded a significant rise in the Brown University Global E-Government index, which seeks to measure on-line availability of the content, services and access quality to government sites. Portugal rose from 48th to 7th place in the ranking and is in second place among European Union member countries. The progress made has also been confirmed in a recently published European Commission report, which classifies Portugal as a "fast mover", recording the greatest rise of all countries in the Online Public Services Ranking in terms of the improved quality of on-line public services between 2005 and 2007. Portugal is in 3rd place in the ranking relative to the on-line availability of services, and it holds 4th place in the sophistication ranking. It should be stressed that Portugal has reached 100% availability and sophistication in the services for businesses and it is classified as the 2nd best country in the European Union for this item.

One of the fundamental traits of PNACE is its articulation with the budgetary consolidation strategy. In practice, the pursuit of a budgetary consolidation strategy based on measures of a structural nature, orientated to guaranteeing the sustainability of the social security and health systems, and modernising the Public Administration, with a view to warranting a stable macroeconomic environment and sound public finances, encourages the promotion of activity among economic agents and, by means of this, growth and job creation in line with the core goals of the Lisbon Strategy.

On the microeconomic front, Portugal has taken up the challenge arising from the growing integration of world trade, fostering the implementation of measures that, as a whole, integrate a coherent and articulated framework of intervention aimed at creating conditions that support and provide incentive for the

modernisation of the country's competitive base, through heavily investing in science, technology and innovation.

The "Connecting Portugal" initiative is a reference mark in this area. The launch of the "UT Austin – Portugal" (comprising the joint implementation of an International Co-Laboratory for Emerging Technologies, and including the establishment of a network to stimulate commercial activities in the science and technology fields), "Fraunhofer – Portugal" (through which advanced information and communication technology applications, aimed at creating environments that facilitate the lives of large sections of the population, will be developed, in particular by developing innovative means of accessing those technologies) and "Harvard – Portugal" (the main objective is to stimulate the internationalisation and cooperation between faculties of medicine and the main national research laboratories and centres in the field of biomedical sciences) programmes was significant in 2007. The Education Technological Plan, launched in August 2007, represents another arm of the Government's endeavour in propagating information and communication technology skills.

The Knowledge and Innovation Networks, established on the basis of partnerships and sub-networks specialised in the different segments of the process of generating economic value from knowledge, constitute instruments of recognised importance in fostering economic activity. The emphasis given to the development of Knowledge and Innovation Networks, focused on excellence founded on the collaboration of institutions of the scientific and technological system, universities and businesses, sets up a distinct instrument to improve the adequacy between technology supply and demand, as well as facilitate access to obtaining funding for the innovation. The partnerships that have been established under the "FINICIA Programme", seeking to broaden the access baseline to financial instruments for developing emerging businesses and small-sized enterprises, are an example of the steps already taken in this field. This initiative promotes the liaison between scientific and technological institutions and local development agents. Thirteen platforms attached to universities have been created, which ensure coverage for all of Portugal, and which comprise more than 160 public and private entities (namely banking institutions, venture capital and mutual guarantee companies, science and technology parks, and municipalities), that foster the speeding up of idea evaluation processes and the incorporation of innovative companies.

The strengthening of the baseline conditions for innovation and entrepreneurship occurs simultaneous to the implementation of human capital valorisation and promotion measures. The "New Opportunities Initiative" was established to respond to the qualification deficit of the Portuguese population. This initiative is intended to cover all age groups and learning means in formal, non-formal and informal environments, and it seeks to raise the employability level of individuals all through their working life. In this context, this initiative is based on two intervention pillars - young persons and adults. The focus in regard to young persons is on fighting the lack of academic achievement and dropping out of the education system, while the second seeks to qualify or requalify the adult working population. The goals to be achieved by 2010 are three-fold: make 12th year of the education system the minimum academic reference mark for all; place 50% of young people in secondary education on qualification pathways providing double certification; and qualify one million of the working population, prioritising the unemployed, based on recognition, validation and certification of competences' processes.

A significant governmental measure to improve the adaptability of workers and companies is the publication of the Green Paper on Labour Relations, which aims to reform labour relations, and the work of the Committee for the White Paper on Labour Relations (the publication of the White Paper, by the end of 2007, shall trigger the process of reviewing the Labour Code).

The strategy to valorise basic education continues to be a priority area for the Government. Hence, the implementation of an integrated set of measures, already applied in the previous year, continued in 2007. The aim of these measures is to improve the quality of learning and to reduce the level of educational non-achievement. This consistent and continued effort resulted in an increase of 8,500 students matriculated in compulsory education in 2006/2007. Notwithstanding the consolidation of this strategy, new measures were introduced, such as the “Mathematics Action Plan” and “Assessment Tests”, the principal objective of these measures being to improve academic success levels. Measures that already existed were also extended to other education levels, such as the “Continuous Mathematics Instruction” programme, which was extended to 2nd cycle of basic education.

PNACE also reflects concerns regarding social and territorial cohesion and environmental sustainability, embodied in, for example, the implementation of the “Neighbourhood Community Services Network”, the development of the “National Logistics System” and the “National Energy Strategy”, which comprise a broad set of measures in fundamental areas such as renewable energy and energy efficiency.

The strong articulation between the measures adopted in the three areas (macroeconomic, microeconomic and employment) should be noted. This articulation not only ensures the more efficient management of available resources but also the mutual reinforcement of their impact, expanding the effectiveness of PNACE. Also notable in terms of resources is the alignment of the priorities of PNACE with those of National Strategic Reference Framework (QREN), where they both share priorities relative to investing in the formation of human capital and creating the baseline conditions and incentives for economic agents that are likely to strengthen the competitiveness of the Portuguese economy.

The recent assessments carried out by the European Commission, in June 2007, and by the Economic Policy Committee, under the multilateral assessment procedure of national reform programmes, which occurred last November, confirm that Portugal is advancing at good pace as regards the implementation of the specific recommendations delivered by the European Council of March 2007, and as regards the implementation of measures in the fields of innovation and small and medium-size enterprises (e.g. through the adoption of tax incentives to stimulate private research and development), better regulation (with the implementation of measures to cut red tape costs) and in the labour market (the most significant of which include the recent amendments made to the unemployment benefit award system).

II. GENERAL GOVERNMENT BALANCE AND DEBT

II.1. Budgetary Goals

Budgetary policy since 2005 has ensured that the objectives focused on correcting budgetary imbalance established in the December 2005 update of the SGP have been achieved. As a result, the structural deficit was reduced by 3.0 p.p. of GDP between 2005 and 2007 (2.3 p.p. in 2006 and 0.7 p.p. in 2007). In nominal terms, the consolidation effort that has been conducted to date should ensure that in 2007 Portugal does not exceed the 3% threshold for overall deficit, one year ahead of schedule.

The structural balance is forecast to register an additional rise of 1.7 p.p. of GDP between 2007 and 2011, achieving approximately $-\frac{1}{2}\%$ of GDP in 2010 and sustaining this value in the following year. This target is concurrent with that established by the Portuguese Government in December 2005, as the medium-term objective for the structural balance. The compliance with this objective requires sustained effort to ensure rigour in the budgetary consolidation process which will be maintained even in a context of the reduction of the (negative) output gap, which is only envisaged to become positive in 2011.

The trajectory of the budgetary balance, particularly the primary balance, should allow, in a context of accelerating economic growth, the government debt to GDP ratio to continue decreasing. It is estimated that this ratio declines to 64.4% in 2007 and to 56.7% by 2011.

II.2. Main Budgetary Consolidation Measures

The process of budgetary consolidation that has been ongoing since 2005 is fundamentally based on structural measures to curb spending and reduce expenditure as a share of GDP and on the improvement to Tax Administration efficiency, namely through fighting tax fraud and evasion, as the basis for the sustained increase of revenue.

Over the time horizon of the SGP, the Portuguese Government will proceed with the budgetary consolidation effort by furthering the restructuring of the Public Administration, human resources and public services, through the results of the reform of the social security and health systems, and through measures to strengthen the tax system's effectiveness.

A. Restructuring the Public Administration, Human Resources and Public Services

The policy of reforming the Public Administration has been undergoing implementation in articulation with the budgetary consolidation strategy, fostering the adaptation of the Portuguese Public Administration under a new model that, in a context of strong pressure from taxpayers to reduce the tax burden, valorises the role played by the quality of the provision of public services and the governance of public institutions in fostering competitiveness and changing the economy's competitive base.

A.1. The Redesign of Roles and Responsibilities in the Public Administration

The Restructuring Programme for the State's Central Administration (PRACE), complemented by the reorganisation of the State's local services, and the development of shared services are the key areas in the Public Administration reorganisation strategy.

The Restructuring Programme for the State's Central Administration (PRACE)

PRACE entailed one of the first steps of the strategy to modernise the Public Administration, proceeding with its reorganisation through the redesign of structures, roles and responsibilities, in articulation with the reforms in progress relative to civil service employment regime and the budgeting process. This process is practically concluded and the organic laws of each one of the services and bodies that integrate the ministries are in an advanced stage of implementation, as a result of which the structures and managerial positions were reduced (Table 3).

Table 3. PRACE – Reduction of macrostructures, microstructures and managerial positions

	Before PRACE	After PRACE	Change	
			absolute	percent
Macrostructures				
Directorate-General	170	124	-46	-27,1
Public Institute	93	70	-23	-24,7
Subtotal	263	194	-69	-26,2
Other (a)	255	137	-118	-46,3
Total	518	331	-187	-36,1
Microstructures				
Service Dep. and others treated as such	1.581	1.187	-394	-24,9
Divisions and others treated as such	3.673	2.760	-913	-24,9
Total	5.254	3.947	-1.307	-24,9
Managers				
Upper management (b)	730	569	-161	-22,1
Middle management (c)	5.254	3.947	-1.307	-24,9
Total	5.984	4.516	-1.468	-24,5

Key: (1) Includes Councils, Committees, Devolved Services, Missions and other structures; (2) Director-General, Inspector-General, Secretary-General, President, Subdirector-General, Subinspector-General, Deputy Secretary-General, Vice-President, Voting Member and others treated as the same; (3) Services Director, Head of Division and Project or Multiple Area Team Leaders and others treated as the same.

Source: Ministry of Finance and Public Administration, State Budget for 2008 Report, October 2007.

The reorganisation of the State's local services has also undergone progress. The process of reorganising the school network of 1st cycle primary schools, aimed at improving conditions in education, has already led to the closure of 2 507 schools.

As regards the restructuring of the network of primary and hospital care, the reconfiguration of existing health centres is under way, through the creation of family health care units (USF) which are smaller and more flexible structures. USF's aim to improve citizens' access to proximity care and lower the pressure

on the demand for more differentiated care, which is characterised by higher average costs.¹ The goal is to have 150 USF up and running by the end of 2008, covering around 1,835,000 people. In relation to hospital care provision, the maternities network was redesigned and the reform of the emergency network is still in progress. The reform of the Portuguese consular network has led to the restructuring of 27 consular career positions and the reallocation of 93 consular personnel, fostering their mobility and the streamlining of their distribution, while implementing the requalification of the consular service. The restructuring planned for the Tax Services and Directorates is also notable. The first phase of this restructuring plan involves the merger of the current 21 directorates into just 13. The merger of the Tax Services will, in turn, be accelerated in the coming months, in liaison with the expansion of the *Loja do Cidadão* (One-stop citizens' shop) network, which are more flexible and efficient structures that ensure the continued availability of services close to citizens.

Shared Services in the Public Administration

As regards the development of shared services in the Public Administration, the Company for the Shared Management of Public Administration Resources (GeRAP) was established, with the mission to support the modernisation of the human and financial resources management systems in the Public Administration through the provision of technical and administrative support in those areas. Hence, the intention is to achieve savings through gains in efficiency associated to the simplification of administrative procedures, in articulation with the introduction of new information and communication technology, and through the reduction of costs generated through economies of scale and economies of scope.

The technical and administrative support services to human resource management comprises, in particular, the recruitment and selection of personnel, including the management of personnel in a special mobility situation, training management and competences management. The activity of GeRAP relative to the provision of services in the financial area will include the dissemination of the Official Public Accounting Standards, the standardisation and optimisation of processes, and management support reports.

GeRAP shall start by implementing shared services in the Ministry of Finance and Public Administration in 2008, with its gradual expansion to the rest of the Public Administration planned for 2009.

In the field of procurement, the National Public Purchasing Agency (ANCP) was created in February 2007 and the National Public Purchasing System defined, the objective being to streamline the State's costs and improve the quality of public expenditure, fostering the cutting of red tape relative to public procurement processes and simplifying the procedures thereto.

The National Public Purchasing System comprises the ANCP, ministerial procurement units, affiliated procurement entities (services under the direct administration of the State and public institutes) and procurement entities under voluntarily contracts (autonomous public bodies and corporate public enterprises).

The adopted management model is based on the ANCP, a central management entity that takes the form of a corporate public enterprise, operating in network with the other entities of the National Public Purchasing System. The ANCP is responsible for defining, implementing, managing and assessing the Na-

¹ A recent study on the budgetary impact of the launch and implementation of the USFs concluded that the organisation model now being proposed, constructed to resemble the Experimental Remuneration Regime (in which the health professionals are paid according to productivity i.e. according to the number of users they monitor and the characteristics of these), will allow considerable cost reductions in health care provision. The impact of the abovementioned incentives is already included in this conclusion.

tional Public Purchasing System and for managing the State's motor vehicle fleet, centralising the purchase of vehicles and respective supplementary services (Box 1).

Box 1. THE NATIONAL PUBLIC PURCHASING AGENCY

PUBLIC PROCUREMENT (STRATEGIC SAVINGS GENERATION GOALS)

Strategic Targets

Generate overall savings in expenditure on transversal materials, goods and services (transversal MGS)

Maximise the creation of value of public expenditure through greater purchasing power

Minimise transaction costs (uniformisation, standardisation, streamlining, automation)

Minimise the total life cycle cost (TLCC) of transversal MGS

Strategic Goals

- 150 million euro saving (2008–2009)
- 50% of MGS expenditure under contract
- Mean reduction of 5% in the unit cost of transversal MGS
- Setting consumption reduction targets at the ministerial and public service level
- 20% reduction in the average MGS transaction cost (in the targeted areas)
- 25% of areas targeted
- Define TLCC calculation methods for the 10 largest procurement categories in terms of volume
- Reduction of inventory, maintenance and operating costs of the 10 largest procurement categories in terms of volume

MANAGEMENT OF THE STATE'S MOTOR VEHICLE FLEET

The current management model of the State's motor vehicle fleet did not allow positive results to be achieved by the end of 2006. Several studies indicate that the maintenance and management of the State's 29 000 motor vehicles is based on procedures in need of urgent overhaul. This is the backdrop to the reform underway, which encompasses a new underlying legislative basis for the State's motor vehicle fleet and new management workflows. The saving forecast under the new management model should be between EUR 10 and 20 million in 2008.

A.2. The Human Resources Management Reform

The reform of human resources management consists of the adoption of a new civil service employment scheme and a new human resources management model in conformity with the effective needs of public services, supported by strengthening voluntary mobility conditions for civil servants within the Public Administration. The Government simultaneously pursues personnel expenditure reduction targets by continuing to control the hiring and admission of personnel based on the rule limiting recruitment to one new civil servant for every two leaving (Table 4).

Table 4. Personnel In and Out in the Public Administration - application of the “2 out 1 in” Rule
(January 2006 to June 2007)

In	14.123
Out	28.915
Balance	-14.792

Source: Ministry of Finance and Public Administration, State Budget for 2008 Report, October 2007.

New Civil Service Employment Scheme

The new civil service employment scheme is based on a new model of aligning the interests (and thus the performance) of managers and employees with the need to improve the public services provided with less resources. The new model consists of supplementing normal compliance of legally established administrative procedures with the creation of incentives for civil servants and managers so that they may achieve, through their initiative and merit, excellence in the provision of public services to citizens and companies.

The new contractual ties, career and remuneration schemes and the new public service, civil service manager and civil servant assessment scheme constitute the legal pillars of the new civil service employment scheme.

The new contractual ties scheme envisages only two kinds of contractual tie: by appointment and by contract. Contractual tie by contract which will be governed by a scheme similar to that set forth in the Portuguese Labour Code, will be the common form of contractual tie. Appointments will now only be applicable for functions related to the exercise of authority and sovereign powers.

The current careers scheme, which is common to both forms of contractual tie, is also subject to reform, by merging all existing careers and categories, currently standing at more than 1400, into three general careers.

In terms of remunerations, a single salary scale will be established and alterations will be made to the supplements system, which will be tied in future to a specific employment position and will, as a rule, be of fixed value. The possibility of a worker changing remuneratory position is dependent on the worker obtaining positive performance assessments and subject to budget availability and managerial decisions, since it vies with the recruitment of new civil servants for the available financial resources. The change of remuneratory position is an acquired right, i.e. it is compulsory, when the civil servant acquires a specified number of credits in annual performance assessments. Associated to the performance classification quotas established through the Integrated System for Management and Performance Assessment of the Public Administration (SIADAP), this new system aims to invert the career progression trend that has existed in recent years, and which has tended to be automatic in nature and has led to an unsustainable salary drift. Thus, the change in remuneratory position of a civil servant that has not achieved the “relevant” level of performance can only occur every five years, provided that the manager’s decisions favour career progression over the admission of new civil servants. In the event that the manager’s decisions do not privilege changes to remuneratory position, then the aforementioned time horizon will be extended to ten years, which is the time taken for the civil servant to attain the credits required for the compulsory allocation of funds to change remuneratory position (see Table 5).

Table 5. Alteration of remuneratory positioning

Performance assessment (initial classification in year t1)	Alteration of remuneratory position		
	Personnel Covered (as % of career)	Year in which the change comes into force	
		With available funds (a)	W/o available funds (b)
Excellent performance	5	t3	t5
Relevant performance	20 (c)	t4	t6
Satisfactory performance	75	t6	t11

Notes:

(a) Where the funds allocated to alterations of remuneratory position (Article 7, paragraphs 1 (b) and 3) accommodate the changes of all civil servants meeting general requirements, i.e. two consecutive maximum classifications (excellent performance), or three consecutive classifications immediately below the maximum (relevant performance); or five classifications immediately below the classification referred to above (satisfactory performance), provided that consecutive positive performances are achieved.

(b) Where there are insufficient funds to accommodate all or some of the situations referred to in the previous note and the conditions for the compulsory change of remuneratory position have been met: accumulation of ten points in performance assessments, where 3 points are awarded for each maximum classification, 2 points for each classification immediately below the maximum, 1 point for each classification immediately below the second-highest classification, and 1 point deducted for each classification at the lowest level of the scale. The two cases referred to are the extreme possibilities, the most and least favourable.

(c) Deducting the 5% of civil servants among those classified with "relevant" that obtain "excellent".

Source: Ministry of Finance and Public Administration, SIADAP and Contractual tie, career and remuneration draft laws.

The award of performance bonuses follows the same logic and is processed in the same manner as the alteration of remuneratory position, i.e. on compliance with the eligibility requirement established for performance bonuses – obtaining the maximum classification or second-highest classification in the most recent assessment – bonuses equivalent to the monthly basic remuneration are awarded according to the ranking of civil servants based on the classification obtained, until the funds allocated for this purpose are exhausted.

The draft law relative to SIADAP has already been approved in the Portuguese Parliament (Parliamentary Decree no. 174/X), and it is envisaged to come into force in January 2008. SIADAP aims to strengthen a culture of assessment and accountability in the Public Administration, by focusing on a performance assessment process based on management by objectives and allowing the performance of the service to be aligned with the performance of those working therein, both managers and employees, which should focus on the objectives to be achieved and the timeframes for achieving the same, moulding their actions to the performance progress. The current Public Administration assessment system, which only assesses middle management and employees, shall be extended, to that end, to include newly created assessment sub-systems for the services and all managerial positions .

The new SIADAP establishes a performance differentiation system, for system equilibrating purposes, which allocates maximum percentages (quotas) based on statistical evidence. This solution, on the other hand, seems to be essential, given the culture prevailing in certain sectors of the Public Administration and considering the budgetary impact arising from performance assessment.

Human Resources Planning and Mobility

The reform of the management of human resources in the Public Administration also encompasses the implementation of improvements in the planning of these resources, an area that is fundamental to

streamlining their use. Services with surplus human resources must accordingly transfer these to more strategic areas lacking such resources. The mobility of human resources is, thus, an essential mechanism for supplementing and ensuring the effectiveness of human resources' planning.

The new careers scheme strengthens the general mobility mechanisms in the Public Administration where the improvement to the cost-cutting, effectiveness and efficiency of the public service is concerned, and it benefits internal mobility between bodies and services, mobility within the same geographical area and mobility within the same career.

Moreover, the implementation of legislation on reorganisation of public services and special mobility mechanisms commenced in 2007, as planned. Some of the services of the Public Administration possessing personnel in excess, taking into consideration their new duties and the available resources, have already transferred civil servants into the special mobility system, using legally established criteria as the basis, namely performance assessment. There were, as at 30 September, 1 232 civil servants with special mobility status and based on the analysis of 95 personnel streamlining processes, it is envisaged that a further 2 468 civil servants may shortly acquire this status.

The following table summarises the stages and wage percentage applicable to civil servants holding special mobility status.

Table 6. Special Mobility – stages and wages

Period	In the 3 mobility phases	Long-term leave		
	% Basic remuneration	Basic remuneration (a)	% Basic remuneration	Remuneration earned
Months 1 and 2, year T1	100,0%	n.a.		
Months 3 to 12, year T1	83,3%	85,7%	70%	50,0%
Years T2 to T5	66,7%	85,7%	70%	40,0%
Years T6 to T10	66,7%	85,7%	60%	34,3%
Year T11 and subsequent	66,7%	85,7%	50%	28,9%

N.B.: (a) Monthly wage prior to transfer to special mobility status, adjusted to the payment of 12 monthly allowances.

Source: Ministry of Finance and Public Administration.

A.3 Reform of the Management of the States' Real Estate Assets

The concern for transparency, good administration and control are found in the reform of the management of the States' real estate assets (Decree-law no. 280/2007 of 7 August). For that purpose, a scheduled inventory programme of the work required to draw up and update the real estate inventory of the public areas owned by the State, the Autonomous Regions and Local Authorities and the real estate owned by the State and public institutes in the private domain, was established in addition to coordination proceedings concerning the supervision of the real estate, based on a programme of real estate management. Also, the information requirements on property management were increased. In this area focus is given to the principle that space occupied in the State's real estate should be subjected to recompense, in the shape of payment by the user entity.

A.4 Budgetary Impact of the Public Administration Reform Measures

Table 7 indicates the impact on the public accounts resulting from the implementation of the Public Administration reform measures, particularly relative to the decrease in personnel expenditure and operating expenditure.

Table 7. Budgetary Impact of the Public Administration Reform Measures

	Share of GDP	Saving (% GDP)					
	in 2005 ^(a)	2006	2007	2008	2009	2010	2011
Personnel and operating expenditure	18,5	1,0	2,1	2,5	3,1	3,6	3,8
Personnel expenditure	14,5	0,8	1,7	2,2	2,8	3,2	3,5
Control of Admissions and Recruitment		0,3	0,7	1,0	1,3	1,6	1,9
Restraining Salary Drift		0,2	0,2	0,2	0,2	0,2	0,1
Salary Restraint		0,1	0,1	0,1	0,1	0,1	0,1
Other savings (b)		0,2	0,7	1,0	1,2	1,3	1,4
Operating expenditure	4,1	0,1	0,4	0,3	0,3	0,4	0,3
PRACE		0,0	0,1	0,1	0,2	0,2	0,1
Shared Services		0,0	0,1	0,1	0,1	0,1	0,1
Other Measures (c)		0,1	0,2	0,1	0,1	0,1	0,1

N.B. The budgetary impact of the implementation of a measure is calculated, in each year, through the comparison of the budgetary scenario underlying this Programme and a scenario in which the measure is not implemented. In the no-policy-change scenario it is assumed that the share of GDP of the budgetary item determined in 2005 is maintained throughout the period analysed (2006-2011).

Key: (a) Share of GDP of each item in 2005. (b) Includes the savings arising from the passage of civil servants to special mobility status, the reduction of overtime, the review of remuneratory supplements, and the convergence of the healthcare sub-systems. In this item is included the impact of the transformation of some hospitals into corporate public entities, which occurred in 2005 and 2007 (about 0.2% of GDP in each year) that is not considered a saving. (c) Includes, besides discretionary cost cutting measures in the acquisition of current goods and services, the reorganisation of the State's local services and the overhead associated to the reduction of the number of civil servants effectively employed (resulting from the control of recruitment and contracting and the transfer of civil servants to special mobility status).

Source: Ministry of Finance and Public Administration.

The main contribution of the reform of the Public Administration to budgetary consolidation results from the control of personnel admissions and contracting. In actual fact, if the Government had not imposed in 2005 the recruitment rule of one new civil servant to every two leaving and restricted retainer and piece-work contracts, it is expected that personnel expenditure would, for example, in 2011, be 1.9% of GDP higher than this Programme's forecast for that year, which represent a saving of more than EUR 3 000 million².

The curbing of salary drift also positively contributed to budgetary consolidation, by means of the impact of freezing automatic career progression and the amount of remuneratory supplements awarded in 2005, and also the fact that the new careers and remuneration scheme is planned to come into force in 2008.

As regards wage restraint, it is expected that following the wage update in 2006 and 2007, at below the inflation rate, the growth of wages from 2008 onwards follows the new rules associated to the management by objectives model.

² Assuming that the share of GDP remains unchanged in the no-policy change scenario can be considered prudent in relation to personnel expenditure, especially if we take into consideration this accounting item's evolution prior to 2005. Thus, it would be reasonable to assume that, in the absence of correction measures, the share of GDP of personnel expenditure would tend to increase, result in an even greater savings estimate.

It is estimated that if, for example, the Restructuring Programme for the State's Central Administration (PRACE) had not been implemented, then operating expenditure in 2010 would be 0.2% of GDP higher than the figure forecast for that year in this Programme.

B. Reform of the Social Security and Health Systems

B.1. Reform of the Social Security General Scheme

The agreement on the reform of social security signed by the Government and Social Partners in October 2006 was embodied in the new Framework Law on Social Security (Law no. 4/2007 of 16 January) and in legislation specific to this sub-system³, which came into force at the beginning of 2007. Measures such as accelerating the transition to the use of the new pension calculation formula, additional penalty for early retirement and the new pension update rule have been in force since that time. The introduction of the sustainability factor in the calculation of new pensions shall, in turn, come into force from 1 January 2008.

The intention in 2008 is to establish the New Public Capitalisation Scheme, a New Contributory Code, and also ensure the continuation of the effort that has been ongoing since 2005 relative to the Plan to Combat Contributory and Benefit Fraud and Evasion.

Creation of the Public Capitalisation Scheme

The Public Capitalisation Scheme (RPC) shall be created during 2008, fruit of the materialisation of Article 82 of Law no. 4/2007 of 16 January (Framework Law on Social Security) and the Social Security Reform Agreement.

This scheme shall consist of voluntary subscription for individual accounts, and it shall constitute a new mean available to Social Security beneficiaries to boost the value of their pension income, thus offsetting the impact arising from the sustainability factor.

Thus, and all through their careers, beneficiaries may channel an additional monthly contribution to the RPC, corresponding to a percentage of the contributory base, which shall be credited in the form of investment units in an individual account.

These contributions shall capitalise according to the return ensured by the overall portfolio of fund assets, guaranteeing an investment profile that is identical to that of the Social Security Financial Stabilisation Fund. Accordingly, in addition to a prudent investment profile, the dimension of the assets managed by the Institute for the Management of Social Security Capitalisation Funds, and the very nature of the entity, ensure low management and transaction costs.

When the holder becomes a pensioner the investment units registered in the individual account of that beneficiary are converted into a lifelong monthly income, thus supplementing the pension received from the regular scheme. The redemption of the capital on retirement as well as the transfer of ownership to the individual account of the beneficiary's spouse or children is a possibility envisaged under the scheme.

The aim of a public scheme of this type is to extend a savings instrument and pension supplement to general beneficiary population, which can easily be subscribed to given the intuitive nature of its rules as

³ Notably Decree Law no. 187/2007 of 18 May.

well as the fact that any issues concerning the scheme can be broached in the national beneficiary assistance network of Social Security throughout the country.

This scheme completes the policies, including, in addition to the RPC, all the rules to strengthen the incentives to extend working life, specifically designed to safeguard the impact on Social Security caused by the increase in average life expectancy.

New Contributory Code

The new Contributory Code shall compile, systemise and simplify the contributory legal framework in regard to Social Security. The registration in, binding to, contribution to and default of the Social Security system shall all become an integral part of the same legislative instrument.

The new Code shall provide for the broadening of the contributory base in order to permit convergence with the tax base, the streamlining of contributory rates and the update of the breakdown of contributory rates.

The review of special contributory schemes, including that of self-employed workers, shall also be carried out, in order to streamline current contributory rates and to approach contributory rates to real income.

Combating contributory and benefit fraud and evasion

The mechanisms to fight system fraud and evasion are strengthened through a set of measures:

- Ending under-declaration and the sporadic absence of earnings declarations to Social Security, namely through the development of a new process for issuing defaulting earnings declarations;
- Strengthening data crosschecking procedures with the Tax Administration;
- Review of the Social Security administrative offences scheme.

B.2. Reform of the Caixa Geral de Aposentações System [civil servants' social protection scheme]

Also defined in 2007 was the scheme for applying the main reform measures of the Social Security sub-system to Caixa Geral de Aposentações - Law no. 52/2007 of 31 August. This new legislation on the sub-system will come into force from 2008. The process of converging the Caixa Geral de Aposentações sub-system (CGA) with the general Social Security scheme has been ongoing since the end of 2005 (Law no. 60/2005 of 29 December). This process included the closure on 1 January 2006 of registration in CGA for new civil servants, which shall instead be registered in the Social Security sub-system, as well as the definition of convergence mechanisms regarding retirement conditions and pension calculations.

In this context, the recent Social Security reform measures shall likewise impact on the CGA sub-system, though with a certain time lag in their implementation. The main reform measures are as follows:

New pension calculation formula for beneficiaries registered on or before 31 August 1993

The new formula considers the salary over the entire contributory career and entails a weighted average in which the weighting corresponds to the length of service completed up to the end of 2005 and the length of service from 2006.

$$Pension \equiv \frac{P_1 \times C_1 + P_2 \times C_2}{C}$$

where,

P_1 corresponds to the value of the pension calculated according to the Retirement Code (as a function of the wage in the last post held);

P_2 corresponds to the value of the pension taking into account the wages received from 1 January 2006, where the annual pension calculation rate (accrual rate) varies between 2 and 2.3% of the reference wage (descending with the value of the wage);

C_1 and C_2 are the length of service up to 31 December 2005 and from 1 January 2006, respectively;

C is the overall length of service.

The calculation formula of new pensions for beneficiaries registered in CGA between 1 September 1993 and 31 December 2005 is identical to that used in for Social Security contributors, which has been revised for the period from the start of 2007 onwards.

Introduction of the "Sustainability Factor"

The value of new retirement pensions from 2008 results from the multiplication of the sum calculated in the previous paragraph by the so-called Sustainability Factor, which indexes the pension's value to the evolution of the average life expectancy at 65 years old.

$$Pension \times \frac{EMV_{2006}}{EMV_{t-1}}$$

where,

EMV is the average life expectancy at 65 years old annually published by INE;

t is the retirement start year.

Contributors can opt to accept this penalisation or to extend their working life in order to (totally or partially) compensate for the reduction to the pension value deriving from the application of this factor.

New pension update rules

According to the new rule, retirement, old-age and disability pensions are updated annually, based on the development of the consumer price index in the last year. This indexation is undertaken considering the recorded value of real GDP growth (annual average of the two previous years) and the pension value, as follows:

Table 8. CGA – New pension update rule

	Real GDP growth rate under 2%	Real GDP growth rate between 2% and 3%	Real GDP growth rate equal to or greater than 3%
Pensions less than 1.5 IAS (a)	CPI growth rate	CPI growth rate + 20% real GDP growth rate (minimum: CPI growth rate + 0.5 percentage points)	CPI growth rate + 20% GDP growth rate
Pensions from 1.5 to 6 IAS	CPI growth rate - 0.5 percentage points	CPI growth rate	CPI growth rate + 12.5% GDP growth rate
Pensions from 6 to 12 IAS	CPI growth rate - 0.75 percentage points	CPI growth rate - 0.25 percentage points	CPI growth rate

N.B. (a) Corresponds to the "Social Support Indexant", specified for 2007 based on the 2006 national minimum wage, updated by inflation at the consumer level of that year (Law no. 53-B/2006). According to this Law, the IAS update rule in the future is identical to that of pensions of the bottom bracket.

This rule shall come into force in a phased manner. In 2008, it is just applicable to the pensions of the bottom bracket and the real GDP growth rate to be considered is only the rate of the previous year. The rule will apply to pensions of the middle bracket from 2009, and from 2011 it will apply to all pensions.

Additional penalty for early retirement

The value of the early retirement pension shall be reduced by 0.5% for each month from taking early retirement until the retired person attains 65 years of age, as opposed to the current penalty which is 4.5% for each year in advance of the compulsory retirement age. This new rule shall only come into force from 2015.

Award of bonuses for extending working life

The monthly bonus varies between 0.33% and 1%, depending on the length of service (no less than 15 years), for each month subsequent to the date on which the beneficiary fulfils legal retirement requirements up to the effective retirement date, with a ceiling for the beneficiary of 70 years of age.

More favourable retirement conditions for absolute and permanent disability compared to all other cases of disability

The minimum contribution period in the event of general absolute disability is now 3 years of age, instead of the 5 years required for all other cases of disability.

Convergence of the guarantee period with the General Social Security Scheme

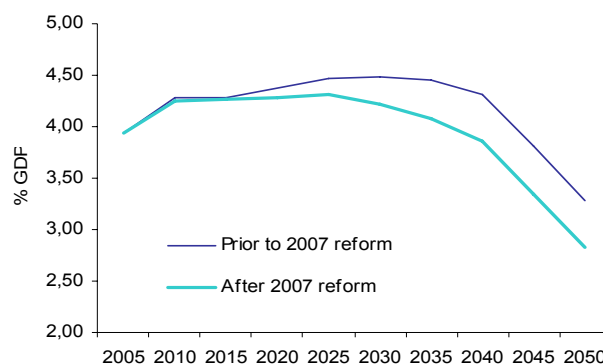
The Council of Ministers approved a draft law at the end of October 2007 that introduces new measures aimed at ensuring the convergence of the Caixa Geral de Aposentações scheme and the Social Security General Scheme. This law defines, in particular, the guarantee period of 15 years of contributions in order to obtain entitlement to a pension, except for old-age and disability pensions.

Impact of the Main Reform Measures on CGA

The impact of the main reform measures (the first four above-described mentions) on the long-term development of pension expenditure was simulated. This simulation makes it possible to assess the measures' contribution to the sustainability of the social security systems.

Given that the measures in question primarily impact on new pensions, their influence on the pension expenditure of CGA should only be most discernible in the long term. Thus, the impact of this reform over the time horizon to 2050 were simulated. Taking into account the fact that CGA has not accepted new registrations since 2006, the pension expenditure of this sub-system significantly drops from the start of the 2040's (Chart 5).

Chart 5. Pension expenditure of CGA

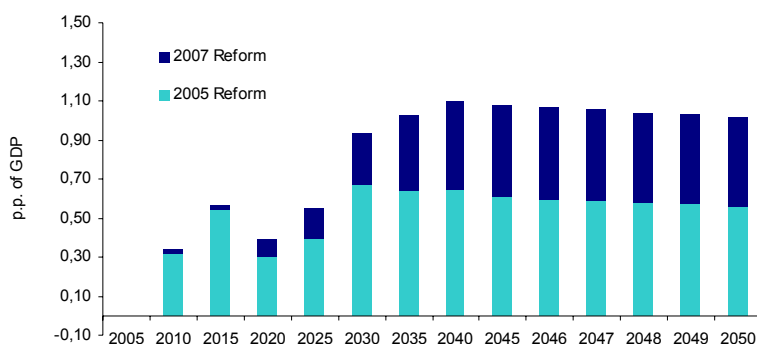


Source: Ministry of Finance and Public Administration.

It was assumed in this simulation, which considers the adaptation of the social security reform measures to the civil servants' social protection scheme, that the contributors to CGA did not change their decisions to retire as a result of this recent reform. Accordingly, the impact solely acts on the evolution of pension expenditure, since no impact on the trend of revenue in the form of contributions is expected. Therefore, the estimated impact must be interpreted as a lower threshold for the total impact of these measures on CGA's financial situation, since contributors' decisions relative to the extension of active life shall translate into additional revenue for the sub-system, greater than the marginal increases in pension expenditure arising therefrom.

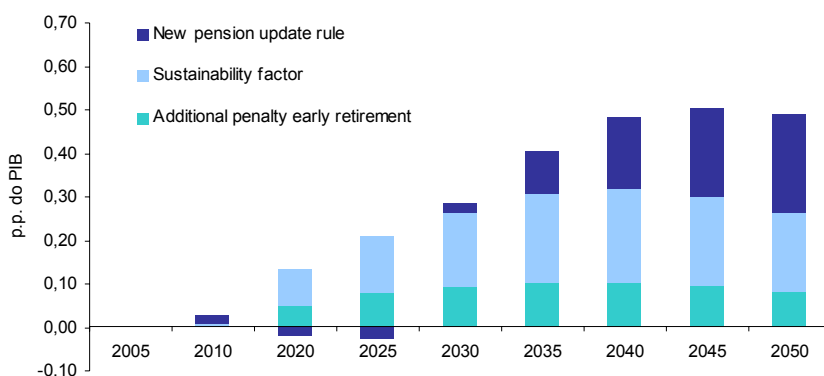
If the estimated impact of the reform implemented in 2005 is added to the impact of these recent measures focused on CGA, then the magnitude of the total impact (measured as p.p. of GDP) of the process of reform of this sub-system on the development of pension expenditure is obtained, which is found to be rather significant (see Chart 6)⁴. It should be noted that the measures taken in 2005 were already directed towards the convergence of this sub-system with the general Social Security scheme, namely through the progressive increase of the compulsory legal retirement age and the length of service required to be entitled to retire.

⁴ The impact of these measures is detailed in the December 2005 update of the Stability and Growth Programme.

Chart 6. Total Impact of the 2005 and 2007 Reforms of CGA

Source: Ministry of Finance and Public Administration.

The scale of the impact of each one of them is nonetheless differentiated. The most relevant in this sub-system are the new pension update rules and the inclusion of the sustainability factor (Chart 7).

Chart 7. The contribution of the measures to reduce pension expenditure

Source: Ministry of Finance and Public Administration.

The new pension update rule removes the discretionary element that existed in this mechanism. It is assumed, taking into account the distribution of the value of pensions recorded in 2006, that this measure implies real growth of 0.2 percent / -0.3 percent in pensions, according to whether GDP growth is greater than/lower than 2 percent. This measure significantly contributes to lowering pension expenditure, in comparison to the no-policy-change scenario, where real growth of 0.1 percent throughout the horizon is assumed.

The impact of the Sustainability Factor grows over time, thus allowing the negative impact that the ageing of the population has on the financial situation of CGA to be offset. This measure also makes the projection environment secure against changes in the underlying demographical scenario, particularly in relation to changes in mortality rates.

The additional penalisation for early retirement measure provides the system with an added saving, though overall it has a minor contribution relative to the overall impact of the reforms.

Bringing forward the implementation of the new pension calculation rule has a much reduced effect on the CGA system for two tiers of reasons: for those registered on or before August 1993, the new calculation rule solely encompasses the use of differentiated (higher) calculation rates for contributory years from 2008 instead of from 2016; for all other contributors, the rule also has an effect by considering the entire contributory period instead of just the best 10 years of the final 15 contributory years, but the probability of effective retirement before 2016 is very low.

In summary, the recent reform measures should, as a whole, have an impact on curbing the pension expenditure of this sub-system as soon as 2010 onwards. This will allow the relative value allocated for this type of expenditure, as percentage points of GDP, to decrease from the middle of the 2020's, which is contrary to the no-policy change scenario in which that decrease will only commence in the 2040's.

B.3. Sustainability of the Health System

In line with the Medicament and Pharmacy Policy, the new legal scheme for pharmacies will be implemented in 2008. This new legal scheme is based on the free access to ownership, but it prevents excessive concentration by limiting the number of pharmacies a property-holder can own to four, and strengthens the framework regarding ownership and management incompatibility. The new, already approved legislation allows pharmacies to sell at discount and dispense medicaments over the Internet and in homes, both of which shall be implemented in 2008. Besides the improved citizens' access, the Hospital Medicaments Programme has been undergoing implementation since July 2007. This programme strives to streamline medicament consumption and improve its systematic and comprehensive monitoring, thereby contributing to the effective control of hospital expenditure in this area.

This Policy is strengthened by the monitoring system implemented by INFARMED (Portuguese Authority of Medicines and Health Products), based on the definition of a harmonised medication code for every National Health System (NHS) hospital; this is the basis of a monthly report of medication consumption and subsidised cashflows per cost centre of each hospital. This system already covers about 90% of total consumption.

Decree-law no. 195/2006 of 3 October, concerning the introduction of new medicaments in NHS institutions, has, from January this year, attributed responsibility to INFARMED for the prior evaluation of each medicament based on the assessment of its added therapeutic value and the economic advantage in comparison with the existing treatment alternatives, founded on scientific studies and economic assessments of the medicament. The decision process also includes the budgetary impact associated to the introduction of the medicament and, if approved, the establishment of a two year contract with the company responsible for its production stipulating the maximum expenditure to be incurred by the NHS for that medicament. Measures to stimulate the prescription of generic medicaments will continue to be implemented in 2008.

The process of transforming hospitals in the public administrative sector into corporate public enterprises continued in 2007, as 10 new institutions were set up. Effectiveness goals were pursued by these means, through the improved access to and quality of the healthcare provided, and efficiency goals through the management performance of these entities.

Planning, budgetary and activity control processes in the health area, as detailed in Section V.4, have likewise been strengthened.

The financial performance data for the first eight months of this year indicate significant progress in operational results for the corporate public hospitals compared to the same period and universe of the previous year, improving from - EUR 437.9m in August 2006 to - EUR 175.1m in 2007. The contribution of the improved cost structure to this result is of note (see Table 9), with the cost of goods sold recording a rate of change of 2.8% up to August 2007, compared to the same period of 2006 (registering a fall of 7.9 p.p. from 2004 to 2006), the cost of suppliers and external services with a rate of change of 0.5% (registering a change of 9.9 p.p. from 2004 to 2006) and personnel costs with a rate of change of 0.6% (adjusting by 3.9 p.p. between 2005 and 2006, after rising by 3.3 p.p. from 2004 to 2005).

Table 9. Change in the main cost categories of corporate public hospitals
(rate of change, %)

	2004	2005	2006	2007 (August)(a)
Cost of material consumed	10.2	12.7	2.3	2.8
Suppliers and external services	7.4	8.4	-2.5	0.5
Personnel	3.9	7.2	3.3	0.6

Key: (a) The following hospitals are not included in the accounts: Centro Hospitalar de Lisboa Ocidental, EPE, Centro Hospitalar de Trás-os-Montes e Alto Douro, EPE, and Centro Hospitalar do Nordeste, EPE.

Source: Ministry of Health.

It is expected that the cost categories will come to reflect the initiatives currently undergoing implementation in the shared services in health area. The Health Systems Central Administration procurement centre and the forming of the Shared Procurement and Logistics Services Unit by the Hospitals' Common Services body (SUCH), in April this year, were significant in instilling dynamism to this area.

Decree-law no. 44/2007 of 23 May amended the remuneration scheme for overtime, which shall have a bearing on the evolution of personnel expenditure. In the reference framework of the professional organisation systems of doctors in general practice and hospital practice, the exceptionality principle is established for the former, taking precedence over overtime, while the liberty principle is created for the latter, which replaces the former obligation of having to perform overtime. Also in the area of human resources management, Decree-Law no. 276-A/2007 of 31 July established the determination of quotas for personnel recruitment in some specific areas of healthcare provision for the maximum period of one year, which are jointly defined by the Minister of Finance and the Minister of Health. 6752 contracts were authorized in 2007, a number that should decrease to 6.000 in 31 December 2008.

The impact of the aforementioned measures undergoing implementation is already perceptible, enabling the NHS to exhibit a balanced financial situation, with a surplus of approximately EUR 104 million in 2006, thus inverting the trend observed in recent years (see Table 10). Hence, 2006 was a turning point year in relation to NHS funding, as its budgeting is now carried out according to the system's real needs. It is estimated that the amount allocated to the NHS in the State Budget for 2007 to be complied with, as occurred in 2006. In 2008, a total of EUR 7,900 million are allocated to the NHS, equivalent to 2.9% growth on the 2007 figure.

Table 10. Financial Situation of the NHS (1995 – 2006)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
EUR million	-253	-314	-651	-851	-968	-1,114	-1,247	-514	-1,287	-1,033	-68	104
% GDP	-0.3	-0.3	-0.7	-0.8	-0.8	-0.9	-1.0	-0.4	-0.9	-0.7	0.0	0.1

Source: Ministry of Health.

The Central Administration of Health Systems, the entity managing the financial resources of the NHS, has been carrying out, in relation to the development of the cash availabilities and short-term debt of NHS entities, the adjustment of the value of the monthly advance payments made to hospitals under the programme contracts, in order to align it with the real invoicing value, thereby contributing to the improvement of cash management, which will have positive repercussions on the management of short-term debt.

Moreover, a process to settle debts between hospitals and Regional Health Authorities is already being conducted, and which will become evident in the strengthening of hospital's cash availabilities, which shall employ these funds to the settlement of debts with external suppliers, before the end of 2007.

The good financial results achieved occur in tandem with citizens' increased access to the healthcare provided by the State, which is gauged, for example, by the reduction of the number of patients on surgery waiting lists (falling from around 421 000 in 2005 to 225 000 in 2006) or the decrease in the waiting time for surgery (from 8.6 months in 2005 to 6.9 months in 2006). Recourse to the services provided by contracted private entities, through the issue of surgery vouchers also contributed to these results. The issue of surgery vouchers grew from close on 400 in 2004 to approximately 36 000 issued in 2006.

Table 11. Budgetary Impact of the Expenditure Cutting Measures in Health

	Share of GDP in 2005 ^(a)	Saving (% GDP)					
		2006	2007	2008	2009	2010	2011
Product sold in pharmacies	1.0	0.1	0.1	0.1	0.1	0.1	0.1
Auxiliary Diagnostic and Therapeutic Means ^(b)	0.8	0.0	0.1	0.1	0.1	0.1	0.1
Total	1.8	0.1	0.2	0.2	0.2	0.2	0.2

N.B. The budgetary impact of the implementation of a measure is calculated, in each year, by comparing the budgetary scenario underlying this Programme and a no-policy-change scenario. The no-policy-change scenario is generically characterised by the assumption that each item grows over the period analysed (2006-2011) in conformity with the average real growth rate recorded in the period from 2000 to 2005, adjusted for inflation over the period from 2006 to 2011. The impacts associated to the process of transforming hospitals into corporate public enterprises in 2003, 2005 and 2007 were taken into consideration.

Key: (a) Baseline scenario – item's share of GDP in 2005; (b) Includes hospitals' purchases.

Source: Ministry of Finance and Public Administration.

Table 11 shows the budgetary impact associated to the saving and streamlining measures implemented since 2005 in the health area, namely the review of the price of co-paid medicaments and the procurement agreements entered into by the NHS, the reduction of the maximum prices for the purchase of pharmaceutical products and clinical material by entities forming part of the NHS, and gains in efficiency associated to the transformation of hospitals into corporate public enterprises⁵.

⁵ If, for example, measures had not been taken in regard to the medicaments co-payment policy, expenditure on co-payments would be expected to be in 2011 approximately 0.1% of GDP greater than the value forecast for that year in this Programme.

C. Tax System

The Portuguese Government, in line with tax policy guidelines, shall continue the fight against tax fraud and evasion and abusive tax planning.

The use of information as a lever in the fight against tax fraud and evasion shall continue to be stimulated. Monitoring compliance with obligations has been facilitated by the acceleration of the respective control and detection mechanism and by the automation of the warning and penalisation circuits for offenders. The dissuasive effect, in addition to the revenue achieved, which has increased significantly, has been the greatest benefit of these actions.

A measure is established in legislation to prevent abusive action in the deduction of capital losses arising from any division operation. The scheme in force already contains some restrictions in relation to the deduction of capital loss arising from a division operation, which are aimed at preventing an abusive behaviour; however, the combination of the company liquidation scheme with the special taxation scheme for company groupings led, in certain cases, to a double deduction of losses, causing the liquidation and winding up of a company for exclusively or predominantly tax reasons. The VAT Code is also amended to include a restriction on the entitlement of taxable persons to the special exemption scheme, which aims to prevent the abusive recourse to the closure of activity procedure, when the prerequisites for integration in the standard VAT scheme exist, and subsequent start up of the company once again.

There are also, in addition to these legislative measures, operational measures that are underway or to be implemented, which contribute to the fight against tax fraud and evasion. These measures include the publication of lists of taxpayers with tax debts, the restructuring of the executive debt and reinforcing the human resources of courts of tax appeals.

Tax revenue and social contributions essentially contributed to budgetary consolidation in the early years of this process, with their share of GDP stabilising from 2009. In fact, discretionary tax raising measures were adopted in the initial adjustment phase. Nonetheless, tax revenue has benefited from growing efficiency gains deriving from the fight against tax and contributory fraud and evasion. Anti-tax and contributory fraud and evasion measures are expected to permit, for example, in 2008, a revenue increase of around 0.8% of GDP, compared to the value forecast for that year in this Programme (Table 12).

Table 12. Budgetary Impact of tax and contributory revenue consolidation measures

	Share of GDP in 2005 ^(a)	Saving (% of GDP)					
		2006	2007	2008	2009	2010	2011
Tax Revenues and Social Contributions	34.9%	0.8%	1.3%	1.4%	1.5%	1.5%	1.5%
of which:							
Amendments to Tax Structure (b)		0.5%	0.6%	0.6%	0.6%	0.6%	0.6%
Tax and Contributory Efficiency		0.3%	0.7%	0.8%	0.9%	0.9%	0.9%

N.B. The budgetary impact of the implementation of a measure is calculated, in each year, by comparing the budgetary scenario underlying this Programme and a no-policy-change scenario. In the no-policy-change scenario it is assumed that the budgetary item's share of GDP in 2005 was maintained over the period analysed (2006-2011).

Key: (a) Tax and contributory revenue as share of the GDP in 2005. (b) Impact of tax amendments that generate a revenue increase (e.g. higher tax rates), less the impact of tax amendments that generate a decline in revenue (e.g. award of tax allowances to biofuels).

Source: Ministry of Finance and Public Administration.

II.3. Budget Implementation in 2007 and State Budget for 2008

The General Government deficit in 2007, on a national accounts basis, should be equivalent to 3% of GDP, and it is forecast to attain 2.4% of GDP in 2008. This downward trend of the deficit, which has been ongoing since 2006, is due to the commitment to consolidation based on curbing current expenditure in all Government sub-sectors, though the greatest consolidation endeavour is focused on the Central Administration. The results achieved in 2006, better than forecast, allowed the Government, in April 2007, to review the budgetary objectives for 2007 and 2008 (Table 13). Even so, the performance in 2007 has bettered the objective established in April 2007. This evolution has allowed the Government to assume that the budget deficit will attain the Stability and Growth Pact's reference value in 2007. Accordingly, the correction of the budget imbalance, which was envisaged to take effect over a three year period, has been achieved in only two years.

Table 13. Budgetary Prospects
(% of GDP)

	2006(e)	2007(e)	2008(f)	2009(f)	2010(f)	2011(f)
Net Lending of General Gov.						
SGP – Dec. 2006	-4.6	-3.7	-2.6	-1.5	-0.4	-
BPSR – Apr. 2007	-3.9	-3.3	-2.4	-1.5	-0.4	-
SGP – Dec. 2007	-3.9	-3.0	-2.4	-1.5	-0.4	-0.2
Structural Balance						
SGP – Dec. 2006	-3.4	-2.6	-1.8	-1.3	-0.5	-
BPSR – Apr. 2007	-2.7	-2.2	-1.6	-1.2	-0.5	-
SGP – Dec. 2007	-2.8	-2.1	-1.6	-1.1	-0.4	-0.4

Key: (e) estimate; (f) forecast.

Source: Ministry of Finance and Public Administration, Stability and Growth Programme, December 2006 Update and Budget Policy Steering Report (BPSR), April 2007.

The analysis of the General Government accounts presented in Table 14 indicates that total expenditure continued the favourable performance it demonstrated in 2006, with a reduction of 1.0 p.p. of GDP esti-

mated for 2007 and 0.3 p.p. for 2008, when it shall be equivalent to 45.1% of GDP. It is significant that the changes in total revenue and expenditure in 2008 incorporate the impact of the increase in EU structural funds associated to the start of National Strategic Reference Framework implementation. It is envisaged that these additional funds account for around 0.5 p.p. of GDP, and notable among these funds are those relative to the European Social Fund. If this impact is discounted, total revenue would decrease by 0.1 p.p. of GDP and total expenditure by 0.8 p.p. of GDP, 0.6 p.p. of which is attributable to the reduction in current primary expenditure.

Table 14. General Government Accounts
(On a National Accounts basis)

	Million euro			% of GDP			Difference (p.p. of GDP)	
	2006	2007(e)	2008(f)	2006	2007(e)	2008(f)	2007/06	2008/07
1. Tax Revenue	37,656.3	40,021.4	42,283.2	24.3	24.6	24.8	0.4	0.2
Taxes on Production and Imports	23,994.7	24,698.9	26,350.2	15.5	15.2	15.4	-0.3	0.2
Taxes on Income and Wealth	13,661.6	15,322.5	15,932.9	8.8	9.4	9.3	0.6	-0.1
2. Social Contributions	19,360.3	20,254.1	21,087.0	12.5	12.5	12.4	0.0	-0.1
of which: Effective Social Contributions	17,712.0	18,810.3	19,799.1	11.4	11.6	11.6	0.2	0.0
3. Other Current Revenue	7,145.1	6,399.9	7,145.2	4.6	3.9	4.2	-0.7	0.2
4. Total Current Revenue (1+2+3)	64,161.7	66,675.3	70,515.3	41.4	41.0	41.3	-0.3	0.3
5. Intermediate Consumption	6,427.8	6,586.7	7,072.8	4.1	4.1	4.1	-0.1	0.1
6. Personnel Expenditure	21,164.9	20,743.9	20,875.8	13.6	12.8	12.2	-0.9	-0.5
7. Social Transfers	29,221.3	30,878.3	32,629.8	18.8	19.0	19.1	0.2	0.1
8. Interest Expenditure	4,312.6	4,737.3	4,992.1	2.8	2.9	2.9	0.1	0.0
9. Subsidies	2,154.5	1,910.6	2,048.6	1.4	1.2	1.2	-0.2	0.0
10. Other Current Expenditure	3,396.6	3,387.0	3,523.0	2.2	2.1	2.1	-0.1	0.0
11. Total Current Expenditure (5+6+7+8+9+10)	66,677.8	68,243.9	71,142.1	43.0	42.0	41.7	-1.0	-0.3
<i>of which: Current Primary Expenditure (11-8)</i>	<i>62,365.2</i>	<i>63,506.6</i>	<i>66,149.9</i>	<i>40.2</i>	<i>39.1</i>	<i>38.8</i>	<i>-1.1</i>	<i>-0.3</i>
12. Gross Saving(4-11)	-2,516.1	-1,568.6	-626.7	-1.6	-1.0	-0.4	0.7	0.6
13. Capital Revenue	1,750.0	2,155.1	2,327.7	1.1	1.3	1.4	0.2	0.0
14. Gross Fixed Capital Formation	3,612.3	3,646.2	3,793.1	2.3	2.2	2.2	-0.1	0.0
15. Other Capital Expenditure	1,651.2	1,811.3	1,998.8	1.1	1.1	1.2	0.1	0.1
16. Total Capital Expenditure (14+15)	5,263.5	5,457.6	5,791.9	3.4	3.4	3.4	0.0	0.0
17. Total Revenue (4+13)	65,911.8	68,830.4	72,843.1	42.5	42.4	42.7	-0.1	0.3
18. Total Expenditure (11+16)	71,941.2	73,701.5	76,934.0	46.4	45.4	45.1	-1.0	-0.3
<i>of which: Total Primary Expenditure</i>	<i>67,628.6</i>	<i>68,964.1</i>	<i>71,941.8</i>	<i>43.6</i>	<i>42.4</i>	<i>42.2</i>	<i>-1.2</i>	<i>-0.3</i>
19. Net Lending/ Borrowing of General Government (17-18)	-6,029.5	-4,871.1	-4,090.9	-3.9	-3.0	-2.4	0.9	0.6
<i>of which: Primary Balance (19+8)</i>	<i>-1,716.8</i>	<i>-133.8</i>	<i>901.2</i>	<i>-1.1</i>	<i>-0.1</i>	<i>0.5</i>	<i>1.0</i>	<i>0.6</i>
Current Primary Balance(19+8-13+16)	1,796.6	3,168.7	4,365.4	1.2	1.9	2.6	0.8	0.6
20. Public Debt	100.563	104.607	109.450	64.8	64.4	64.1	-0.5	-0.2

Key: (e) estimate; (f) forecast.

Source: Ministry of Finance and Public Administration, State Budget for 2008 Report, October 2007.

The social transfers and personnel expenditure items, the main components of current expenditure, followed distinct trends. The behaviour of the social transfers item reflects both the increase in pension expenditure as well as the development of social transfers in kind, representing an increase of 0.3 p.p. of GDP from 2006 to 2008, when it is forecast to account for 19.1% of GDP. This trend results from the

slowdown of the rate of change of social transfers, envisaged to grow by 5.7% in 2008, as opposed to the average growth rate of around 11% in the period from 2001 to 2005. Personnel expenditure, in contrast, is in decline, and has been since 2006. It is estimated to decrease by 1.4 p.p. of GDP over 2007 and 2008 jointly, and is forecast to account for 12.2% of GDP in 2008. The freezing of automatic career progression in the civil service (in 2006 and 2007), the reorganisation of the security, education, healthcare services and justice networks, the implementation of the Restructuring Programme for the State's Central Administration (PRACE), and, to a lesser extent, the impact caused in 2007 by the transformation of hospitals into ten corporate public hospitals⁶ all contributed to this performance.

It is forecast that in 2008, as opposed to 2007, the total revenue contributes to the reduction of the deficit, by registering an increase of 0.3 p.p. of GDP to 42.7% of GDP. Breaking this growth down into its component parts shows that the main contributor is tax revenue and social contributions, in particular from tax on production and imports, reflecting the baseline impact of VAT reimbursements in 2007⁷.

The evolution of current expenditure, which reflects the impact of budgetary consolidation measures, as well as the good performance of tax revenue, still benefiting from gains in efficiency, allows for a forecast of a positive primary balance in 2008, equivalent to 0.5% of GDP, which shall be the first time this has occurred since 2002.

Interest expenditure is expected, given the context of interest rates rising to a certain extent, to slightly worsen, growing from 2.8% of GDP in 2006 to 2.9% of GDP in 2007 and 2008.

The budgeted funds for investment in 2008 have risen by 4% relative to 2007. Of note is the increase in investment in Science and Technology and to support the qualification of the Portuguese public. The policy of selectivity and reorientation of public investment to areas focussed on knowledge and to support economic competitiveness, in a context of public finances consolidation, demonstrates the growing awareness of the need to improve the quality of public expenditure.

The government debt to GDP ratio, reflecting the budget deficit trend, is also following a downward dynamic, and a value of 64.4% of GDP (0.5 p.p. less than in 2006) is estimated for 2007, and this ratio is forecast to undergo a further decrease in 2008, to 64.1% of GDP.

Lastly, a reference should be made to the changes made to the management and financing model of road infrastructures⁸. These changes include the creation of the Road Service Contribution (CSR)⁹, which substitutes financing through transfers from the State, and the transformation of Estradas de Portugal, EPE into a state-owned public limited company¹⁰. The Estradas de Portugal company remains within the

⁶ The impact associated to this transformation is estimated to be 0.2% of GDP. This reduction in personnel expenditure is, nonetheless, counterweighted by an increase in social transfers in kind.

⁷ The Legislative Order on VAT Reimbursements came into force in 2006, and it has been applicable in reimbursement requests since June 2006. In the new framework, requests are submitted via the electronic transmission of data, which accelerates the reimbursement procedure and leads to faster settlement by the State. This impact is estimated to account for 0.1% of GDP.

⁸ Resolution no. 89/2007 of the Council of Ministers, of 11 July, establishes the general principles that the management and financing model of the road sector should comply with.

⁹ The Road Service Contribution established by Law no. 55/2007, of 31 August, applies to petrol and road diesel subject to and not exempted from tax on oil and energy products. The tax on oil and energy products is reduced, as a counterbalance to the creation of the Road Service Contribution and to ensure that the users of road infrastructures are not additionally burdened, in order to ensure neutrality. The road service contribution constitutes the exclusive revenue of EP – Estradas de Portugal, EPE.

¹⁰ Decree-Law no. 374/2007, of 7 November, transforms the state-owned company Estradas de Portugal, EPE, into a state-owned public limited company. This new governance model provides the company with greater flexibility and autonomy. This new legal status also makes the corporate structure more comprehensible to national and international

consolidation perimeter of General Government and therefore, in national accounts, all revenue and expenditure is reported in the General Government accounts¹¹.

II.4. Medium-Term Objectives

The projections to 2011 that are presented reveal the commitment to maintain fiscal rigour, in order to comply with and uphold the medium-term objective (MTO) for Portuguese public finances from 2010. In fact, the Government established as the MTO, in the December 2005 update of the Stability and Growth Programme, a structural balance of -0.5% of GDP, to be achieved in 2010. Current projections indicate compliance with this objective, as a result of the ongoing consolidation effort.

Table 15. Breakdown of Structural adjustment
(% of GDP)

	2005	2006	2007	2008	2009	2010	2011	Change 2011-2005
Revenue	41,7	42,5	42,4	42,7	42,8	43,1	43,1	1,5
of which Fiscal and contributory revenue	34,9	35,7	36,2	36,4	36,4	36,4	36,4	1,5
Temporary measures	0,0	0,0	0,1	0,0	0,0	0,0	0,0	
Expenditure	47,8	46,4	45,4	45,1	44,4	43,5	43,3	-4,5
of which Primary expenditure	45,2	43,6	42,4	42,2	41,5	40,9	40,6	-4,5
Current primary expenditure	40,8	40,2	39,1	38,8	38,1	37,4	37,1	-3,8
GFCF	3,0	2,3	2,2	2,2	2,2	2,4	2,6	-0,4
Interest	2,6	2,8	2,9	2,9	2,8	2,7	2,7	0,0
Net lending/borrowing of General Gov.	-6,1	-3,9	-3,0	-2,4	-1,5	-0,4	-0,2	6,0
Primary balance	-3,5	-1,1	-0,1	0,5	1,3	2,2	2,5	6,0
Structural balance	-5,1	-2,8	-2,1	-1,6	-1,1	-0,4	-0,4	4,7

Source: Ministry of Finance and Public Administration.

The consolidation that has been followed since 2005, and which will be maintained for the near future, has concentrated on expenditure (Chart 8), particularly current primary expenditure. The pursuit of reforms of a structural nature intended to curb personnel expenditure, such as the Restructuring Programme for the State's Central Administration (PRACE) and the new contractual ties, careers and remunerations scheme for civil servants, has contributed decisively to that end. Other structural measures, such as the reform of social security, will produce a more significant effect on social transfers in the longer term, though they have already had a certain impact in this medium-term scenario.

financial markets, reinforcing the principle that the State does not directly or indirectly guarantee or stand surety for any debt or obligation of this corporation, nor take on any liability for its liabilities, irrespective of their nature.

¹¹ Investment expenditure, for example, is accounted for under public investment, even if not registered under the State Central's Programme for Investment and Development Expenditure (PIDDAC).

Chart 8. Budget Consolidation Planning
(Change in p.p. of GDP)

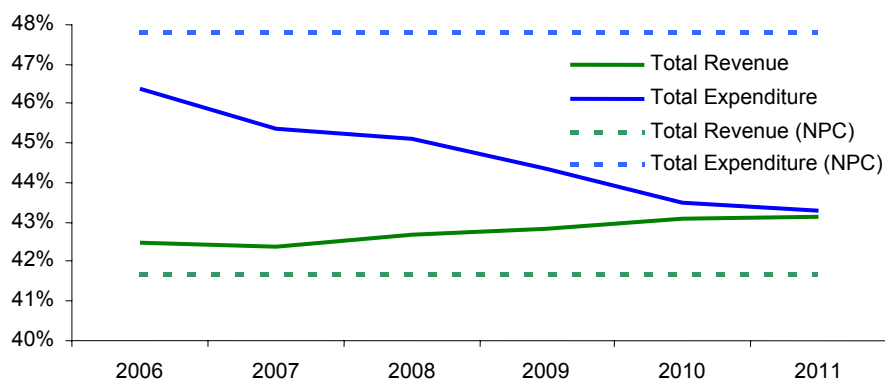


Source: Ministry of Finance and Public Administration.

The tax revenue and social contributions, which contributed to the adjustment process in the initial years after the excessive deficit situation in 2005, should maintain their share of GDP at relatively stable levels. In fact, discretionary measures concerning the increase in tax rates were employed in the frontloading phase of the adjustment. Tax revenue has further benefited from important efficiency gains in the fight against tax and contributory fraud and evasion. The total revenue in 2007 also benefited from a non-recurring revenue associated to the long-term concession contract for the exploitation of the Alqueva dam, providing an impact of 0.1 p.p. of GDP.

Chart 9 indicates the budgetary consolidation effort underpinning this Programme by comparison with a no-policy-change since 2005 budgetary scenario. In the no policy change (NPC) scenario it is assumed that the budgetary items maintain the share of GDP they held in 2005¹². The consolidation impact, calculated as the difference between the two scenarios, tends to increase the further along the Programme time horizon we advance.

Chart 9. Impact of Consolidation Process
(% of GDP)

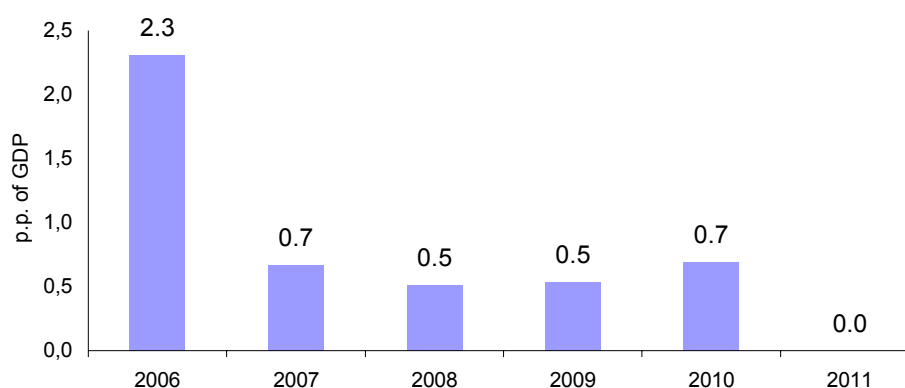


Source: Ministry of Finance and Public Administration.

¹² This assumption can be deemed to be prudent. In fact, if we consider the trend of the main budgetary items up to 2005, it would even be reasonable to assume that expenditure and revenue as a share of GDP would tend to increase in the absence of correction measures.

Chart 10 shows compliance with the corrective action of the excessive deficit situation in regards to the evolution of the structural deficit. The reduction was very significant in 2006 (-2.3 p.p. of GDP) and up to 2008, the year initially established for compliance with the nominal rule on the deficit, the structural deficit should decrease 0.7 p.p. in 2007 and 0.5 p.p. in 2008. Between 2008 and 2011 a further structural adjustment of 1.2 p.p. is forecast, primarily occurring in 2009 and 2010. It is forecast that in 2010 the cyclical component is practically zero, and it should become positive in 2011.

Chart 10. Change in structural balance



Source: Ministry of Finance and Public Administration.

The trajectory of budgetary consolidation in a context of recovering economic activity drives a downward trend for the government debt to GDP ratio (Table 6 of the Appendix). A value that is below the 60% established in the Treaty is forecast for 2010. The revenue of privatisation processes destined for debt amortisation also contributes to this result, though with a progressively smaller impact towards the end of the horizon considered. The favourable effect of the interest rate differential to GDP shall only become significant from 2009, given the stock of debt's inertia to changing interest rates.

Table 16. Debt developments

	2006	2007	2008	2009	2010	2011
Consolidated public debt (% GDP)	64,8	64,4	64,1	62,5	59,8	56,7
Change (p.p. of GDP)	1,1	-0,5	-0,2	-1,6	-2,7	-3,0
Primary balance effect	1,1	0,1	-0,5	-1,3	-2,2	-2,5
Snow-ball effect	0,2	0,0	-0,1	-0,4	-0,6	-0,6
Other	-0,2	-0,5	0,4	0,1	0,0	0,1

Source: Ministry of Finance and Public Administration.

II.5. Budgetary Implications of Major PNACE Measures

Table 17 illustrates the expected direct budgetary implications associated to the implementation of the seven intervention policies of PNACE. It was decided for the period between 2009 and 2011, taking into account the expected launch of the New Cycle of the Lisbon Strategy, to project the 2008 values for the

microeconomic and qualification, employment and social cohesion areas. The data used for the macroeconomic area was that of the savings deriving from the implementation of the measures to reform the Public Administration and the social security systems and to streamline health expenditure.

Table 17. Budgetary impact of policies under PNAE
(% of GDP)

	2007	2008	2009	2010	2011
Macroeconomic Policies	-2.2	-2.7	-3.2	-3.6	-3.7
Economic Growth and Sustainability of Public Finances	-2.2	-2.7	-3.2	-3.6	-3.7
Governance and Public Administration	0.0	0.0	0.0	0.0	0.0
Microeconomic Policies	0.5	0.5	0.5	0.5	0.5
Competitiveness and Entrepreneurship	0.1	0.1			
Research, Development and Innovation	0.2	0.2			
Territorial Cohesion and Environmental Sustainability	0.2	0.2			
Qualification, Employment and Social Cohesion Policies	0.4	0.4	0.4	0.4	0.4
Qualification, Employment and Social Cohesion	0.4	0.4			
Total	-1.3	-1.8	-2.3	-2.7	-2.8

N.B. The budgetary impact of the implementation of a measure is calculated, in each year, by comparing the budgetary scenario underlying this Programme and a no-policy-change scenario.

Key: (a) Includes simplification and red tape reduction, improved customer service, dematerialization, qualification, streamlining and security measures.

Source: Ministry of Finance and Public Administration.

The data illustrate that the reforms of the macroeconomic area ensure that the financial effort associated to the implementation of the measures of all the other areas do not jeopardise the consolidation dynamic of public finances towards the established medium-term objective. Of further note is the significant financial effort directed to the qualification, employment and social cohesion policies, thus putting into practice the Government's strategy directed to elevating and valorising human capital potential and, thus, fostering the growth and development of the Portuguese economy. In this context, measures such as the New Opportunities Initiative or the valorisation of basic education constitute manifest and demonstrative reference marks of the involvement of the various stakeholders to this strategy.

The importance of the legislative and administrative simplification measures to the implementation of the National Reform Plan, especially relative to the areas of governance and the Public Administration and competitiveness and entrepreneurship, is also significant, despite the fact that these measures may be of limited financial scope.

III. SENSITIVITY ANALYSIS AND COMPARISON WITH THE DECEMBER 2006 UPDATE

This section describes the evolution of the main macroeconomic and budgetary variables in response to two types of exogenous shock: an increase in the oil price, with the consequent downward repercussions on external demand growth and ascendant impact on external prices, and an increase in interest rates¹³. The shocks occurring in opposite directions produce roughly symmetrical effects, therefore they do not need to be analysed here.

The oil price included in the baseline scenario already reflects the growth trend that has been observed all through 2007. Nonetheless, given the climate of uncertainty around the evolution of this variable, it is prudent to acknowledge that the oil price may upwardly deviate from the price used in the baseline scenario.

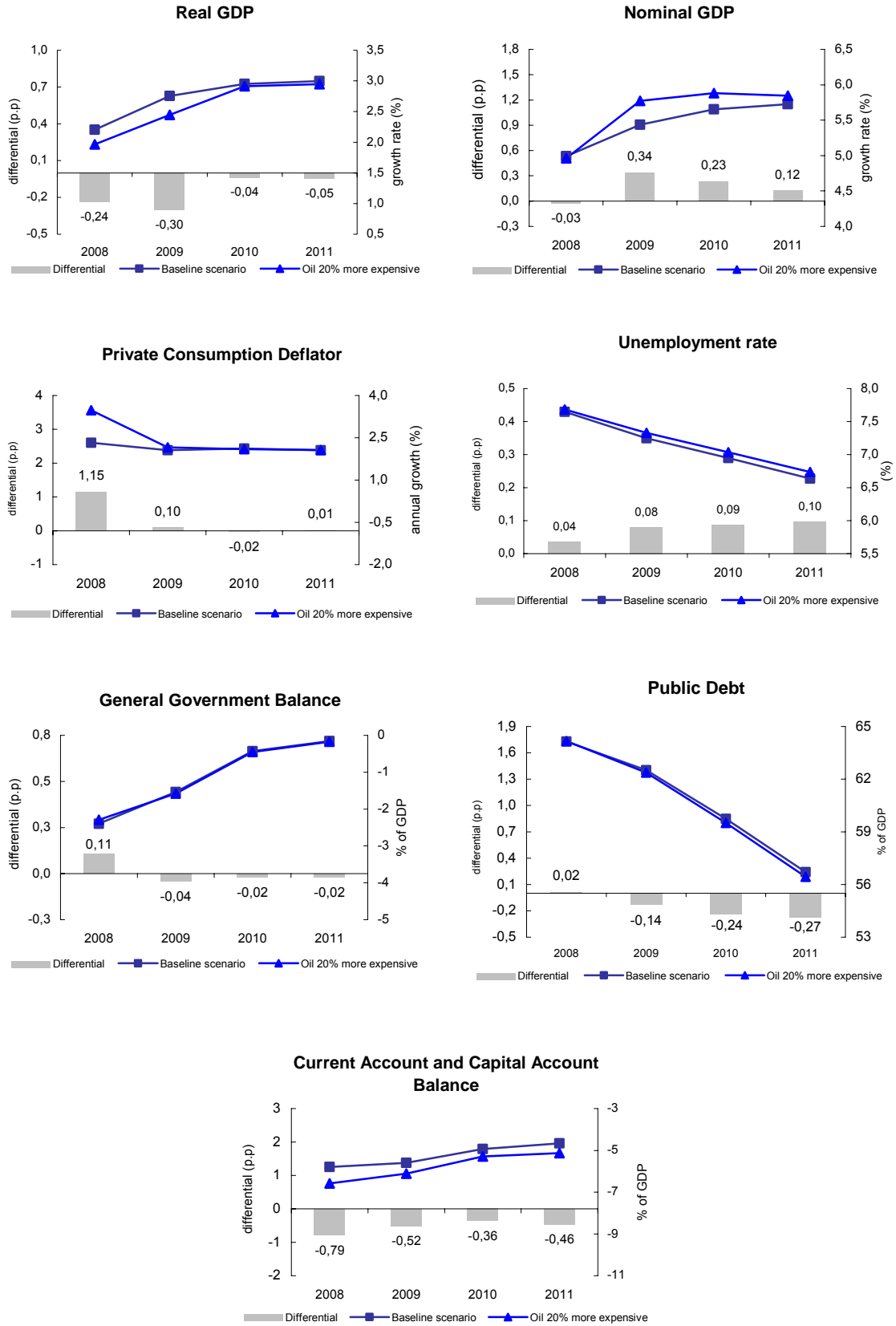
In this context, Chart 11 illustrates the evolution of the main variables of the domestic economy in a scenario where the oil price is 20% higher than the price existing in the baseline scenario. It is assumed that the shock occurs in 2008 and that the impact is permanent.

The simulation indicates significant acceleration in consumer prices in the year of occurrence of the shock and a less steep, but more prolonged rise in the GDP deflator. The real growth of GDP is also negatively affected in 2008, with a more pronounced impact in 2009. The external deficit also performs less favourably compared to the baseline scenario, registering greatest impact in the year of the shock.

In relation to the impact on public accounts, the budgetary balance improves in the year of the shock as a result of the prevalence of the positive effect on the collection base of tax revenue. In subsequent years, the ascendant effect on expenditure, particularly on social transfers, gains primacy, leading to a deterioration of the balance. In terms of percentage of GDP, the impacts are not very prominent, given the increase of nominal GDP.

¹³ The macroeconomic model on which these projections were based underwent improvement during 2007. This is why the response of the macroeconomic and budgetary variables to the exogenous shocks is also different to those presented in the December 2006 update of the SGP.

Chart 11. Sensitivity analysis relative to a 20% increase in oil price



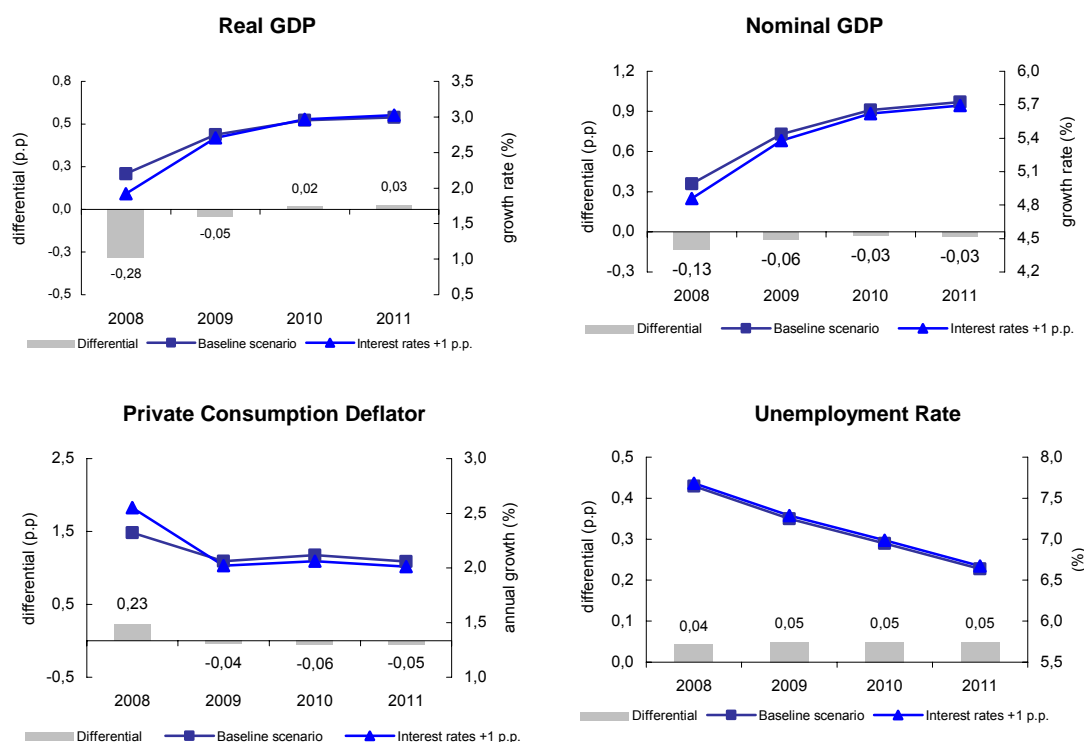
Source: Ministry of Finance and Public Administration.

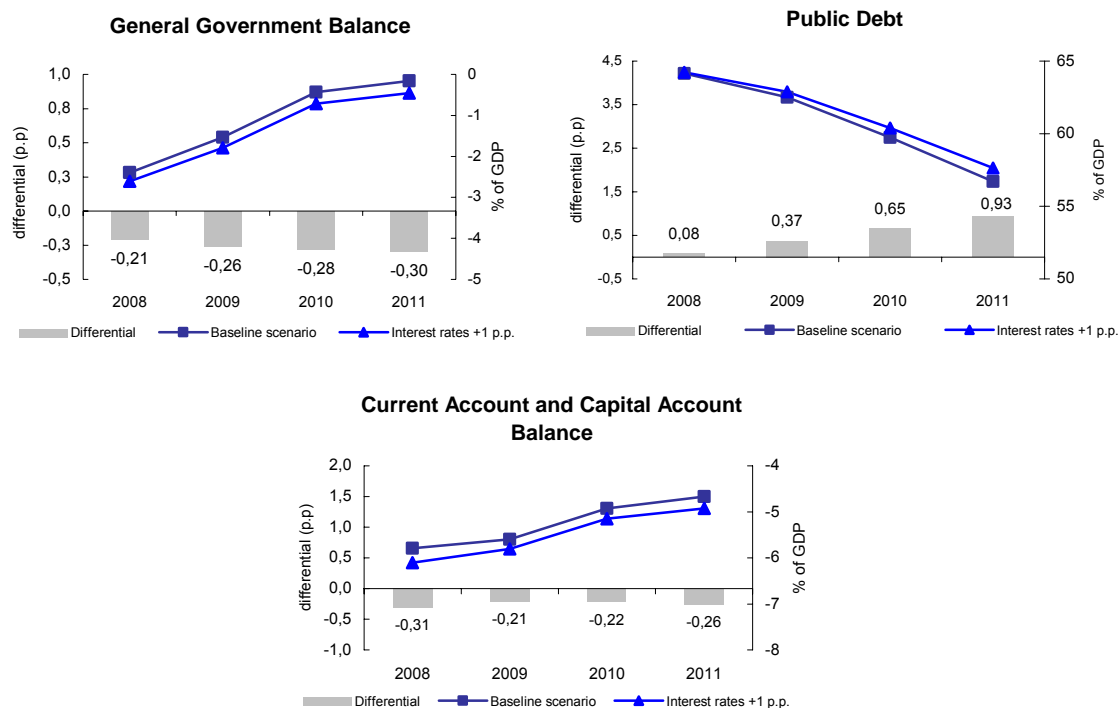
It is assumed in the simulation of the domestic economy's response to a scenario of higher interest rates that the short-term rates remain 1 p.p. above the value projected in the baseline scenario throughout the projection horizon. Chart 12 illustrates the main results of the projection in this new scenario.

The adverse effects on the real growth of the domestic economy are concentrated into the first 2 years of the projection horizon, and the acceleration of consumer prices occurs in 2008. The negative impact of the higher interest rates on the external deficit is most notable through the higher value of interest paid abroad. This impact is most marked in the first year of the projection horizon.

The financial burdens associated to public debt are also higher than those of the baseline scenario, a situation that leads to the progressive worsening of the budget deficit. The deficit dynamic over the projection period leads, as would be expected, to an unfavourable deviation in the budgetary consolidation objective.

Chart 12. Sensitivity analysis relative to a 1 p.p. increase in the short-term interest rate



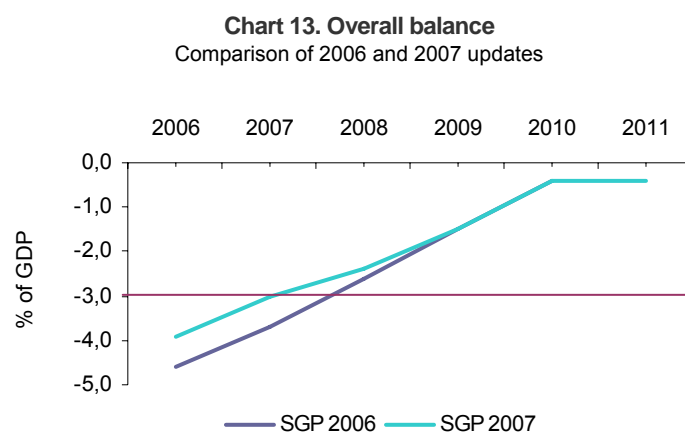


Source: Ministry of Finance and Public Administration.

Comparison with the December 2006 Update

The overall General Government balance and public debt register an improved performance on the December 2006 update of the Stability and Growth Programme, whereas the real growth rate of GDP was revised downwards for 2008 and 2009 (Table 8 of the Appendix).

The improved overall balance from 2006 to 2008 reflects the policy of frontloading the adjustment required to correct the budgetary imbalance essentially in 2006 and 2007, compared to that expected for subsequent years. Thus, the overall balance achieves the reference value of 3% of GDP one year ahead of schedule (Chart 13).



Source: Ministry of Finance and Public Administration.

The government debt to GDP ratio, compared to the value presented in the December 2006 update, decreased in all years of the analysis period. This decrease not only reflects the reduction of the deficit over the previous update, but also the arithmetic impact of the increase in the denominator (GDP), resulting from the revision of national accounts.

The downward revision of economic growth for 2008 and 2009 derives from the less favourable external conditions (comprising the higher price of imported energy goods and the decline in relevant external demand for the Portuguese economy) and a certain degree of worsening of financing conditions.

IV. SUSTAINABILITY OF PUBLIC FINANCES

Sustainability of Public Finances

The analysis presented herein is based on the methodologies recommended by the Code of Conduct of the Stability and Growth Pact. In particular, the projections presented in Table 9 of the Appendix use the assumptions defined by the Working Group on Ageing Populations and Sustainability (AWG) that assists the Economic Policy Committee (EPC) of the European Union's Economic and Financial Affairs Council (ECOFIN). As a consequence of the reform of the public social security systems in Portugal, which came into force in 2007, the long-term projections for pension expenditure presented herein underwent the Peer Review process by the AWG in October this year¹⁴. All other expenditure associated to population ageing maintained the trajectory defined by the EPC and the services of the European Commission.

Pension expenditure projection

The projections for pension expenditure take into account the impact of the main reform measures that have an affect on the two public social security sub-systems: the Social Security sub-system, which covers workers in the private sector and civil servants recruited since the start of 2006, and the Caixa Geral de Aposentações sub-system, which covers all other civil servants.

The measures considered were:

- i) The faster transition to the new pension calculation formula, which considers the entire contributory career and discriminates the pension accrual rate in conformity with the value of the reference remuneration (i.e. lower remuneration values have higher pension accrual rates);
- ii) The inclusion of the sustainability factor, which ties the value of new pensions to the evolution of average life expectancy at 65 years of age (legal retirement age);
- iii) The introduction of the new pension update rule, indexing pensions to the development of consumer inflation, according to the value of the pension and the real GDP growth rate;
- iv) Fostering so-called "active ageing", by increasing the financial penalty for early retirement. In relation to the Social Security sub-system, the possibility of retirement prior to the legal age without any penalty in case of long contributory careers was also considered;
- v) A ceiling for the value of new pensions and pensions undergoing update was established in the Social Security sub-system.

¹⁴ The projections were, in actual fact, analysed in the AWG meeting of 4 October 2007. The Working Group issued a favourable opinion on the projections and they were approved at the EPC meeting of 29 October.

These measures brought about a reduction in pension expenditure as a share of GDP, as detailed in the following table.

Table 18. Pension expenditure
(% of GDP)

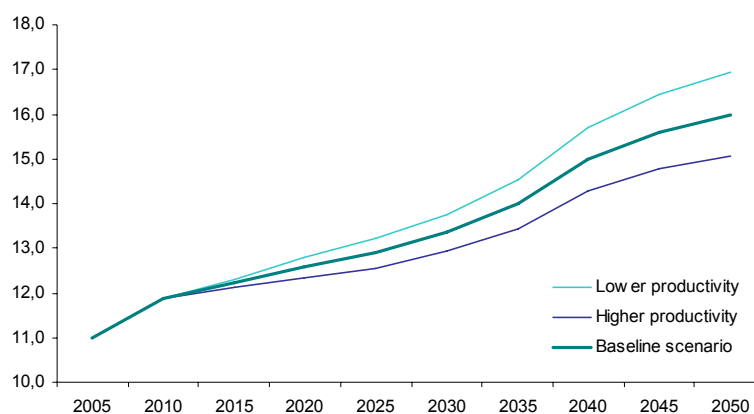
	2004	2010	2020	2030	2040	2050	Change 2004/2050
Pre-reform (2006)	11.1	11.9	14.1	16.0	18.8	20.8	9.7
Post-reform (2007)	10.5	11.9	12.6	13.4	15.0	16.0	5.5

Sources: AWG Report (2006), Ministry of Labour and Social Solidarity, Ministry of Finance and Public Administration, (2007).

It was assumed, when modelling these reforms, that the individuals did not change their behaviour, namely they did not put off their retirement, despite the incentives with that objective that have undergone further strengthening in these reforms. Therefore, based on this working assumption, the results obtained must be interpreted as a lower threshold for the impact of the reform measures, since the extension of active life has repercussions in terms of economic activity and revenue in the form of contributions, which is only offset by a marginal in nominal pension expenditure. In a scenario where the labour market exit age is higher, which seems to be perfectly reasonable given the incentives to active ageing created in the meantime, the impact of the social security reform measures is even more favourable than that presented here.

The sensitivity analysis performed under the Peer Review exercise revealed that the new trajectory for pension expenditure provides for significant improvement in the financial situation of social security, it is more resilient to different scenarios, and therefore reduces the risk associated to these projections. Different trends in life expectancy or labour market participation rates do not significantly affect the projections presented herein, while scenarios of greater or lower productivity lead to a certain degree of spread in the results, though quite contained. In practice, alterations in the labour productivity growth rate equivalent to 0.25 p.p. imply, at the end of the projection horizon, changes in the ratio of pension expenditure to GDP that are equivalent to 0.9 p.p. and opposite in sign. (Chart 14).

Chart 14. Pension expenditure - sensitivity analysis



Sources: Ministry of Labour and Social Solidarity, Ministry of Finance and Public Administration.

Impact on sustainability indicators

The trajectory for expenditure associated to population ageing, taking into account the pension expenditure projections established prior the recent reform measures, would significantly increase in Portugal. This trend had a number of implications, including its impact on the public finances' sustainability indicators calculated by the European Commission and published in the Sustainability Report in 2006¹⁵.

The first of these indicators – S1 – evaluates how much tax revenue, as a percentage of GDP, would have to permanently increase in a certain year (or public expenditure in other headings would have to decrease) to finance the costs associated to the ageing of the population, in order to ensure a public debt ratio of 60% in that year (end of the forecast horizon). The second indicator – S2 – gives the permanent increase of tax revenue, as a percentage of GDP (or the reduction of other expenditure headings) required to make the present value of the future primary surpluses equal to the current gross debt stock, in other words, comply with the inter-temporal budget constraint in an infinite horizon.

The S1 indicator results from the aggregation of 3 components:

$$S1 = IBP_{2050} + DR + LTC_{2050} \quad (1)$$

where,

IBP_{2050} = The difference between the initial budgetary position (2005 in the referred to Report) and that which would stabilise the debt at the end of the projection horizon (2050), i.e. the initial primary balance gap

DR = The additional reduction of debt required to achieve the objective of 60 percent of GDP in 2050

LTC_{2050} = The long-term change of primary balance, i.e. the additional adjustment required to finance the increase of public expenditure related to the ageing of the population to 2050.

The aggregation for the S2 indicator is similar:

$$S2 = IBP_{\infty} + LTC_{\infty} \quad (2)$$

where,

IBP_{∞} = The initial budgetary position compared to that which would stabilise debt in the long-term (i.e. initial primary balance gap)

LTC_{∞} = Long-term change of primary balance, i.e., the additional adjustment required to finance the increase of public expenditure related to the ageing of the population over an infinite horizon.

¹⁵ EC-DGECFIN, "The Long-Term Sustainability of Public Finances in the European Union", *European Economy* no. 4/2006.

It can thus be evaluated if the sustainability risks for public finances arise from the initial budgetary position and/or from a significant increase in expenditure associated to population ageing.

These indicators are usually constructed for two scenarios: one with the projection baseline year as a reference and another that assumes compliance with the medium-term objective for the structural balance. The values obtained for Portugal in the modelling of the latter scenario, which assume a value of -0.5% of GDP for the structural balance and 2.5% of GDP for the structural primary balance, in 2010, are detailed in the following table.

Table 19. Sustainability indicators – medium-term objective scenario
(% of GDP)

	S1	IBP	DR	LTC	S2	IBP	LTC
Pre-reform	2.5	-1.7	0	4.1	5.2	-1.5	6.7
Post-reform (estimate)	0.8	-1.7	0	2.4	2.7	-1.5	4.2

Sources: European Commission and Ministry of Finance and Public Administration.

The values prior to the recent social security reform indicated significant sustainability gaps, whereas the estimate presently made reduces the component of expenditure associated to population ageing, thereby permitting notable improvements to the sustainability indicators to be achieved. It is to be noted that this estimate should be considered as prudent, given that it is assumed that the macroeconomic and public finances scenario used by the European Commission in 2006 to draw up the respective Sustainability Report remain unchanged. Only the impact of the reform measures on the pension expenditure determined under the 2007 Peer Review, *ceteris paribus*, is considered in this calculation, which immediately allows the importance of the social security reform in ensuring the sustainability of public finances in Portugal to be gauged.

The impact of different labour productivity scenarios on sustainability gap values was modelled using the same methodology. The sensitivity analysis of the development of pension expenditure revealed, as already seen, that the trajectory of this expenditure following recent reform measures is relatively resilient to different demographic and macroeconomic scenarios, while showing itself to be more sensitive to the development of productivity. It can be concluded from the results presented in the following table that even in a situation of less favourable productivity growth (-0.25 p.p. less than the baseline scenario), the sustainability gap values are significantly lower than those of the baseline pre-social security reform scenario. Simulation in a more favourable scenario, which is deemed to be rather pertinent given that the scenario for Portugal defined by the GWA adopts quite moderate economic growth figures, naturally generates an improved sustainability situation for Portuguese public finances.

Table 20. Sustainability indicators – Sensitivity Analysis
(% of GDP)

	S1	IBP	DR	LTC	S2	IBP	LTC
Higher productivity	0.4	-1.7	0	2.0	2.1	-1.5	3.6
Lower productivity	1.2	-1.7	0	2.8	3.4	-1.5	4.9

Source: Ministry of Finance and Public Administration.

That evaluation is made sounder in a scenario with the same assumptions as those of the Report on the Sustainability of the Social Security attached to the State Budget for 2008 Report. This scenario is based on a more optimistic GDP growth rate of 2% per year from 2030. In such a scenario, the results detailed in the following table are obtained.

Table 21. Financial Prospects of Social Security
(Scenario of the Report on the Sustainability of the Social Security
annexed to the State Budget for 2008 Report)
(% of GDP)

	2000	2005	2010	2020	2030	2050
Pension Expenditure of Social Security (a)	5,6	7,1	7,6	8,3	8,7	9,7
Old-age and early retirement pensions	3,8	5,2	5,7	6,5	7,1	8,0
Other pensions (disability and survivor)	1,8	1,9	1,9	1,8	1,7	1,7
Social Contributions	7,2	7,5	8,0	8,3	8,6	8,8
Assets of the Social Security Stabilisation Fund	2,5	4,2	6,2	10,0	11,3	6,6

N.B. (a) Includes pensions of the contributory and non-contributory schemes.

Source: Ministry of Labour and Social Solidarity.

It is notable that the burden with pensions as a percentage of GDP in this scenario describe an even more restrained trajectory, despite the fact that the pension updates encompass higher rates (according to the new update rule, greater economic growth implies improved update rates). Greater economic growth, on the other hand, provides higher revenue levels, in nominal terms, through social contributions. The higher surpluses obtained in this scenario allow the improved accrual of assets by the Social Security Financial Stabilisation Fund (FEFSS), which positively contributes to the sustainability of public finances in Portugal.

The context of progressive ageing of the population also demands the promotion of births in order to guarantee population rejuvenation. The Government has thus recently adopted important measures, such as the award of family allowance from the 12th week of gestation, increasing the family allowance for second and subsequent children, and doubling the income tax allowance relative to dependents aged less than 3 years. The Government, aware that the childbirth trend is intrinsically connected to demands concerning participation in the labour market, has, in addition to the above-stated measures, reinforced corporate income tax incentives to companies regarding the construction and upkeep of child and baby care nurseries and pre-schools and it has also made it possible for companies making donations to external institutions to claim tax relief.

V. QUALITY OF PUBLIC FINANCES

V.1. Modernisation of the Public Administration

The Portuguese Presidency of the European Union during the second half of 2007 elected the modernisation of the Public Administration as a key institutional element of the much needed improvement to the quality of public finances. The need to improve competitiveness, concerns regarding budgetary sustainability and greater demands of taxpayers, citizens and businesses for better public services at lower cost, underpin comprehensive reform of the public sector and endeavours to implement better regulation and reduce administrative costs. Moreover, a leadership role by the public sector in promoting the quality of governance in organisations and good management practices can generate significant positive spillover effects for the performance of the private sector.

The Portuguese Government, as stated in chapters I and II, has been committed to modernising the Public Administration, through broad and ambitious reforms regarding the public sector's management practices, concerning in particular the division of roles and responsibilities within an organisation, the management of human resources, measures aimed at the implementation of e-government and the simplification of administrative procedures.

V.2. Tax System

In addition to the measures referred to in section II.2.C, the State Budget for 2008 contains measures to foster the domestic economy's competitiveness, for building regeneration, for environmental quality and also measures to improve the equality of the tax system.

The approval of a tax benefits classifier by the Higher Statistics Council also deserves note. The aim of this classifier is to identify all of the possible tax benefits awarded to taxpayers, as well as quantify and describe the State's tax expenditure, thus facilitating the *a posteriori* control of the State's accounts by external entities.

A. **Support to Business, to the Development of SME Activity and Strengthening the Competitiveness of the Economy**

Measures aimed at dynamically improving and consolidating the existing business structure, which is primarily composed of small and medium-size enterprises (SME), are adopted:

- Tax benefits for inlanders are strengthened, with the corporate income tax rate applied in the inlanders scheme reduced to: (a) 15% for most of the companies covered by the scheme; and (b) 10%, during the first five years of activity, for newly incorporated companies;
- the deduction from taxable profit of a sum equivalent to 3% of the value of the equity capital increase paid in by the shareholders is envisaged for a period of three financial years, when the company is incorporated or a equity capital uplift operation occurs between 2008 and 2010. This

tax measure is introduced in order to seek to correct the skew toward debt capital, by promoting the reinforcement of equity;

- the possibility of entering into unilateral, bilateral or multi-lateral advance agreements on transfer pricing (involving associated companies and the tax administrations of two or more countries);
- the establishment of tax incentives for venture capital investment, extending the application of the tax benefits provided venture capital enterprises to venture capital investors (business angels).

B. Incentives to Urban Regeneration

A special tax incentive scheme applicable to urban regeneration was created in 2008, which includes:

- The taxation of building construction, reconstruction, improvement or preservation contract work, carried out for this purpose, at the reduced VAT rate;
- Exemption in the payment of Municipal Property Tax on the urban property covered by this extraordinary support scheme, for a broad period of time that may extend to 8 years;
- Exemption of corporate income tax for income obtained by real estate investment funds to be set up, provided that at least 75% of the fund's assets are real estate properties liable for regeneration;
- Personal or corporate income taxation at the special rate of 10%: i) on income paid to the holders (natural or legal persons) of the investment units in such funds; ii) on the positive difference between capital gains and capital losses resulting from the sale of investment units.

C. Environmental Protection

Council of Ministers Resolution no. 161/2005 of 12 October, approving incentives for the use of less polluting vehicles and technology, as well as the 2006 National Programme for Climate Change, approved by Council of Ministers Resolution no. 104/2006 of 23 August, addressed, among the list of additional measures introduced to comply with the Kyoto Protocol, the reform of motor vehicle tax and the inclusion of a component concerning carbon dioxide emissions in the respective tax base. This new component shall account for 60% of revenue in 2008. The purpose is to induce consumers to opt for lower polluting vehicles. The significant measures in this area are:

- Extend the reform of motor vehicle taxation, bolstering the weight of the environmental component. Thus, as established by the publication of Law no. 22-A/2007 of 29 June, which approved the Motor Vehicle Tax Code and the Single Road Tax Code:
 - a. under the new Motor Vehicle Tax, the engine capacity component accounts for an average of around 70% of the total tax, while the environmental component accounts for around 30%, on average;
 - b. diesel powered passenger cars and combined passenger/goods vehicles with particle emissions lower than 0.005 g/Km, have innovatively been awarded a EUR 500 reduction on the total value of tax payable;
 - c. Motor Vehicles Tax was reduced by an average of around 10% and the burden has been transferred to the road tax (spread out over a number of years);

- d. The environmental component was likewise included in the calculation of the Single Road Tax, at the same percentages used for Motor Vehicle Tax.
- Extend the incentives in the energy area, related to the introduction of biofuels, the growth of agricultural output, the guarantee of agricultural land use and prevention of rural desertification, in addition to the indirect spillover on job generation (or the non-generation of unemployment), lead the Government to propose the differentiation in the relief of the tax on oil and energy products for petrol-substituting biofuel (bioethanol) and which shall be attributed relief to be defined by ordinance, varying between 400 and 420 euro per 1 000 litres;
 - Revenue generated by electricity micro-generation units, i.e. by means of low electrical power systems, is exempted from taxation under personal income tax, as established in legislation governing this type of electricity generation.

D. Improved Equality of the Tax System

Tax equality is one of the priority goals of the Government's tax policy, with the following measures in this area being particular of note:

- The possibility of deducting the sums invested in the public capitalisation scheme from the tax payable;
- The amendment of the taxation scheme for professional sportspersons envisages the exemption of the payment of income tax on awards provided to disabled sportspersons and on grants provided to top-class sportspersons, as well as training grants provided to other sportspersons up to an annual value equal to five times the minimum monthly wage;
- The tax deduction per taxable person is raised for disabled dependent and ancestors. The tax deduction of expenditure on homes for disabled dependents also becomes permissible.

V.3. Institutions, Processes and Budgetary Rules

A. Institutional Framework of Fiscal Policy – Measures already Implemented

The institutional framework of fiscal policy has undergone many alterations in recent years in order to strengthen budgetary control and institutional solidarity. Table 22 summarises the main measures that have been implemented in this area and which have already been presented in previous updates of the Stability and Growth Programme.

Table 22. Institutional Framework of Fiscal Policy – measures implemented

Measure	Legislation	Objectives
Reform of Autonomous Regions Finance Law	Organic Law no. 1/2007, of 19 February	<ul style="list-style-type: none"> • Amendment of the rules used to calculate the annual transfer to the Autonomous Regions from the State Budget, with the division between the two Autonomous Regions governed by principles of equality • transfers of the Cohesion Fund are determined according to the relative development of each region • levying of a penalty in the event of infringement of specified levels of indebtedness • the State prohibited from providing personal guarantees for debts of the Autonomous Regions
Local Government Finance Law	Law no. 2/2007, of 15 January	<ul style="list-style-type: none"> • limits to net municipal debt are defined according to the principles of budgetary rules and procedure • the State prohibited from taking on obligations that municipalities and parish councils have bound themselves to
Improving Information Reporting Quality	-	<ul style="list-style-type: none"> • quarterly publication of budget implementation data relative to all General Government sub-sectors • quarterly reporting of national accounts from 2007 • bolstering the information reporting of local and regional government, and strengthening the convergence of reported data to a national accounts basis
Creation of a budget technical support unit in the Portuguese Parliament	Parliamentary Resolution no. 53/2006, of 7 August	<ul style="list-style-type: none"> • drafting technical studies and documents on the budgetary and financial management of General Government, analysing the State Budget, budget implementation, the Stability and growth Programme updates and the budget impact of legislative initiatives.
Creation of the position of Financial Controller	Decree-Law no. 33/2006, of 17 February	<ul style="list-style-type: none"> • strengthen financial control in the areas of budget preparation, implementation and assessment • to guarantee that the principle of economy, efficiency and effectiveness relative to public spending is complied with
Monitoring Public-Private Partnerships	Decree-Law no. 141/2006, of 27 July	<ul style="list-style-type: none"> • strengthening discipline and the assessment of costs and benefits • strengthening articulation with budgetary framework standards
Increasing the Court of Auditors' Supervisory Powers	Law no. 48/2006, of 29 August	<ul style="list-style-type: none"> • increase in the powers of preliminary supervision and concomitant supervision • extension of powers to all situations in which bad management or the improper use of public funds can occur • extension of empowerment to other entities, besides the Public Prosecution Service, to lodge financial accountability suits in the Court of Auditors.

B. Performance-Based Budgeting

The Technical Committee given the task of making recommendations on the model and method of structuring the Performance-based State Budget, where the aim is to establish by 2010 a multi-year budget framework characterised by rules and focused on results and, consequently, on public expenditure efficiency and effectiveness, has already presented an interim report in May this year indicating the general principles to be followed in the structuring of the reform. The final report is planned for 2008, and this shall

be taken into consideration in any draft amendment to the Budget Framework Law. Shortly, an operational working group will be created with the intention of integrating a set of pilot programmes into the State Budget for 2009.

BOX 2. PERFORMANCE-BASED BUDGETING

Performance-based Budgeting consists of a multi-year cycle of planning, programming, budgeting, control and assessment of the State's performance with a view to guaranteeing to the citizen-taxpayer the best use of their taxes, i.e. public expenditure with quality, in the sense that it leads to social-economic impacts that are capable of improving our level of well-being.

A core component of Performance-based Budgeting is the change of focus, which is no longer centred on resources but focused on outcomes. Thus, the a priori definition of the objectives of a specific body, which will also allow the a *posteriori* gauging of expenditure effectiveness, are as important to know as the size of the financial envelope allocated to said body.

The Performance-based Budgeting model signifies a break from the current budget framework. The current framework is based on an administrative culture; it is hierarchical and focused on the public resources used, where the legality of public expenditure is the main criteria, often in prejudice of the economical nature of the expenditure. In the current mould, public expenditure is inflexible and the budgetary process merely incremental. The Performance-based Budgeting model, on the contrary, embodies a management culture focused on the assessment of outcomes, assessing, for example, how much the intervention of the State contributes to improving the quality of life of the Portuguese general public. In this model, public expenditure is not as fixed as the existing model because the programmes have a predefined time horizon (even though they may be successively renewed over time), subject to periodic assessment.

Performance-based Budgeting also allows greater emphasis to be placed on the accountability for performance. Nevertheless, there is no compulsory systematic relationship between the performance of a programme and its budget allocation. In this new model, the performance of a specific programme in the previous multi-year cycle is a data element to be taken into consideration vis-à-vis its maintenance and, if necessary, in the definition of its new budget allocation.

Even though managers are held more accountable in Performance-based Budgeting, they also benefit from greater flexibility in the operational management of the public funds allocated to them. Improved conditions are thus provided for management and, as a consequence, to achieve the previously defined results.

The setting of budgetary policy rules which steer the evolution of public expenditure represents another element likely to reinforce the expenditure control at the macro level. The establishment of multi-year goals for the primary expenditure of Central Government and Social Security, which must be understood to mean ceilings defined in a national accounts basis and resulting from the application throughout the Government's mandate of a stable annual rate of change impervious to cyclical economic fluctuations, constitutes an example of the form these rules can take on.

In summary, the implementation of Performance-based Budgeting will bring three major innovations compared to current practice: the assessment of results, a multi-year budget framework and expenditure rules. The driving force behind this reform is twofold: foster budgetary discipline and increase the quality of public expenditure, raising its efficiency and effectiveness.

C. Management of EU Funds and of Investment

The State Central's Programme for Investment and Development Expenditure (PIDDAC) reformulation process shall commence in 2008. The objective is to integrate this public investment plan into a coherent national framework that, including QREN, may effectively and efficiently provide a response to the strategic priorities defined for the country in the field of social and economic development. The Ministry of Finance and Public Administration, through the Budget General Directorate (DGO), has, arising from the implementation of PRACE, taken over full responsibility for the financial control of PIDDAC in this reformulation process and, consequently of the block of EU funds allocated to the Central Administration. This control of the process has allowed the simplification of procedures and unification of concepts.

The governance model of the structural EU funds was reformulated along the same lines as the budget reform process i.e. greater efficiency and effectiveness of public expenditure. QREN and the respective operational programmes are guided by the principles of the concentration of interventions, of resources and types of action, of selectivity and focus of investment and development initiatives (implemented through meticulous candidature selection and hierarchisation criteria that contribute to the achievement of the adopted development strategy), of economic feasibility and financial sustainability of the interventions orientated to satisfying the public interest, through the appraisal of the respective impact on current and future public expenditure.

V.4. Planning and Control Processes in Health Systems

In Healthcare area, a strategic planning process was implemented for hospitals, with the definition of medium-term plans that include the definition of strategic goals, main lines of action, investment plans and economic and financial projections for that period.

This planning process takes the form of programme contracts, ensuring that each hospital may plan its activities in good time, considering the underlying objectives and the available resources. The programme contracts are a commitment from the hospital's board of directors to a convergence programme for best practices in terms of effectiveness, efficiency and quality in the healthcare provision, and to the guarantee of economic and financial equilibrium in hospitals. It is significant that a compensation model based on contracted production is currently in force. This model is contrary to a financing mechanism based on a cost covering rationale, which is unrelated with the volume and quality of services provided. This model was extended in 2006 to the hospitals of the public sector, which is justified by the good results achieved in the universe of corporate public hospitals.

The monitoring of performance in terms of effective production and the evolution of the main services and economic-financial indicators is based on the monthly network provision of data, with quarterly monitoring meetings with the boards of all the hospitals, individual meetings with hospitals deemed to be critical in terms of performance and thematic meetings aimed at disseminating best practices.

Work on the procedures to be followed in the consolidation of the accounts of the different entities forming part of the NHS, which shall improve information quality, is already in progress. The definition of a set of rules that will be submitted to the Accounting Standardisation Commission for appraisal is planned.

Budgetary and activity control was further reinforced through the definition of an internal control model for hospitals, based on the best international practices of the sector. The model is based on the disclosure of

administrative and accounting procedures. The internal audit component has been reinforced and the training of auditors in this area is a particular focus.

V.5. Planning and Control of the State-Owned Company Sector

The publication of Decree Law no. 300/2007 of 23 August provided the framework for the revision of the Legal Scheme governing the State-Owned Company Sector. The aim of this legislative act is to ensure the effective definition of the guidelines for this sector, in order to provide for a more rational, effective and transparent management and to strengthen the financial control mechanisms and the special information requirements of State-owned companies. It has also sought to ensure consistency and alignment with the new Public Manager Statute (Decree Law no. 71/2007 of 27 March), enabling the convergence of this figure to that of director of private-owned companies, as regulated in commercial law. The establishment of a management contract in the new Statute, as an accountability instrument and serving to set quantified targets, is of particular importance. The public manager can be dismissed if the targets are not met. Accordingly, the emphasis is placed on performance assessment, and the public manager may earn a variable remuneration that depends on the achievement of pre-defined goals. In line with international standards, the document also establishes the need to abide by rules of ethics and good practices. Council of Ministers Resolution no. 49/2007 of 28 March, in this context, establishes the good governance principles in the State-owned company sector. This Resolution is directed to all parties intervening in the sector (the State, as shareholder and stakeholder, and the companies). Of note in this Resolution are the principles regarding the disclosure of information.

The State-Owned Companies, Partnerships and Concessions Sector Monitoring Office has been formed in the Finance and Treasury General Directorate under the reorganization promoted by PRACE. It will carry out a specific role in evaluating the economic and financial situation of the State's main business units from a current and prospective viewpoint and recommend measures aimed at guaranteeing their sustainability.

The financial situation of the non-financial State-owned companies in 2006 is detailed in Table 23. Large differences in balance sheets are observed between the different business sectors. The media and transport sectors reported negative equity, as had occurred in the previous year.

Table 23. Financial situation of non-financial state-owned companies
(million euros)

Sector	Assets		Liabilities		Equity		Minority Interests	
	2006	2005	2006	2005	2006	2005	2006	2005
Media	455,8	412,8	1.159,2	1.163,7	-703,4	-750,9	0,0	0,0
Infrastructure Management	22.320,4	20.716,9	8.391,7	7.621,1	13.923,6	13.096,5	5,1	-0,7
Industry	693,9	483,9	564,8	352,5	129,0	130,9	0,1	0,5
Parpública, State Holding Company	7.904,6	6.681,0	4.606,7	3.720,3	3.274,9	2.935,7	23,0	25,0
Urban Regeneration	935,5	985,4	783,0	830,5	165,5	166,6	-13,0	-11,7
Health	2.850,0	2.061,7	1.549,3	1.026,6	1.300,6	1.035,1	0,0	0,0
Services of Public Utility	5.959,9	5.257,7	5.132,7	4.516,5	640,3	607,9	186,9	133,3
Transport	7.202,3	7.028,2	9.160,9	8.508,0	-1.958,7	-1.479,8	0,0	0,0
Other	649,8	578,0	473,0	376,0	174,5	199,8	2,2	2,1
Total	48.972,1	44.205,6	31.821,3	28.115,2	16.946,4	15.941,8	204,3	148,6

Source: Ministry of Finance and Public Administration, State Budget for 2008 Report, October 2007.

The results achieved in 2006 show a positive performance, that were significantly buoyed by the improvement of the results attained by Parpública, which recorded a rise in consolidated profits of EUR 627.1 million (Table 24).

Table 24. Results of non-financial state-owned companies
(million euros)

Sector	Operating Profit		Financial Result		Net Profit	
	2006	2005	2006	2005	2006	2005
Media	18,4	4,5	-34,2	-28,3	-23,7	-30,1
Infrastructure Management	-47,5	-56,8	-139,5	-89,9	-164,8	-140,8
Industry	-7,3	-23,4	-0,8	-2,6	-0,9	-13,0
Parpública, State Holding Company	268,4	49,9	378,8	130,0	791,8	164,7
Urban Regeneration	-2,1	8,8	-22,1	-20,1	-1,1	-7,6
Health (a)	-229,8	-168,6	25,7	19,8	-190,6	-91,5
Services of Public Utility	92,7	78,5	-83,4	-40,1	34,0	30,8
Transport	-348,4	-340,5	-227,5	-196,6	-557,1	-518,2
Other	5,7	9,9	-9,8	-8,3	-2,4	0,3
Total	-249,8	-437,7	-112,8	-236,2	-114,7	-605,5

Source: Ministry of Finance and Public Administration, State Budget for 2008 Report, October 2007.

N.B. (1) Decree-Law no. 233/2005 transforms Hospital de Santa Maria and Hospital de São João into corporate public entities, and creates Centro Hospitalar de Lisboa Ocidental E.P.E., Centro Hospitalar de Setúbal E.P.E. and Centro Hospitalar do Nordeste E.P.E. This amendment to the universe of companies of the Health sector causes the figures of 2005 and 2006 to be incomparable.

The financial sector, which almost totally consists of the Caixa Geral de Depósitos Group, reported a positive consolidated net profit of EUR 734.6 million, with total assets of around EUR 96 200 million.

Net financial flows to the set of state-owned companies in 2006 were around - EUR 30 million, which corresponds to a year-on-year decrease of EUR 747 million. This change was driven by the atypical year experienced by CGD which prevented it from distributing dividends in 2005, and notwithstanding the growth registered in compensatory allowances (Table 25).

Table 25. Transfers to the State-owned company sector
(million euro)

Flows	2005	2006
1) Dividends	84,6	473,3
2) Compensatory Allowances	338,2	366,2
3) Equity raise	463,3	77,4
4) Net Transfers to the State-owned Company Sector 2) +	716,9	-29,8

Source: Ministry of Finance and Public Administration, State Budget for 2008 Report, October 2007.

Proceeding with the consolidation dynamic in the operating activity of State-owned companies in 2007 is forecast, though net profits will be restricted by interest rate behaviour, given the high level of exposure of State-owned companies to variable interest rate debt instruments. The compensatory allowances to award to the State-owned company sector in 2007 should reach around EUR 397.4 million, which has already been allocated for this purpose by Council of Ministers Resolution no. 149/2007, of 28 September.

V.6. Reducing the Payment Duration in the Public Administration

The structural objective of improving the quality of public expenditure, as a means of enhancing economic competitiveness, shall be backed by a new area of governmental action from 2008 – the Programme to reduce payment duration in the Public Administration – which shall be applied to all levels of the Public Administration (Central, Regional and Local) and to some State-owned companies. In addition to some mechanisms already included in the Draft State Budget Law for 2008, the Government is concluding the preparation of the underlying legislative instruments of the Programme to reduce payment duration in the Public Administration.

Late payment in commercial transactions negatively affects businesses' competitiveness, since receivables difficulties can raise the insolvency risk (placing jobs at risk), it limits capacity to mobilise resources for investment and increases administrative and financial costs, namely those associated to cash funding. This problem is even worse in the case of companies with low capitalisation levels, as is true for a number of Portuguese SMEs.

The Programme will establish payment duration reduction goals for public bodies, the monitoring and disclosure of average payment duration data, the creation of incentives associated to achievements, the accountability of the different bodies for the financial effort required to achieve the payment duration reduction goals and the financial discipline inherent to the budgetary consolidation process.

APPENDIX

Statistical Tables

Table A.1. Macroeconomic Prospects

	ESA Code	2006	2006	2007	2008	2009	2010	2011
		Level (10 ⁶ euros)	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP¹	B1*g	150.784,6	1,3	1,8	2,2	2,8	3,0	3,0
2. Nominal GDP	B1*g	155.131,1	4,2	4,8	5,0	5,4	5,7	5,7
Components of real GDP								
3. Private Consumption expenditure	P.3	97.743,3	1,1	1,2	1,4	2,1	2,3	2,4
4. Government Consumption expenditure	P.3	31.449,5	-0,3	-0,4	-1,1	-0,6	-0,3	1,1
5. Gross fixed capital formation	P.51	31.743,9	-1,6	1,0	4,0	6,7	7,0	7,2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P53	1.386,3	1,2	1,2	1,7	1,7	1,7	1,8
7. Exports of goods and services	P.6	46.198,4	8,9	6,9	6,7	6,0	6,3	6,5
8. Imports of goods and services	P.7	57.737,0	4,3	3,8	3,9	4,8	5,6	6,6
Contributions to real GDP growth								
9. Final domestic demand		-	0,3	1,1	1,5	2,6	3,0	3,3
10. Changes in inventories and net acquisition of valuables	P.52 + P53	-	0,1	0,2	0,0	0,0	0,0	0,0
11. External balance of goods and services	B.11	-	0,9	0,7	0,7	0,1	0,0	-0,3

¹ Real GDP is measured at previous year prices.

Table A.2. Price Developments

	ESA Code	2006	2007	2008	2009	2010	2011
		rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		2,9	2,9	2,7	2,6	2,6	2,6
2. Private consumption deflator		3,3	2,5	2,3	2,1	2,1	2,1
3. HICP		3,0	2,3	2,1	2,1	2,1	2,1
4. Export price deflator (goods and services)		4,4	2,9	2,7	2,1	2,1	2,1
5. Import price deflator (goods and services)		4,6	1,4	3,3	1,1	1,1	1,1

Table A.3. Labour Market Developments

	ESA Code	2006	2006	2007	2008	2009	2010	2011
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment (thousand individuals)		5.153,3	0,7	0,4	0,9	1,4	1,5	1,5
2. Employment (thousand individuals, adjusted with hours worked)		4.947,6	0,4	0,4	0,9	1,4	1,5	1,5
3. Unemployment rate (%)			7,7	7,8	7,6	7,2	6,9	6,6
4. Labour productivity, persons (10³ euros)¹		25,0	0,6	1,4	1,3	1,4	1,5	1,5
5. Labour productivity (10³ euros, adjusted with hours worked)		26,0	0,9	1,4	1,3	1,3	1,5	1,5
6. Compensation of employees (10⁶ euros)	D.1	77.350,0	3,0	3,0	3,4	4,0	4,3	4,6

¹ GDP (2000 prices) per worker.

Table A.4. Sectoral Balances

% of GDP	ESA Code	2006	2007	2008	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-8,8	-7,0	-5,8	-5,6	-4,9	-4,7
of which:							
- Balance on goods and services		-7,8	-6,4	-5,9	-5,1	-4,6	-4,3
- Balance of primary incomes and transfers		-2,0	-1,8	-1,7	-1,8	-1,6	-1,5
- Capital account		1,1	1,3	1,8	1,4	1,3	1,2
2. Net lending/borrowing of the private sector	B.9/EDP B.9	-4,9	-4,0	-3,4	-4,1	-4,5	-4,5
3. Net lending/borrowing of general government	B.9	-3,9	-3,0	-2,4	-1,5	-0,4	-0,2

Table A.5. General Government Budgetary Prospects

	ESA Code	2006	2006	2007	2008	2009	2010	2011
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector								
1. General government	S.13	-6.029,5	-3,9	-3,0	-2,4	-1,5	-0,4	-0,2
2. Central government	S.1311	-6.648,5	-4,3	-3,5	-2,8	-1,7	-0,6	-0,3
3. Local government	S.1313	39,1	0,0	0,0	0,0	0,0	0,0	0,0
4. Social security funds	S.1314	579,9	0,4	0,5	0,4	0,2	0,2	0,1
General government (S13)								
5. Total revenue	TR	65.911,8	42,5	42,4	42,7	42,8	43,1	43,1
6. Total expenditure	TE	71.941,2	46,4	45,4	45,1	44,4	43,5	43,3
7. Net lending/borrowing	EDP B.9	-6.029,5	-3,9	-3,0	-2,4	-1,5	-0,4	-0,2
8. Interest expenditure	EDP D.41	4.312,6	2,8	2,9	2,9	2,8	2,7	2,7
9. Primary balance		-1.716,8	-1,1	-0,1	0,5	1,3	2,2	2,5
10. One-off and other temporary measures		0,0	0,0	0,1	0,0	0,0	0,0	0,0
Selected components of revenue								
11. Total taxes (11=11a+11b+11c)		37.660,4	24,3	24,6	24,8	24,8	24,7	24,7
11a. Taxes on production and imports	D.2	23.994,7	15,5	15,2	15,4	15,4	15,4	15,4
11b. Current taxes on income, wealth, etc	D.5	13.661,6	8,8	9,4	9,3	9,3	9,3	9,3
11c. Capital taxes	D.91	4,0	0,0	0,0	0,0	0,0	0,0	0,0
12. Social contributions	D.61	19.360,3	12,5	12,5	12,4	12,4	12,3	12,3
13. Property income	D.4	987,0	0,6	0,6	0,5	0,5	0,6	0,5
14. Other (14=15-(11+12+13))		7.904,0	5,1	4,7	5,0	5,2	5,5	5,6
15=5. Total revenue	TR	65.911,8	42,5	42,4	42,7	42,8	43,1	43,1
p.m.: Tax burden (a) (D.2+D.5+D.61+D. 91-D.995)		55.372,3	35,7	36,2	36,4	36,4	36,4	36,4
Selected components of expenditure								
16. Compensation of employees + intermediate consumption	D.1+P.2	27.592,7	17,8	16,8	16,4	15,8	15,3	15,0
16a. Compensation of employees	D.1	21.164,9	13,6	12,8	12,2	11,7	11,3	11,0
16b. Intermediate consumption	P.2	6.427,8	4,1	4,1	4,1	4,0	4,0	4,0
17. Social payments (17=17a+17b)		29.221,3	18,8	19,0	19,1	19,0	18,9	18,8
17a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	5.788,5	3,7	4,0	3,9	3,8	3,7	3,7
17b. Social transfers other than in kind	D.62	23.432,9	15,1	15,0	15,2	15,3	15,2	15,2
18=8. Interest expenditure	EDP D.41	4.312,6	2,8	2,9	2,9	2,8	2,7	2,7
19. Subsidies	D.3	2.154,5	1,4	1,2	1,2	1,3	1,3	1,3
20. Gross fixed capital formation	P.51	3.612,3	2,3	2,2	2,2	2,3	2,4	2,6
21. Other (21=22-(16+17+18+19+20))		5.047,8	3,3	3,2	3,2	3,2	3,1	2,9
22=6. Total expenditure	TE	71.941,2	46,4	45,4	45,1	44,4	43,5	43,3

N.B.: (a) Excluding imputed social contributions (D612).

Table A.6. General Government Debt Developments

% of GDP		2006	2007	2008	2009	2010	2011
1. Gross debt		64,8	64,4	64,1	62,5	59,7	56,7
2. Change in gross debt ratio		1,1	-0,5	-0,2	-1,6	-2,8	-3,0
Contributions to changes in gross debt							
3. Primary balance		1,1	0,1	-0,5	-1,3	-2,2	-2,5
4. Interest expenditure		2,8	2,9	2,9	2,9	2,8	2,6
5. Stock-flow adjustment		-0,2	-0,5	0,4	0,0	0,0	0,1
of which: Differences between cash and accruals							
- Net accumulation of financial assets		-0,3	-0,1	0,0	-0,2	-0,1	0,0
of which: - privatisation proceeds		0,8	0,5	0,4	0,3	0,2	0,1
- Valuation effects and other							
p.m. implicit interest rate on debt		4,5	4,7	4,8	4,8	4,7	4,7

Table A.7. Cyclical Developments

% of GDP	ESA Code	2006	2007	2008	2009	2010	2011
1. Real GDP growth (%)		1,3	1,8	2,2	2,8	3,0	3,0
2. Net lending of general government	EDP B.9	-3,9	-3,0	-2,4	-1,5	-0,4	-0,2
3. Interest expenditure	EDP D.41	2,8	2,9	2,9	2,8	2,7	2,7
4. One-off and other temporary measures		0,0	0,1	0,0	0,0	0,0	0,0
5. Output gap		-2,4	-2,2	-1,7	-1,0	-0,1	0,6
6. Cyclical budgetary component		-1,1	-1,0	-0,8	-0,5	-0,1	0,3
7. Cyclically-adjusted balance (2-6)		-2,8	-2,0	-1,6	-1,1	-0,4	-0,4
8. Cyclically-adjusted primary balance (2+3-6)		0,0	0,9	1,3	1,7	2,3	2,2
9. Structural balance (7-4)		-2,8	-2,1	-1,6	-1,1	-0,4	-0,4

Table A.8. Divergence from Previous Update

	ESA Code	2006	2007	2008	2009	2010	2011
Real GDP growth (%)							
Previous update (Dec. 2006)		1,4	1,8	2,4	3,0	3,0	
Current update (Dec. 2007)		1,3	1,8	2,2	2,8	3,0	3,0
Difference		-0,1	-0,1	-0,2	-0,2	0,0	
General government net lending (% of GDP)	EDP B.9						
Previous update (Dec. 2006)		-4,6	-3,7	-2,6	-1,5	-0,4	
Current update (Dec. 2007)		-3,9	-3,0	-2,4	-1,5	-0,4	-0,2
Difference		0,7	0,7	0,2	-0,1	-0,1	
General government gross debt (% of GDP)							
Previous update (Dec. 2006)		67,4	68,0	67,3	65,2	62,2	
Current update (Dec. 2007)		64,8	64,4	64,1	62,5	59,7	56,7
Difference		-2,6	-3,6	-3,1	-2,6	-2,4	

Table A.9. Long-term sustainability of public finances

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	43,1	47,8	44,7	44,6	44,8	50,5
Of which: age-related expenditures	20,0	24,3	24,7	25,3	25,9	29,7
Pension expenditure	8,4	11,0	11,9	12,6	13,4	16,0
Social Security subsystem	5,6	7,0	7,6	8,3	9,1	13,2
Old-age and early pensions	3,8	5,1	5,7	6,5	7,4	10,9
Other pensions (disability, survivors)	1,8	1,9	1,9	1,8	1,8	2,3
Civil servants subsystem (CGA)	2,8	3,9	4,3	4,3	4,2	2,8
Health care ^(a)	5,3	6,7	6,8	6,7	6,6	7,2
Long-term care (<i>this was earlier included in the health care</i>) ^(a)	0,3	0,5	0,5	0,5	0,6	0,9
Education expenditure ^(a)	5,1	5,1	4,7	4,7	4,5	4,8
Other age-related expenditures ^(a)	0,9	1,0	0,8	0,8	0,8	0,8
Interest expenditure	3,0	2,6	2,7	2,0	1,6	3,5
Total revenue	40,2	41,6	44,2	44,2	44,2	44,2
Of which: property income	0,0	0,0	0,0	0,0	0,0	0,0
<i>of which: from pensions contributions (or social contributions if appropriate)</i>	9,4	9,8	9,8	9,4	9,2	9,3
Pension reserve fund assets	2,5	4,2	6,0	7,0	5,5	-35,3
Of which: consolidated public pension fund assets (assets other than government liabilities)	0,7	1,9	2,8	3,2	2,5	-16,2
Assumptions						
Labour productivity growth	1,1	0,4	2,1	2,5	1,7	1,7
Real GDP growth ^(b)	3,9	0,5	2,4	2,2	1,0	1,0
Participation rate males (aged 20-64)	85,2	85,5	86,5	86,8	85,9	86,3
Participation rates females (aged 20-64)	68,4	72,4	75,1	77,7	78,2	79,1
Total participation rates (aged 20-64)	76,6	78,8	80,7	82,3	82,1	82,7
Unemployment rate	4,1	7,4	5,4	5,3	5,3	5,2
Population aged 65+ over total population	16,4	17,0	17,7	20,3	24,3	31,9

Key: (a) Values since 2005 based on the projections of EPC and European Commission. (b) Basic assumption of the AWG's exercise of October 2007.

Table A.10. Basic Assumptions

	2006	2007	2008	2009	2010	2011
Short-term interest rate (annual average)	3,1	4,3	4,2	4,2	4,0	4,0
Long-term interest rate (annual average)	3,9	4,4	4,4	4,4	4,2	4,2
USD/€ exchange rate (annual average)	1,26	1,36	1,42	1,42	1,42	1,42
Nominal effective exchange rate (annual change)	0,2	0,8	0,5	0,0	0,0	0,0
World excluding EU, GDP growth	6,0	5,6	5,3	5,4	4,5	4,4
EU GDP growth	3,0	2,9	2,4	2,4	2,2	2,1
Growth of relevant foreign markets	8,4	6,8	6,2	5,8	5,8	5,8
World import volumes, excluding EU	8,5	8,1	7,4	7,9	7,9	7,9
Oil prices, (Brent, USD/barrel)	65,1	72,5	80,8	77,9	77,9	77,9