PORTUGUESE REPUBLIC

Stability and Growth Programme

2006 - 2010

December 2006 Update

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EXECUTIVE SUMMARY

This document forms part of the Portuguese State's obligations to the European Union, in particular in relation to the Stability and Growth Pact. It comprises the update of the Stability and Growth Programme (SGP) for the period from 2006 to 2010. After its presentation and discussion in the Portuguese Parliament on 14 December 2006, it is sent to the European Commission on 15 December 2006, according to the deadlines established for Portugal in the Pact Code of Conduct.

The Government once again reiterates its commitment to proceed with the structural reduction of public spending, so as to keep on target to achieve the budgetary consolidation objectives, which are:

(i) The gradual reduction of the nominal deficit ratio until it achieves a value below 3% of GDP in 2008; this reduction maintains exactly the same format as that previously established – a reduction of 1.4 percentage points (p.p.) in 2006, 0.9 p.p. in 2007 and 1.1 p.p. in 2008;

(ii) Budgetary consolidation based on measures that are structural in nature, with particular focus on the reduction of primary expenditure, as opposed to employing one-off measures providing a transitory impact; the commitment made to European partners, embodied in the recommendations of the Council of the European Union, of September 2005, in the context of the Excessive Deficit Procedure (EDP), is wholly honoured, since it is forecasted that the measures shall lead to reductions of 1.5, 0.8 and 0.8 p.p. of the share of the structural deficit in GDP (i.e. the ratio of the deficit, net of cyclical effects and one-off measures, relative to GDP), in 2006, 2007 and 2008 respectively[1];

(iii) The continuation, at a rate of no less than 1.1 p.p. per year, of reductions to the deficit in 2009 and 2010 until a structural balance of at least -0,5% of GDP is attained in 2010, which is, in view of Portugal's needs for economic growth and the restrictions imposed by the trends of public debt, the Medium-Term Objective (MTO) that the Portuguese Government has committed itself to in the context of the Stability and Growth Pact;

(iv) Improve the quality and transparency of public finance statistics. Instituto Nacional de Estatística (INE) is now responsible for the calculation of the deficit on a national accounts basis, as well as the figures to be included in the half-year reports to Eurostat's in the ambit of the EDP, as a result of the protocol between the Statistics Department of the Bank of Portugal, the Department of Macroeconomic Statistics of INE and the Budget Directorate-General (DGO) of the Ministry of Finance, entered into in January 2006. This new position of transparency and quality regarding public accounts' statistics, which has been expressly recognised by Eurostat and the European Commission, confers added internal and external credibility on the information provided by the Portuguese authorities;

(v) Strengthening the sustainability of long-term public finances, in a context of growing pressure on public policies sensitive to population ageing. The Government, after an initial endeavour to strengthen fiscal revenue and preparing the way for Public Administration reforms, has undertaken, as committed to in the previous SGP update (December 2005), with the country's social partners, the reform of social security all through 2006, which was passed in the Portuguese Parliament in November 2006, resulting from an agreement which has been reached with the majority of social partners. This reform allows long-term sustainability risk to be significantly reduced, both with regard to public finances and the social security sys-tem proper, based on the principle of solidarity.

[1] See Council recommendation at http://register.consilium.eu.int/pdf/en/05/st12/st12401.en05.pdf#page=2.

Both 2006 budget implementation and the detailed objectives for 2007 established in the State Budget recently passed in Parliament demonstrate that the Government is determined and earnest in its budgetary consolidation strategy. The budgetary forecasts extended to 2010, which were drawn up with the necessary prudence with regard to tax revenue growth, also indicate a reduction of their share of GDP in most of the primary expenditure items. This fact principally reflects not only the impact of the results of the Restructuring Programme for the State's Central Administration (PRACE), but also, in relation to welfare expenditure, the gradual strengthening of curbs brought about by the reforms to general and civil servant social security schemes.

Budgetary consolidation is one of the fields of action of the structural reforms currently in progress. The Government is aware that the widespread recovery of the competitiveness and growth, both effective and potential, of the Portuguese economy, forecasted for the time horizon of this SGP update, decisively depends on the continued and vigorous implementation of the set of structural reforms set out in the National Action Programme for Growth and Jobs (PNACE).

Chapter

1

I. MACROECONOMIC AND BUDGETARY SITUATION

I.1. Macroeconomic Development in 2006

The progression of the Portuguese economy in 2006 has corroborated and consolidated the economic recovery that commenced in mid-2005. The recovery has been based on the upbeat trend of exports, and it has made significant net job creation possible – greater even than the expected figure based solely on the still moderate growth in GDP. 2006 has also been characterised by the advances made in correcting public accounts' imbalances.

The forecast growth for the Portuguese economy in 2006 is 1,4%, accelerating over the 0,4% recorded in the previous year[2]. This performance is primarily due to strong increases in exports, promoted by significant gains of market share in countries outside the EU and by the increased dynamism of the economies of Portugal's main Euro area trading partners. The growth of domestic demand has proven to be quite moderated, which has contributed to the reduction of macroeconomic imbalances in Portugal. Private consumption is forecast to slow down relative to 2005 and public consumption will mirror the impact of budgetary consolidation on the current primary expenditure side of accounts. Investment, which is heavily influenced by the relative share held by the civil construction sector, has not accompanied the recovery in economic growth. The out-of-step performance of the civil construction sector may be due to adjustment costs in the inter-sectoral re-allocation of resources. This re-allocation of resources has been flagged by the observable shifting in the exports' structure, favouring products with greater technological content. On the other hand, the Portuguese economy has still not registered full use of its installed production capacity (i.e. the output gap is still negative), which has reduced the need to expand this same production capacity through new investment.

Table I.1.1. Domestic Expenditure

(Real year-on-year growth rates, %)

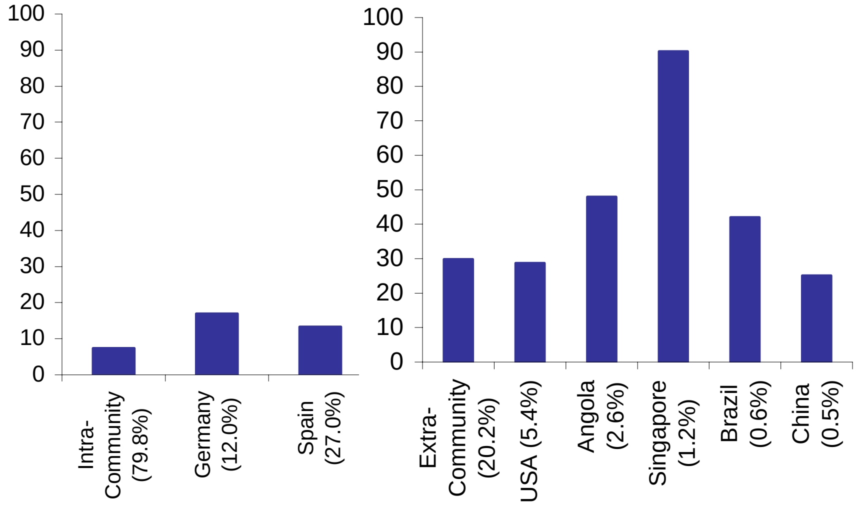
	2004 Structure(%)	**2005**	**2006 (e)**	**2006**		
				I	**II**	**III**
Private Consumption	65,5	2,0	1,0	0,9	0,1	1,8
Public Consumption	21,1	1,8	-0,2	0,3	-0,2	-0,6
Investment (GFCF)	21,6	-2,9	-2,6	-1,6	-2,0	-3,1
Domestic Demand		0,8	0,0	0,2	-0,8	0,5
Exports	28,6	0,9	8,6	8,6	7,7	8,8
Imports	37,4	1,8	2,8	4,5	2,0	4,7
GDP	**100,0**	**0,4**	**1,4**	**1,1**	**0,8**	**1,5**
Contributions to real GDP growth (p. p.)						
Domestic Demand		0,9	0,0	0,3	-0,8	0,6
Net Exports		-0,4	1,4	0,8	1,7	0,9

Sources: INE and Ministry of Finance.
(e) Estimate for 2006.

[2] Underlying the growth estimate for 2006 is an intra-annual acceleration profile, which has proven to be in harmony with the most recent data published in the Quarterly Accounts for the 3rd quarter.

The growth in exports is accompanied by greater geographical diversification in regard to the destination markets as countries outside the EU gain a greater share, as Chart I.1.1 clearly indicates.

Chart I.1.1. Exports – Markets recording Largest Growth
(January to September 2006 – year-on-year growth in value, as %)

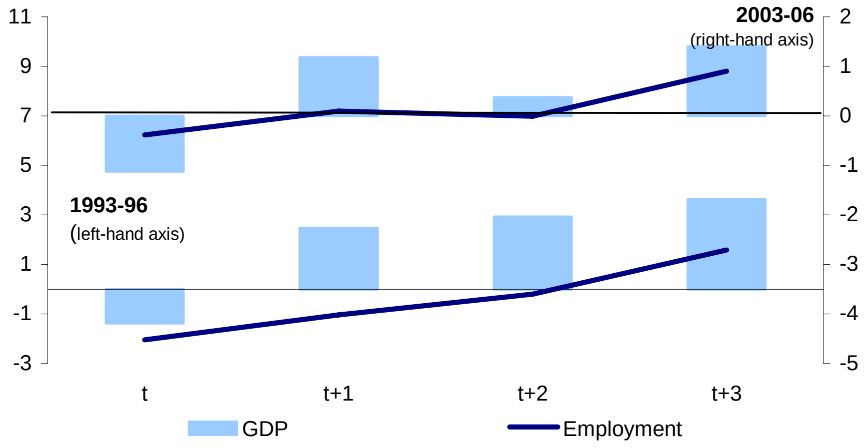


Source: INE.
N.B. the percentage in brackets indicates total share of exports (2005).

This dynamism in exports in 2006 should ensure that net exports provides quite a positive contribution to GDP, taking into account the fact that imports record less vigorous growth as a result of the restrained growth of domestic demand, particularly demand for investment goods and for oil products. The performance of foreign trade should lead to a reduction of the current account deficit since the impact of the resulting volume effect shall more than offset the negative effects of the terms of trade and the increase in the income account deficit. The economy's net borrowing, measured via the joint deficit of the capital and current accounts, should decrease from 7,9%, in 2005, to 7,5% in 2006 (Table 1d of Appendix).

Noteworthy in the labour market is the 0,9% increase in employment during the first three quarters, after the stagnation recorded in 2005. This performance is in line with the more favourable economic outlook, though it does exceed expectations in a recovery context of still modest economic growth. In fact, the current recovery phase, when compared to that of the previous cycle (after the 1993 recession), has a much slower growth in economic activity, although recording a greater net creation of jobs (see Chart I.1.2).

Chart I.1.2. Real GDP and Employment
(% growth rates)

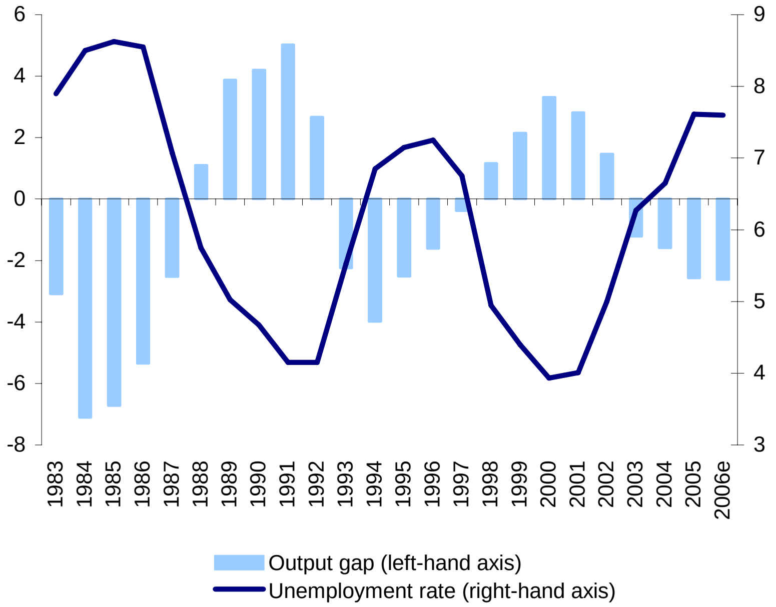


Sources: INE and Ministry of Finance.
N.B. Estimate for 2006.

The change in employment mainly mirrors the recovery of job creation in the agricultural and industrial sectors. Nonetheless, the services sector remained the most dynamic in terms of net job creation, contributing 0.7 percentage points (p.p.) to the total increase in employment. The employment rate rose to 68,0%, a level that has not been recorded since 2003. Accordingly, the rate is back on track for the target established in the Lisbon Strategy for 2010 (70%).

Unemployment rate also indicated a favourable trend, though still remaining high. It has registered an overall average of 7,5% for the first three quarters of 2006 (7,6% in 2005). It is expected, for the year as a whole, that the rate stabilises compared to the previous year. This behaviour suggests that the trend of higher levels of the unemployment rate should occur earlier than it did in the previous cycle, occurring in a phase when a negative output gap still exists (see Chart I.1.3).

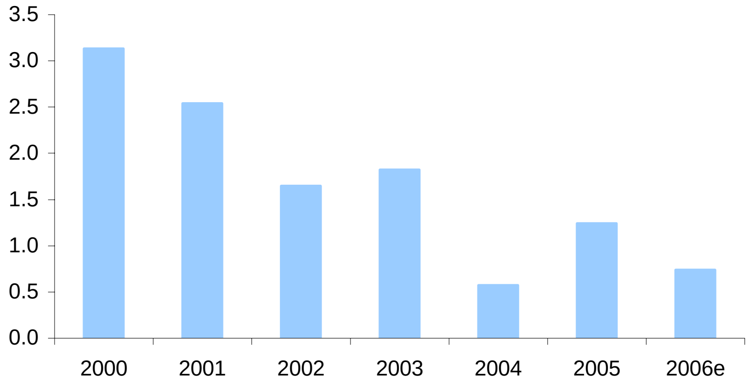
Chart I.1.3. Output Gap and Unemployment Rate
(%)



Sources: Ministry of Finance and INE.
N.B. Output gap estimated in accordance with European Commission methods.

The growth of nominal pay per worker should remain moderate in 2006, similar to that verified in 2005. This behaviour is due to a number of factors: an unemployment rate that remains still high; economic growth that is still below potential; competition-based pressure from foreign markets and curbing the growth in Public Administration wages. Wage restraint has, however, still not proven to be enough in bringing about gains in competitiveness against Portugal's European partners, since the acceleration of labour productivity remains tentative. As a matter of fact, unit labour costs in Portugal are still growing faster than those of the rest of the euro area.

Chart I.1.4. Unit Labour Costs in Portugal Compared to the Euro Area (*)
(Growth rates, %)



Source: European Commission, *Price and Cost Competitiveness*, 3rd quarter 2006.
(*) Change in unit labour costs in the economy as a whole compared to the euro area (positive change signifies a loss of competitiveness);
(e) estimate.

The average annual inflation rate in 2006, measured through the Harmonised Index of Consumer Prices (HICP), should be 2,9%, *i. e.*, 0.8 p.p. above the 2005 figure. It should be noted that this forecast incorporates the methodological correction made by INE in October of this year, without which the forecast would be 2,5%.

The available data indicate that the transfer to households of the rise in the standard VAT rate from 19 to 21% occurred, in regard to the majority of goods and services subject to that rate, in 2006. Despite the fact that the rise in the rate occurred in July 2005, the very weak economic growth recorded at that time as well as the strategies implemented in order to not mirror this tax increase in final prices, meant that the reflection of the increase in retail prices was deferred for a few months.

In addition to the impact of VAT, the rise in oil prices during the first half of 2006 continued to strongly influence consumer price trends. The registered acceleration of these prices was also partly due to growth in food and non-energy industrial goods prices (clothing and footwear in particular). This trend reversed in the third quarter of 2006 and inflation slowed down. This was primarily due to the price of industrial goods, in particular to the price of energy goods (Table I.1.2).

Table I.1.2. HCPI - Total and Main Aggregates
(Growth rates, %)

	2004	2005	2006 (e)	2005 III	2005 IV	2006 I	2006 II	2006 III
	Average annual			Year-om-year				
Total	2,5	2,1	2,9	2,4	2,6	3,2	3,6	2,9
Aggregates								
Goods	1,6	1,9		2,2	2,4	3,2	4,0	3,2
Food	1,4	0,1		-0,2	1,2	2,9	3,6	4,0
Unprocessed	0,0	-0,5		-0,7	0,3	1,2	2,8	3,9
Processed	2,8	0,8		0,2	2,1	4,6	4,5	4,1
Industrial	1,8	2,8		3,6	3,1	3,4	4,3	2,8
Non-energy	0,8	1,0		1,0	1,0	0,9	2,0	1,5
Energy	5,4	10,0		12,9	10,6	12,7	12,4	6,9
Services	3,9	2,5		2,7	2,8	3,0	2,8	2,3

Source: Eurostat.

I.2. National Action Programme for Growth and Jobs (PNACE)

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, is a valuable coordination instrument of a range of structural reforms, embodied in macroeconomic, microeconomic and employment measures, that aim to strengthen the country's competitive base, thereby contributing to raising its potential for growth and promoting the sustainable development of the same. The Programme's strategic objectives are:

- To give renewed credibility to Portugal through budgetary consolidation and the implementation of strong, transparent and focussed policies;
- To re-establish confidence in Portugal through economic growth, the improvement of the legal and legislative environment and public investment in key economic areas, with the aim of attracting more private in-vestment;
- 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 employment-orientated policies, education and qualification, with special focus of life-long learning.

There is strong liaison between PNACE and the SGP in the macroeconomic area in particular, embodied in the pursuit of a budgetary consolidation strategy based on structural measures. These measures focus on the reform of Public Administration, the sustainability of the healthcare and social security systems and administrative and legislative simplification. The aim is to foster the creation of a stable macroeconomic framework, consolidated public finances and a business climate that favours investment, innovation and the growth of productivity, which are factors likely to promote growth and the achievement of the potential that economic agents, small and medium-sized companies in particular, possess. A further aim is to foster cooperation between industry and science.

The Government's choice of promoting a development strategy for the country that is based on strengthening research, development and innovation is noteworthy. In the microeconomic field, the "Commitment to Science" programme aims to increase scientific knowledge and technological skills to the level of highest international standards, strengthen human resources and a science and technology-orientated work culture, reinforce responsibility, organise public research and private research and development entities into a network, promote international expansion, demand top-quality performance and assessment, and obtain economic value from research. Worthy of note in this context is the increase of the sum set aside in the 2007 state budget for science and technology – an increase of around EUR 250m compared to 2006. The recent agreement between the Portuguese and Spanish governments to establish an International Iberian Nanotechnology Laboratory in 2007, in *Braga*, as well as the international partnerships in science, technology and higher education entered into with world-renowned universities, such as the Massachusetts Institute of Technology and the Carnegie Mellon, are further examples of note in regard to the implementation of this policy.

The investment in knowledge, technology and innovation is also reflected in the close ties between PNACE and PT. The "Connecting Portugal" initiative (defining national policy regarding the information society and fostering broadband access) and the promotion of top-quality primary education (through training and monitoring mathematics, Portuguese and experimental science teachers, endeavours to guarantee that students stay longer and receive improved instruction in schools and the inclusion of English teaching at the first level of primary education, thereby promoting an international ethos amongst Portuguese citizens) are noteworthy.

The backing of the training of human resources is also evident in initiatives such as "New Opportunities", which aims to requalify close on one million people through the "The Recognition, Validation and Certification of Skills System", for example. The "Inov-Jovem" and "Inov-Contacto" programmes which promote qualified employment, support the employment of young university graduates by small and medium-sized companies and promote work training placements abroad, thereby fostering the input of management, technological, marketing and internationalisation skills in companies.

Fostering entrepreneurship is implemented through the provision of risk capital instruments ("FINICIA Programme"). This framework is aided by the reduction of red tape associated to the adoption of administrative and legislative simplification measures, through the simplification of procedures and elimination of unnecessary formalities (the SIMPLEX - Administrative and Legislative Simplification Programme forms part of this strategy), creating a business environment that is suited to the realisation of rights and compliance with obligations in regard to companies and citizens. The fact that Portugal was ranked in the Doing Business report of the World Bank as one of the ten fastest countries in 2005/2006 for a company start-up, being considered a top reformer, and the recent award of the European Commission's Enterprise Award for the " On-the-spot Firm" initiative, are examples of the recognition of the effectiveness that these type of measures can provide.

PNACE also encompasses measures that foster the use of renewable energy and improved energy efficiency, expressing territorial cohesion and environmental sustainability concerns.

The liaison and mutual reinforcement existing between the measures implemented in the three main areas of policy (macroeconomic, microeconomic and employment) is also significant, since they allow the positive effects individually associated to each one to be catalysed, ensuring that they jointly contribute to the achievement of the established objectives.

Also in a context of liaison, PNACE functions as a support programme for the National Strategic Reference Framework (NSRF), a device that sets the strategic framework for Community Funds for the period from 2007 to 2013, both sharing the same concerns regarding the qualification of human resources and the competitiveness and sustained growth of the Portuguese economy.

As indicated in the Economic Policy Committee's (EPC) assessment of the national reform programme progress reports under the EPC country reviews procedure, which occurred in November 2006, the implementation of the measures is proceeding at a good pace in areas such as innovation and research and development (benefiting from the fact that the coordinating structure of PNACE is also responsible for the PT), the labour market (with particular reference to the social security reform measures), energy (the operational start up of the Iberian Electricity Market, for example) and the improved control over and reduction of red tape.

A set of indicators that will be used to assess the implementation of the PNACE programme, which will bring the programme's monitoring process to a close, are currently undergoing development.

Section I.3.4., taking the data contained in the PNACE measures' implementation matrix, forming part of the report on the first year of implementation, as a reference, contains a forecast of the direct budgetary implications associated to the implementation of the seven policies established in the same: economic growth and the sustainability of public accounts; governance and Public Administration; competitiveness and entrepreneurship; research, development and innovation; territorial cohesion and environmental sustainability; efficiency of the markets; and qualification, employment and social cohesion.

BOX 1. PROGRESS ASSESSMENT BY THE EUROPEAN COMMISSION OF IMPLEMENTATION OF PNACE

The progress report on PNACE (National Reform Programme, in common EU nomenclature) by the European Commission, published on 12 December 2006, concluded that[3] :

" Portugal is making good progress on implementing the measures in the National Reform Programme, especially in the macro and micro-economic areas. On employment related policies, there has also been progress, especially on reforming education and training, but the important area of the adaptability of the labour market and flexicurity is not yet being fully addressed. Progress towards meeting the commitments made at the 2006 Spring European is generally good. Considerable further efforts across all policy areas will be necessary to fully achieve the objectives of the programme, given their welcome ambition and Portugal's point of departure.

The Commission identifies as strengths of the reform process in Portugal: the extensive reforms launched to the public administration, the measures to facilitate business start-ups within an hour, the adjustment of old-age pension schemes and comprehensive consolidation measures in health care. Efforts to reinforce R&D have been strengthened and dovetailed into a coherent strategy through the ambitious Technological Plan. Extensive reforms are also being implemented in the education sector in particular with measures to increase literacy levels of the young and rationalise the national school network.

[3] Refer to http://europa.eu.int/growthandjobs/index_en.htm.

Portugal is recommended by the Commission to:

• in the context of the on-going correction of fiscal imbalances and public administration reform, redirect public spending towards uses more supportive to potential growth, while maintaining firm control over public expenditure overall;

• implement measures to strongly improve the education attainment levels of the young, and develop a vocational training system that is relevant to labour market needs and based on a "National Qualifications Framework";

• modernise employment protection, including legislation to foster flexibility and security to reduce the high levels of labour market segmentation.

In addition, it will be important for Portugal to focus on: ensuring that the promising Technological Plan is fully implemented, the linkages between research and industry consolidated and the involvement of the private sector strengthened; ensuring effective competition in energy and financial services markets; reducing emissions; reducing the deficit in transposing EU legislation into national law; and addressing the factors undermining social cohesion.

I.3. The Budgetary Consolidation Process

The budgetary consolidation process, which commenced in mid-2005, provides an indispensable contribution to the range of structural reforms being undertaken by Portugal and which are specifically established in PNACE. Making public finances healthy is not only essential to the continued funding of all other reforms, but it also, in itself, directly contributes to improving the economy's competitiveness, given that it provides an excellent opportunity for the modernisation of public administration and services.

In view of the serious situation faced by public finances at the beggining of 2005 – the underlying macroeconomic imbalances, the level of inter-generational sustainability of public and social policies, and also Portugal's commitments within the European Union, particularly in regard to the Stability and Growth Pact – the Government drafted a public finances' consolidation programme for 2005/2009, which has now been drafted for the 2006-2010 period. This programme is broadly based on structural reforms: given that the public accounts deficit situation has proven to be structural and basically caused by the growth of primary public expenditure, the use of one-off and temporary measures are ineffective and deceptive since, even though they immediately increase public revenue, they end up creating equivalent or even greater expenditure in subsequent years. Curbing primary expenditure through structural reforms, generates other potentially very positive effects on the confidence of domestic and international economic agents, as has occurred in other successful international cases. This potential supplementary effect impacts on the capacity for the sustained recovery of economic activity.

Even though a gradualist and, therefore, realistic approach has been considered in regard to the difficulties facing the recovery of Portugal economic growth (difficulties that itselves have been caused by structural inefficiencies), the curve mapped out in Chart I.3.1 for the General Government balance as a percentage of GDP, implies robust and sustained budgetary discipline. Both 2006 budget implementation and the detailed objectives established in the 2007 State Budget recently passed in Parliament prove that the Government is determined and earnest in its budgetary consolidation strategy.

Chart I.3.1. Change in General Government Balance, Stability and Growth Programme 2005/2009 and 2006-2010
(% of GDP)

Source: Ministry of Finance.

I.3.1. Public Finances: Budget Implementation in 2006 and 2007 State Budget

The trend in the public accounts' main indicators in 2006 (estimated) and 2007 (2007 State Budget), illustrated in Table I.3.1, is clearly in harmony with the established strategy.

Table I.3.1 General Government Accounts
(On a National Accounts basis)

	2005		2006		2007	
	Million euro	% of GDP	Million euro	% of GDP	Million euro	% of GDP
1. Tax Revenue	35.001,6	23,7	37.257,8	24,4	39.413,6	24,7
Taxes on Production and Imports	22.214,1	15,1	23.649,3	15,5	24.726,0	15,5
Taxes on Income and Wealth	12.787,5	8,7	13.608,5	8,9	14.690,6	9,2
2. Social Contributions	18.443,6	12,5	18.684,4	12,2	19.525,9	12,2
Of which: Effective Social Contributions	16.715,1	11,3	17.350,7	11,4	18.413,4	11,5
3. Other Current Revenue	6.122,8	4,2	5.580,3	3,7	6.094,1	3,8
4. Total Current Revenue (1+2+3)	**59.568,1**	**40,4**	**61.522,5**	**40,3**	**65.033,6**	**40,7**
5. Intermediate Consumption	5.997,3	4,1	6.194,2	4,1	6.392,7	4,0
6. Personnel Expenditure	21.327,6	14,5	21.207,1	13,9	21.010,0	13,2
7. Social Transfers	27.205,1	18,5	28.235,4	18,5	29.394,0	18,4
8. Interest Expenditure	4.028,9	2,7	4.363,5	2,9	4.770,2	3,0
9. Subsidies	2.353,2	1,6	1.786,9	1,2	1.802,9	1,1
10. Other Current Expenditure	3.426,9	2,3	3.394,9	2,2	3.722,2	2,3
11. Total Current Expenditure (5+6+7+8+9+10)	**64.338,9**	**43,7**	**65.182,0**	**42,7**	**67.092,0**	**42,0**
Of which: Current Primary Expenditure (11-8)	**60.310,0**	**40,9**	**60.818,5**	**39,8**	**62.321,8**	**39,0**
12. Gross Saving (4-11)	**-4.770,8**	**-3,2**	**-3.659,5**	**-2,4**	**-2.058,4**	**-1,3**
13. Capital Revenue	**1.954,8**	**1,3**	**2.118,9**	**1,4**	**1.594,7**	**1,0**
14. Gross Fixed Capital Formation	4.183,1	2,8	3.746,9	2,5	3.634,3	2,3
15. Other Capital Expenditure	1.895,5	1,3	1.739,8	1,1	1.811,6	1,1
16. Total Capital Expenditure (14+15)	**6.078,5**	**4,1**	**5.486,8**	**3,6**	**5.445,8**	**3,4**
17. Total Revenue (4+13)	**61.522,9**	**41,7**	**63.641,4**	**41,7**	**66.628,3**	**41,7**
18. Total Expenditure (11+16)	**70.417,4**	**47,8**	**70.668,8**	**46,3**	**72.537,8**	**45,4**
Of which: Total Primary Expenditure	**66.388,5**	**45,0**	**66.305,3**	**43,4**	**67.767,6**	**42,4**
19. Net Lending / Borrowing of General Gov. (17-18)	**-8.894,5**	**-6,0**	**-7.027,4**	**-4,6**	**-5.909,5**	**-3,7**
Of which: Primary Balance (19+8)	**-4.865,6**	**-3,3**	**-2.663,9**	**-1,7**	**-1.139,3**	**-0,7**
Of which: Current Primary Balance (19+8-13+16)	**-742,0**	**-0,5**	**704,0**	**0,5**	**2.711,8**	**1,7**
20. Public Debt	**94.394,0**	**64,0**	**102.948,0**	**67,4**	**108.598,0**	**68,0**

Sources: 2005 – INE; 2006 and 2007 – Ministry of Finance, 2007 – State Budget Report.

The reduction in public spending between 2005 and 2007, 2.4 percentage points of GDP, is clear, particularly in regard to primary expenditure (a reduction of 2.6 p.p. of GDP), while the share of total revenue remains stable.

It is significant that all expenditure items, except for interest expenditure – which increased as a result of rising interest rates and the inertia of government debt level, which shall only diminish its share of GDP in 2008 –, have been curbed or reduced. Personnel Expenditure, which decreased by 1.3 p.p. of GDP from 2005 to 2007, deserves particular mention due to its structural nature and dominant share of total public expenditure. Also deserving highlight are Social Transfers, which have a structural tendency to expand and so are currently – and shall remain so for the near future – the object of strong containment regarding medium and long-term sustainability (through Social Security reform) and also the control of healthcare expenditure.

Tax revenues and social contributions are still increasing, even though the share held by total revenue in terms of GDP has remained stable. This increase is partly due to the initial focus of consolidation on the revenue side, but it is also a result of efficiency gains that have been obtained by government entities in tackling tax and contribution evasion and fraud. It is expected that the pace of these efficiency gains will be maintained in 2007.

It should be noted that the objectives drawn up by the Government are being complied with: the deficit will be reduced from 6% of GDP in 2005 to 3,7% in 2007, complying too with the intermediate objective of a 1.4 p.p. of GDP reduction in 2006. Of further significance is the fact that the primary balance is already close to equilibrium (the current primary balance will even become positive from 2006 onwards), which heralds that the upwards trend of the share of GDP held by the public debt service will soon be inverted. The deceleration in the growth of public debt during 2006 confirms this inversion, to which the revenue from the privatisation programmes made a very positive contribution, and despite the implementation of large debt payment operations at the year's start – one of the most significant of which was that associated to the National Health Service.

I.3.2. The Main Budgetary Consolidation Measures

The measures with greatest impact on the budgetary consolidation process undergoing implementation by the Portuguese Government can be grouped into four main categories:

A) Measures to restructure Public Administration, human resources and public services;

B) Measures to curb Social Security and Healthcare expenditure;

C) Measures to improve budgetary control and institutional solidarity of regional and local governments;

D) Measures focusing on the tax system.

These measures take time to produce effects, due to their essentially structural nature, which explains why their impact in terms of the budgetary consolidation of public accounts extends beyond the period in which the bulk of legislation is passed – 2005/2007 in other words. This is valid to the extent that the forecast reduction in General Government net borrowing in 2010, to 0,4% of GDP (see Appendix, Table 2), will basically be brought about by the persistent trends of previously implemented structural reforms.

A. Restructuring Public Administration, Human Resources and Public Services

The undergoing reforms in Public Administration will continue in 2007 to focus to a large extent on the following fields:

- Restructuring Programme for the State's Central Administration (PRACE);
- Reorganising Education, Security, Healthcare and Justice networks
- The reform of civil servants' pay, career and employment affiliation schemes;
- The reform of public services, civil services' managers and civil servants' performance assessment system;
- Implementing the common civil servants' mobility scheme;
- Personnel reduction;
- Fostering the qualification of the Public Administration's human resources;
- The reform of civil servants' social protection scheme (*Caixa Geral de Aposentações*);
- The reform of civil servants' supplementary welfare;

- The reform of civil servants' healthcare sub-systems;
- E-Government development;
- Extending administrative simplification measures.

A.1. Restructuring Programme for the State's Central Administration (PRACE)

The general and special guidelines to be followed in the reorganisation of all government ministries were established in April 2006 by Council of Ministers Resolution no. 39/2006. The new organic laws for the different ministries, which implemented the objectives established for the first phase of PRACE (Decree-Law nos. 201 to 215/2006, of 27 October), came into force in October 2006.

This new organisational model will promote governance-support functions, resources' management and operational functions, in order to provide a better service to citizens. Its results can be summarized as follows:

- A 25,6% reduction in Central Government structures: of the 518 existing services (central ministerial services, decentralised services, consultative bodies and other structures) that were assessed, 133 were wound up by the ministries' organic laws; the remaining closures that are planned will be implemented via the services' organic laws;
- A 28,5% reduction in senior management positions: the number of posts established in the organic laws was reduced from 761 to 544;
- A close on 40% reduction in indirect administration by the State (public institutes given general administrative and financial autonomy). Only 56 public institutes out of the 100 assessed are provided with administrative and financial autonomy through the organic laws of the ministries.

The implementation of PRACE is now focused on the definition of services' microstructures. The legislative act that establishes the legal framework for the winding up, merger and restructuring of public services and the streamlining of personnel has also become law (Decree-Law no. 200/2006, of 25 October). The services' organic laws are scheduled for approval by the Council of Ministers before the end of 2006.

Structural reorganisation in 2007 will target results in areas such as the reduction of administrative microstructures, driven by identical criteria – structural streamlining, coordinated decentralisation and simplification of the State's means of functioning – to those already employed in relation to ministerial macro-structures.

These wide-ranging structural reform operations in 2007 will be followed by a period of stabilisation and sedimentation of the new structures, at all levels.

The provision of shared services within Public Administration, which will have an impact on the reorganisation of the State's central administration, will commence during the first quarter of 2007. The shared services' provision will follow a corporate model in the management of financial, human and material resources. The following priorities for the provision of shared services are defined:

- The provision of accounting services, promoting the implementation of the Official Public Accounting Chart;
- The provision of employee management services in regard to civil servants in a situation of special mobility, and the processing of civil servants' pay;

- The centralised management of public procurement;
- The centralised management of the State's fleet of vehicles.

The provision of shared services established in PRACE will create a new driving force that will provide for, in subsequent years, further reductions in administrative structures and expenditure related to the management of Public Administration's common resources.

A.2. Reorganising Education, Security, Healthcare and Justice networks

The restructuring of schools' network, which started in 2006, led to the closure of isolated 1st cycle primary schools and those with insufficient teaching conditions, as well as the integration of 1st cycle primary schools into vertical groupings. This process of increased streamlining in the management of resources and improving teaching quality will continue in 2007, in strict liaison with local government and municipal councils.

In the field of Home Affairs, the geographical ambit of the GNR and PSP police forces will be reviewed, leading to the removal of some duplications of the presence of the two police forces in the field and also of small stations and barracks.

In the healthcare sector, the most significant development is embodied in Decree-Law no. 233/2005, of 29 December, which broadened the corporate public entity model to the country's two largest hospitals (Hospital de Santa Maria and Hospital de S. João) and created three new corporate public hospitals through the merger of eight hospitals of the national health system, with the aim of improving management practices in the healthcare public sector. Also of note is Legislative Order no. 9/2006, of 16 February, which restructured the model in place for healthcare centres, creating family healthcare units. These are smaller and more flexible organizations, which aim to approach healthcare to citizens, and improve their access, and to create conditions that reduce the pressure on demand for more specialised healthcare, which has higher unit costs. Measures that reorganise the emergency network were also adopted to streamline the network access points (Ministerial Order nos. 17736/2006, of 31 August, and 18459/2006, of 12 September, of the Minister of Health).

Measures fostering streamlining and development will be passed in the Justice field, namely:

- The reform of prison infrastructures. 4 prisons have already been closed down in 2006 (*Brancanes*, *Felgueiras*, *Monção* and *São Pedro do Sul*);
- The review of the judicial territorial map (Law Courts). This process is in its final phase and it is scheduled to be completed in the first quarter of 2007;
- The review of the social reinsertion territorial map (educational centres).

A.3. The Reform of Civil Servants' Pay, Career and Employment Affiliation Schemes

The publication of the "Evaluation Report and Prospects for Change" in September 2006 provided an exhaustive portrait of the current pay, career and employment systems in force in the civil service, the changes that have occurred in these areas since 1990, the imbalances that currently exist and also provided some proposed corrections. This assessment indicates the need for relatively broad reform that will implement, in particular, a new human resource management system and interaction with the global management cycle of public services, governed by goal-setting management principles.

The process of hearing the opinion of trades unions on this subject matter commenced in November 2006.

The principles of the reform will be published shortly and their implementation is forecast for 2007, under the following terms:

- The approval of the legislation governing the new human resources management system and the principles of the new civil service employment affiliation, careers and pay schemes (during the first half of 2007);
- The approval of the legislation establishing the new general civil service careers (during the first half of 2007);
- The approval of the legislation establishing the new special civil service careers (during the second half of 2007).

Specific measures were implemented to ensure that these reforms are not hampered in any way, including through budgetary means. Said measures establish the extension through 2007 of those instruments set down in Law no. 43/2005, of 29 August (currently known as frozen career progression and wage top-ups).

Significantly, the new primary and secondary education teaching career scheme was passed by the Council of Ministers. This legislative instrument already contains, in certain fields, some of the rules and principles that underpin this reform.

A.4. The Reform of Public Services, Civil Services' Managers and Civil Servants' Performance Assessment System

The review of the current assessment system – Integrated Civil Servants' Performance Assessment System (SIADAP) – has almost been completed, and after amendments included by Law no. 15/2006, of 26 April, which provide a broader scope for application, the project for the reform of the civil servants' and civil service managers' assessment scheme and creating the public services' assessment system is at an advanced drafting stage. The reform comprises a single legislative instrument that aims to establish connections between its different targets (civil servants, including managers, and services). This reform must likewise follow the scheduling set out for the reform of civil service employment affiliation, career and pay schemes, in view of the links existing between them. It must also be approved during the first half of the year, so as to allow sufficient time to settle into operation and for the approval of special performance assessment schemes for certain State sectors.

The legislation concerning the new primary and secondary education teacher career scheme, referred above, includes a new performance assessment scheme for primary and secondary teachers, which comprise one of the State's main bodies.

A.5. The Operational Implementation of the Common Civil Servants' Mobility Scheme

Law no. 53/2006, of 7 December created the conditions, when it came into force, to increase management and mobility effectiveness in regard to the Public Administration’s human resources. This allows the rational allocation of said resources amongst the different administrative sectors, their re-qualification and profession change and the provision of support for seeking employment in other sectors. The groundwork for the creation of the entity that will manage mobility, which will come under the scope of the shared services’ provision (referred to above under PRACE), was established in the last quarter of 2006. On the completion in 2007 of the winding up, merger and restructuring operations of the services defined and included under PRACE 2007, the first movements of personnel under the new common mobility scheme, as well as the special mobility scheme, will take place. Significantly, under the special mobility legislation it is possible to reduce the pay of civil servants falling in the ambit of the same to 66,6% of the basic monthly salary. This measure is offset by the civil servant being permitted to hold other employment outside of the scope of the Public Administration.

A.6. Personnel Reduction

A further concern during 2006 has been the implementation of the policy to reduce personnel. In this vein, and as a consequence of the provisions established in the 2006 State Budget Act, the Council of Ministers passed Resolution no. 38/2006, of 18 April, which established the implementation norms for the outside recruitment rule of one worker in for every two out. Decree-Law no. 169/2006, of 17 August, was published with the same objectives, in other words, the strengthening of the personnel recruitment and contracting control mechanisms, amongst others.

The result of these measures was that the number of civil servants was reduced by 10.633 between January and November 2006, corresponding to a replacement rate of 40%, clearly complying with the established rule.

The policy of personnel reduction, governed by the same principles, will persevere during 2007.

A.7. Fostering the Qualification of the Public Administration's Human Resources

Programmes aimed at fostering the qualification of the Public Administration's human resources, especially those holding special mobility status and those possessing a low level of qualifications, are currently being drafted. These programmes come under the scope of the measures established for the qualification of human potential in QREN.

In parallel, priority will continue to be given to training the civil services’ managers, as established in the regulations of such personnel - Law no. 51/2005, of 30 August.

The higher education establishment recognition system (Ordinance no. 264/2006, of 17 March) regarding qualifications in upper management for the civil services’ managers, came into force to meet this objective, thereby broadening the response capacity that had, up to then, consisted solely of *Instituto Nacional de Administração*.

It is forecast that the training of the civil services’ managers will also be provided by higher education establishments certified to that end in 2007, on the conclusion of the call for tenders procedure, which is in its final stages.

A.8. The Reform of Civil Servants' Social Protection Scheme (*Caixa Geral de Aposentações*)

In the field of social protection, and as a consequence of Law no. 60/2005, of 29 December, which established mechanisms fostering the convergence of the retirement conditions and pension calculation components of the civil servants' social protection scheme with the general social security scheme, the following legislation was passed:

- Decree-Law no. 55/2006, of 15 March, which defines the scope of social protection, guaranteed by social security, of civil servants and agents recruited from 1 January 2006 onwards, encompassing protection for disability, death and family-related costs. This legislative instrument is essential in view of the reform of the civil service retirement scheme;
- Decree-Law no. 117/2006, 20 June, which establishes the transition from the compulsory civil service social protection scheme to the general social security scheme of workers that alter their employment relationship with the civil service (transferring from public to private law).

The reform of the civil servants' general social protection scheme will be carried out in 2007, closely tied to the reform of the employment affiliation system. This reform will also implement, in the ambit of the civil service, the "Agreement on Social Security Reform", entered into by the Government and its social partners, and which focuses in particular on the inclusion of a sustainability factor.

The aim of this review is to establish coherency on the subject, by moving the social protection of civil servants closer to the general social protection schemes and by preventing and eliminating differences founded on the different types of labour affiliations schemes.

A.9. The Reform of Civil Servants' Supplementary Welfare

The report assessing supplementary welfare that is actually provided to civil servants and their families in certain sectors of the State will be published by the end of 2006. The draft legislation reforming social transfers according to the principles of harmonisation, financial sustainability and the reduction of administrative costs will be published at the same time. This legislation will also govern the merger of five public social services into one single public service (Public Administration Social Services), as established in PRACE.

The implementation of the referred to service will occur in 2007, leading to the harmonisation of social transfers.

A.10. The Reform of Civil Servants' Healthcare Sub-systems

In 2006, convergence measures were adopted (namely defining common criteria for establishing family beneficiaries) in order to implement the ongoing reform, commenced in 2005, regarding the convergence of the specific healthcare sub-systems existing in the ministries of Home Affairs, Defence and Justice with the general system of the Directorate-General for the Social Protection of the Public Administration's Employees and Agents (ADSE), which is the scheme covering the majority of civil servants.

As concerns ADSE, draft Law no. 105/X was presented in Parliament. This law aims to guarantee the financial sustainability of the scheme by establishing a 0,5 p.p. increase in the contribution from civil servants registered with ADSE, as well as widening the scope of the contribution (by 1%) to the retirement and old-age pensions of beneficiaries, when the value of the same is greater than or equal to 1,5 times the minimum monthly wage.

A.11. E-Government Development

E-Government development will receive additional focus in 2007, through the coordinating intervention of the new Agency for Administrative Modernisation, a product of PRACE. The focus areas will be public investment, the definition of binding transversal policies and mandatory rules in the information technology and communication fields, and the development of current technological infrastructure as well as streamlining communication costs through transversal projects.

A.12. Extending Administrative Simplification Measures

The Government implemented a wide range of initiatives during 2006 with the aim of modernising and focusing Public Administration on the citizen and corporate initiative.

SIMPLEX 2006 was one of these initiatives. The Administrative and Legislative Simplification Programme encompassed measures aimed at making citizens and companies' lives easier. SIMPLEX 2006, which was introduced in March 2006, is a programme embracing the entire Government, with all the ministries sharing implementation responsibility.

It includes a comprehensive range of measures along 6 main branches:

- Abolition of certificates;
- Abolition of paper / reducing use of materials;
- Simplification / cutting red tape;
- Deregulation;
- Facilitating access to public services;
- Harmonising and consolidating legal systems.

The results of the first six months of the SIMPLEX Programme indicate that 84% of the measures have been implemented, taking into consideration the measures that were forecast for this time horizon. The remaining measures established at the outset will be implemented by the end of 2006.

The 2007 Simplex Programme will be published at the start of next year. It is already undergoing public consultation (www.ucma.gov.pt).

B. Curbing Social Security and Healthcare Expenditure

The following measures are considered in the Social Security field:

- Reform of Social Security;
- Social protection in the event of unemployment.

The main measures in the healthcare field refer to:

- Medicaments Policy;
- Review of Healthcare Services Procurement Agreements;
- Users' co-payments;
- Committee for the Sustainability of National Healthcare Service Funding.

B.1. Curbing the Growth of Social Security Expenditure

B.1.1. Reform of Social Security

The Government promoted in-depth debate on the reform of Social Security with the social partners and the different political forces all through 2006, seeking to achieve broad consensus in Portuguese society regarding the best reform strategy to deal with the challenges that the social security system faces in the coming decades.

The negotiations carried out through the Standing Council for Social Dialogue promoted an in-depth analysis of the proposed reform measures and their long-term economic and social implications, aiming the financial sustainability of the system and guaranteeing social equality and justice. The talks with social partners resulted in a tripartite agreement in October 2006, and the Government, as a result, immediately set in motion its transposition into legislation.

The structural reform of social security, currently underway, is set down in the draft Framework Law on Social Security (draft Law no. 101/X) broadly approved in November by Parliament. The new law, which shall come into force from January 2007, introduces automatic adjustment mechanisms into the system, which guarantee that it remains in equilibrium as well as providing an appropriate response to the challenges of an ageing population.

In brief, the reform underway is based on the development of the following measures, included in the Agreement on Social Security Reform:

The inclusion of a Sustainability Factor

The calculation of new pensions will include a new parameter, resulting from the ratio between life expectancy in 2006 and life expectancy in the year before the request to retire. This allows the pension of each beneficiary to be redistributed over a wider number of years, the aim of which is to neutralise the effect of ageing population on the system's equilibrium.

Faster transition to the new pension calculation formula

From 2007 onwards, pensions will be calculated based on the weighted analysis of the years of contributing career under the old calculation formula and those under the new formula. Thus, the calculation method approved in 2002 immediately comes into force. This method is deemed to be more just since it takes into account the entire contributory period and it provides better social protection to low-earning workers.

New updating rules

The indexation of social benefits to the Minimum Wage will end from 2007 onwards and social benefits will be tied to a new update rule that provides more sustainability and positively discriminates the update of lower value pensions, thereby ending with discretionarity.

Fostering active ageing

The legal framework on retirement age flexibility will be reviewed in order to promote active ageing, bringing it into line with the principle of actuarial and financial neutrality through the increase in the penalties applicable to early retirement and the inclusion of a mechanism providing financial bonus for those who stay in the labour force according to length of active service and age.

The inclusion of a ceiling in the calculation of pensions

A ceiling will exist to the portion of the pension resulting from the calculation based on the final contributory years, in order to limit the impact on the social security system of the concentration of contributions at the end of a contributor's working life.

The adequacy of the Social Security funding model

The scope of non-contributory expenditures funded by the State Budget, will be clarified through the broader application of the principle of selective adequacy.

The approval of a Contributory Code

The approval of the Code permits the expansion of the scope of the contributory base, with the end aim of convergence of the following components with tax base:

- Pre-established representation expenses;
- Compensation for the termination of an employment contract by mutual agreement, in regard to the amount exceeding the limits legally established for taxation purposes;
- The portion of daily allowances exceeding the legal thresholds or when the assumptions regarding their provision to civil servants are not complied with;
- Sums that the employer compulsorily or voluntarily invests in financial instruments to benefit employees, in particular insurance in the life segment, pension plans and retirement saving plans or any other supplementary social security schemes, when subject to early withdrawal, advance payment, redemption or any other form of making the corresponding sum(s) available prior to maturity or, regardless, receiving capital before retirement;
- Allowances for errors' payments attributed to those that handle money as part of their work, on the part that exceeds 5% of the monthly basic wage;
- Companies' performance related bonuses when the same is deemed to be stable, either due to how it is awarded or due to its regular and permanent nature, irrespective of variability in the amount.

Moreover, the systemization of the contributory legal framework in regard to social security will be performed, as well as the review of special contributory schemes, including those of self-employed workers, the aim of which is to rationalise current contribution rates and to approach contributory bases 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 salary declarations to Social Security, namely through the development of a new process for issuing notification regarding defaulting salary declarations, as established in the Social Security Framework Law which has been broadly approved;
- Strengthening data crosschecking procedures with the Tax Administration, in order to combat contributory evasion and false self-employed work in particular;
- Review of the Social Security administrative offences' regime;
- The development of a salary declarations' monitoring system and automatic and centralised notification in the event of default;
- The implementation of a new debt management model, and the automation of the law compliance process;
- The implementation of a new current account management computer system.

Supplementary scheme

Strengthening supplementary saving mechanisms, particularly through providing incentives to collective and individual supplementary savings' schemes, which, in relation to the latter, is made possible through the creation of a new optional public capitalisation scheme for individual accounts.

Convergence of Social Protection schemes

In the spirit of Law no. 60/2005, of 29 December, which establishes mechanisms for the convergence of the civil service's social protection scheme with the general social security scheme, the reform measures approved under the Agreement on Social Security Reform, in particular the sustainability factor, the pension updating rules, the incentives for those who stay in the labour market and the penalties for early retirement, will be applicable in a framework of convergence between the public and private social security schemes.

Other measures

New measures to adapt the protection provided by the system to new social situations, and to improve the effectiveness of the legal regimes in protecting disability, single parents and survival, in particular, will be developed during 2007. A further aim is to introduce a number of incentives promoting childbirth, in order to reduce the impact of the ageing population phenomenon on the social security system.

B.1.2. Social Protection in the Event of Unemployment

Decree-Law no. 220/2006, of 3 November, is one of the most significant measures in the area of social protection in the event of unemployment. This decree-law reinforces the role played by public employment services and provides measures for beneficiaries to re-enter the labour force, control the award of benefits, combat fraudulent activity through the review of the applicable penalty regime and increasing fines. The decree-law also improves the incentives for active ageing.

B.1.3. Measures to Curb the Growth in Social Security Expenditure that have already been Implemented or will be Implemented

As referred to above, the Government has proceeded with the implementation of the measures agreed to with the social partners in the abovementioned agreement, through a series of draft laws that have already been discussed in Parliament or are in the public consultation phase. There follows the measures that have already been passed or are in an advanced state of implementation:

Council of Ministers Resolution no. 141/2006, of 12 October

This resolution endorses the set of social security reform measures aimed at guaranteeing the system's sustainability, including approval of the Social Security Framework Law and the law creating the new Public Support Index and establishing pension updating rules, the appraisal of the new legislative system providing old age and disability protection. It further specifies that collective negotiation should be undertaken in regard to the convergence of public and private social protection schemes, and establishes deadlines for the approval of the Contributory Code in the ambit of which the special contribution schemes will be reviewed, the contributory base will be extended and the penalty system updated and systematically organised. It further establishes the deadline for the creation of the supplementary public system of individual accounts.

Draft Law for the Review of Social Protection legislation on the social security general scheme for old-age and disability situations, as approved in the Council of Ministers meeting of 12 October and already published in the Employment and Labour Bulletin and currently undergoing public consultation and discussion

Establishes the new beneficiary protection in the social security general scheme for disability and old-age situations, sets up a range of morality-based measures concerning pension ceilings in the calculation of large-value pensions, abiding by the "contributions made" principle. It reviews the rules for calculating disability and old-age pensions, including a sustainability factor from 2008 onwards, which is related to changes in average life expectancy, it brings forward the transition period established in Decree-Law no. 35/2002 for pension calculation, it introduces a ceiling for pensions calculated using the old formula and it adjusts the flexibility of the retirement age system to the principle of actuarial and financial neutrality, providing incentive for workers to remain in the labour force beyond retirement age.

Draft Law no. 101/X – establishes the framework of the Social Security System, broadly approved by Parliament

Approves the general framework of the social security system, establishing a new system concept and making the following alterations: the inclusion of a sustainability factor in pension calculations which adapts the pension system to changes in average life expectancy; the period of transition for the new formula on pensions' calculation, which takes into account the worker's entire contributory career, is accelerated, and the selective adequacy of the system's funding sources is performed in greater depth, clarifying the expenses covered by the national solidarity system; a new optional public capitalisation scheme is established, based on the creation of individual accounts.

Draft Law no. 102/X – establishes the Public Support Index and the pensions' update rule, broadly approved in Parliament

Creates the Public Support Index (IAS), which replaces the minimum wage as the benchmark for defining, calculating and updating public financial support, thereby continuously safeguarding the purchase power of beneficiaries with medium and low value benefits. It defines the updating rules for social security system pensions according to the known annual change in inflation and the average trend of the real GDP in the two preceding years. It specifies a ceiling for the update of pensions that are greater in value than 12 IAS, for reasons of morality and social justice.

Anti- fraud and evasion plan

This plan, which started in 2005, comprises goal-setting and annual targets definition which aim to combat contributory and benefit fraud and evasion, with the overall goal of improving the system's efficiency. The undergoing plan encompasses a considerable increase in contributor and beneficiary inspection, based on new inspection driving forces, optimisation in the use of the Social Security computer systems and other public administration services via systematic crosschecking.

The use of new working methods, which led to a significant improvement of the system, allowed an additional EUR 297m to be recovered in 2005. The target of EUR 350m for 2006 has already been exceeded.

Draft Decree-Law that performs the 3rd review of Decree-Law no. 124/84, passed in the 9 November meeting of the Council of Ministers

Increases the applicable penalties when newly admitted employees are not registered with the Social Security. This measure aims to reduce and discourage contributory and fiscal evasion.

Decree-Law no. 220/2006, of 3 November

Establishes legislation regulating social protection in the event of unemployment.

B.2. Financial Sustainability of the National Healthcare Service

A range of liaised policies to curb costs and to improve efficiency in the provision of healthcare have been implemented, with the aim of bolstering the medium-term financial sustainability of the National Health Service (NHS).

B.2.1. Medicaments Policy

The draft 2007 State Budget Law sets out a 6% reduction (compared to 2006) in NHS establishments' purchase price regarding the most widely consumed pharmaceutical products and clinical products. It further establishes the reduction in the public retail price of co-paid medicaments, including generic medicaments, which will be borne by the pharmaceutical industry, wholesalers and pharmacies, as occurred in the previous price and wholesale and retail sales margins reductions, as well as the co-payment rates reduction in all brackets, except for bracket A, which has already undergone a 5 p.p. reduction this year. Nevertheless, the percentage value of the accrued co-payment applicable to low-income pensioners remains unchanged.

Decree-Law no. 176/2006, of 30 August, establishes rules and procedures for the market launch of medicaments, tying them to a cost-benefit analysis.

Furthermore, legislation is being prepared to alter the way in which the price of medicaments is determined, which includes amongst the measures the conversion of a fixed prices system to a model based on price ceilings.

B.2.2. Review of Healthcare Services' Procurement Agreements

The analysis, review and possible amendment of procurement agreements entered into by the NHS are also sanctioned.

Thus, the draft 2007 State Budget Law establishes an upper ceiling for the overall expenditure of each area, using 2006 expenditure as a reference point. The price of each medical intervention is no longer fixed, but floats in terms inversely proportional to growth in activity. Expenditure would grow by a forecast 5% without this measure.

B.2.3. Users' Co-payments

Users' co-payments will be updated in 2007. These co-payments will be dynamically updated, on an anuall basis, and in line with inflation. Users' co-payments are extended to cover all medical areas, including outpatient surgery and hospital admission (article 139 of the draft 2007 State Budget Law). All current exemptions remain unchanged.

B.2.4. Commission for the Sustainability of National Healthcare Service Funding

The Commission for the Sustainability of National Healthcare Service Funding was created on 30 March by joint Order no. 296/2006, of the Minister of State and Finance and the Minister of Health. The goal of the commission is to evaluate the new international guidelines on public healthcare policies, to analyse the recent trend in NHS funding and to identify the way it is influenced by healthcare supply and demand>, to analyse the current NHS organisation and also to identify the critical aspects that would permit the control of production costs.

C. Budgetary Control and Institutional Solidarity of Regional and Local Authorities

The main measures in this area were:

- Reform of Autonomous Regions' Finance Law;
- Reform of Local Government Finance Law;
- Improving information reporting quality;
- Creation of the position of Financial Controller;
- Public-Private Partnerships' monitoring process;
- Increasing the Court of Auditors' supervisory powers.

C.1. Reform of Autonomous Regions Finance Law

The reform of the rules used to calculate the annual transfer to the Autonomous Regions from the State Budget is carried out in accordance with the draft law on the finances of the Autonomous Regions, passed in November by Parliament. Under this law, the annual sum included in the State Budget is indexed to the State's current expenditure rate of change, excluding the State's transfer to Social Security and contribution to *Caixa Geral de Aposentações*. It is established a ceiling for the rate of change equivalent to that of GDP at current market prices, which is a reference base that is more consistent with the principle of national solidarity. Thus, the intention is that the transfer to the Autonomous Regions, which is used to fund part of their expenditure, evolves, in principle, in line with the evolution of the State's corresponding current expenditure. The expenditure items that will still be fully borne by the State Budget and not by the Autonomous Regions were excluded, in order to maintain this equivalence. The established ceiling is activated when current expenditure is increasing as a % of GDP for transitory reasons, thereby preventing that a greater increase in the transfer value worsens that situation.

The division of the total annual transfer between the two Autonomous Regions is governed by principles of equality and, also, seeks to instil more efficient performance. Accordingly, the division is calculated taking into account the total population, the population of young and old people (which generate greater expenditure), the Region's periphery index and a tax collecting effort index. The objective of this last indicator is to reward the Autonomous Region that makes the greatest effort to collect its tax revenue. The aim of the periphery index, which is defined for each Autonomous Region by means of a weighted average of the shortest distance to Lisbon and the number of islands with a resident population, is to take into account the added costs that greater distances and territorial dispersal generate. It is significant that the surcharge used to calculate the transfer value to the Autonomous Regions in the first year in which the new law is in force, is used to cover the difference between the VAT revenue currently transferred to the Regions through the mechanism based on the VAT capitation and the sum that is forecast to be produced by the new scheme, that will come into force, of direct assignment of VAT revenue generated by each of the Regions.

The transfers of the Cohesion Fund are determined as a decreasing function of the ratio of the Region's per capita GDP at market prices and the national per capita GDP at market prices, in line with the end purpose of ensuring economic convergence with mainland Portugal. As a matter of fact, the continuation of the Cohesion Fund in a Region that has already attained the level of national GDP per capita is no longer justified, except in temporary situations. Moreover, the negative impact of the use of the new formula to carry out Cohesion Fund calculations is offset by a clause that safeguards the gradual introduction over time.

The levying of a penalty, which is already established in the Budgetary Framework Law, is confirmed in situations of infringement of the specified maximum levels of debt. This penalty encompasses a reduction in the State's transfer in the following year, equivalent to the Region's level of debt exceeding the ceiling. This subject of numerical budgetary rules is detailed in Chapter IV. The State is also prohibited from providing personal guarantees for the debt of the Autonomous Regions and is also prohibited to take responsibility for their debts.

C.2. Reform of Local Government Finance Law

The draft Local Government Finance Law, passed in November by Parliament, sets out a new local government financing system, which, besides re-defining the framework for local government involvement in

State tax revenues (included here is the fact that local governments can decide on the level of income tax supported by taxpayers in their municipality, which reinforces the principle of assigning responsibility for revenue management and introduces an element of tax competitiveness between local governments), guarantees that the assignment and transfer of duties to local government is escorted by sufficient financial resources to assure performance. In relation to the division of financial resources, positive discrimination has been established for the first time – those municipalities in which land use is limited for environmental or nature conservation reasons are favoured.

Limits to net municipal debt are defined according to the principles of budgetary rules and procedures described in more detail in Chapter IV. Adjustment mechanisms, which will be implemented by local governments whenever these debt ceilings are exceeded, have also been established. The new law also establishes, in addition to net debt ceilings, that each local government's medium and long-term loans may not exceed the total revenue, relative to the previous year, from municipal taxes, municipal financial equilibrium fund (FEF) share, income tax share, profit sharing in local companies and Municipal Surcharge, as at 31 December of each year.

Furthermore, the general principle that the State cannot take on the obligations that municipalities and parish councils have bound themselves to is established.

C.3. Improving Information Reporting Quality

It is also essential that reforms promoting the improvement of the quality and transparency of budgetary processes and institutions are implemented so as to guarantee that the budgetary consolidation process is long-lasting. The information reporting duties of the different sub-sectors of the Public Administration have been subject to ongoing improvement since the beginning of the mandate, under this process to promote information quality. The measures not only encompass improved requirements regarding the periodic publication of financial information, but also quality requirements concerning their content and presentation (see Box 4).

A recent reform regarding the quality of General Government financial data is the introduction of legal measures concerning discipline in the provision of said data. The 2006 State Budget Law and the draft 2007 State Budget Law specify that transfers may be withheld and the advance payment of any twelfth part of the total may be refused to autonomous bodies of Central Government, to Autonomous Regions or to Local Government, when the information stipulated in the Budget Implementation Law is not submitted to the Ministry of Finances by the respective accountable bodies in due time.

The Portuguese Government sought to strengthen Regional and Local Governments' information reporting duties in the wording of the draft finance laws for the Autonomous Regions and Local Government by introducing penalties for non-compliance with the provision of information, similar to those established in recent State Budget legislation, but with the difference that the legal validity will not just be confined to the year to which the budget refers. The referred draft laws also reflect a closer definition of the aggregates subject to control to that established on a national accounts basis underlying the European System of Integrated Economic Accounts (ESA95) used to draw up the General Government national accounts. In addition to this, the new Autonomous Regions' Finance Law specifies a term of 2 years for the adoption of the Portuguese Official Chart of Public Accounts and respective Autonomous Regions' Sectoral Plans.

Also of note in the field of information reporting quality is the loading of the Public Administration Human Resources' Database (BDAP), which allowed the Public Administration's human resources to be quantified and described, something that had not occurred since 1999. The loading of the data generated the following fundamental figures on the number of civil servants and agents, as at 31 December 2005:

Table I.3.2. Public Administration Human Resources' Database
(Number of civil servants and agents)

General Government	737.774
Central Government	568.384
Regional Government	38.740
Local Government	130.650

Source: Ministry of Finances.

Now that the database has been loaded, the systems' redesign will start in 2007, which will ensure the permanent update of the information on the Public Administration's human resources.

C.4. Creation of the Position of Financial Controller

The publication of Decree-Law no. 33/2006, of 17 February, created the ministry-level financial controller. The objective of the financial controller, which is a position similar to that existing in large private companies and according to the best practices of other public administrations, is to strengthen financial control in the areas of budgetary drafting, implementation and assessment. Thus, the objective is for the financial controller to intervene to guarantee that the principle of economy, efficiency and effectiveness relative to public spending is complied with, particularly in relation to specific expenses that encompass large values.

Twelve financial controllers were appointed during the first and second quarters of 2006. They were allocated duties in the fields of budgetary planning, budget implementation and the taking on of commitments, the provision of accounts, as well as reporting obligations, in the ministry in which they were appointed. The reference terms of their ambit are established in their respective mission charter.

The financial controllers' duties also involve the submittal of a monthly report to the Ministry of Finances indicating budgetary progress in the respective ministry, warning of possible situations that may lead to budgetary risk and providing suggestions on fostering quality in public spending.

The role of the financial controllers has been acknowledged as one that provides additional quality in and has made the difference to the process of budgetary monitoring and the quality assessment of public spending. The quality of the financial controllers' intervention has been improved by the synergy resulting from the sharing of information and experience within the controllers' network, which holds frequent meetings with senior management of the Ministry of Finance. The frequency of these meetings is increased during the periods when the State Budget is being drawn up and at decisive periods of budget implementation.

C.5. Public-Private Partnerships' Monitoring Process

The publication of Decree-Law no. 141/2006, of 27 July, implemented the reform of the legal framework of Public-Private Partnerships (PPP). The objective was to ensure greater rigour and increased assessment of the costs and benefits of decisions taken under PPP's, in order to provide value-for-money. A further objective was the respective tying in with budgetary framework standards.

The new legislative act aims to correct shortcomings or frailties in the original legislation, such as the absence of mechanisms for private sector partners to share financial gains with the State, the fact that supplementary income resulting from the partnership is not taken into consideration in the baseline case (this income was claimed as hidden revenue of the private sector partner), the excessive use of outside consultants — not always with the necessary transparency or desired value for the State — or the inadequacy or low level of competition occurring in call for tender procedures.

The law, on the other hand, sets out a range of innovations that bolster the cohesion and liaison between the ministries co-involved in PPP's, as well as improve a number of arrangements in order to increase the financial control of new partnerships' implementation, amendments to partnership contracts already entered into or in other situations likely to generate increased costs for the public partner or for the State.

C.6. Increasing the Court of Auditors' Supervisory Powers

The new Court of Auditors Process and Organisational Law which resulted from the amendments set out in Law no. 48/2006, of 29 August, increases the Court of Auditors' powers of preliminary supervision and concomitant supervision, making it more active and effective in upholding the common good and in controlling the good use of public funds.

The Court of Auditors' scope of preliminary supervision is accordingly extended to new entities that, prior to the Law no. 48/2006, were outside of the Court's jurisdiction. Conversely, the so-called 'supplementary contracts' are exempted from this control and the deadline for sending processes to the Court of Auditors requiring preliminary supervision is reduced, thereby ensuring faster decisions in regard to these processes. Likewise, concomitant supervision is strengthened through the specification that the performance of the contracts that underwent preliminary supervision is audited.

The Court of Auditors' jurisdiction is extended to cover those managing and using public funds, regardless of the entity to which they belong, and including financial accountability encompassing penalties or the return of the funds. The Court of Auditors' powers are thus extended to include all situations in which bad management or the improper use of public funds can occur.

The supply of the lawful right to lodge financial accountability suits in the Court of Auditors is another area of reform. Previously, the Public Prosecution Service was exclusively invested with this right, but this law provides for the extension of said empowerment to entities with the institutional profile to lodge such petitions. Thus, internal control bodies are empowered to lodge petitions, though on a lesser scale, given that the exercise of the right depends on the Public Prosecution Service deciding not to judicially proceed.

D. Tax System

In line with the main action areas that have been identified and declared a priority in the December 2005 SGP update, tax policy for 2007 will focus on the following areas of intervention:

- Bolstering the fight against tax fraud and evasion;
- Simplification and reduction of the tax system's compliance and red tape and other contextual costs;
- Increasing the Tax Administration's effectiveness and efficiency;
- Improving the equality of the tax system; and,
- Reforming the Tax Benefits Code (EBF).

D.1. Bolstering the Fight Against Tax Fraud and Evasion

The fight against tax fraud and evasion, which has been systematically specified as a priority of the Government, is a field of action that will encompass operational and legislative measures.

The objective of the operational measures will be to improve tax inspection performance. Of note in this context is the fact that 2007 will be a year in which the potential created during 2006 will be optimised. This potential created during 2006 comprises the implementation of varied and significant measures in this field, as established in the December 2005 SGP, one of the most significant of which is the increase in resources available for tax inspection (an additional 400 personnel). It will accordingly be possible to focus the Government's forthcoming initiatives in this area, on aspects related to:

- The improved segmentation of the most significant taxpayers, namely through the use of appropriate risk analysis tools;
- Focus on taxpayers operating outside the system and who regularly form part of the underground economy;
- The development of computer assisted auditing techniques.

In relation to the operational measures aimed at tackling tax fraud and evasion, a number of measures will continue to be implemented and others, of a more innovative nature, will be introduced, with the joint aim of providing greater awareness of the risk of non-compliance and the associated costs. Accordingly, the following deserve particular mention:

- The publishing of a tax debtors' list – in July 2006 the first lists of the corporate and individual taxpayers that are the main tax debtors were published. The procedure will be implemented in greater depth in 2007 through the adoption of broader criteria that allow more defaulting taxpayers to be included.
- The optimisation of automatic control activities, which, based on information crosschecking, will not only allow non-compliance to the detected but also permit the penalisation of the same;
- The exchange of information with Tax Administrations of other States;
- Closer and more intensive collaboration with other national entities with inspection mandates, such as the Portuguese criminal investigation police (PJ), supervisory brigades (BF), the Labour General Inspectorate, the Border and Aliens' Service (SEF), Social Security, the Directorate-General for Customs and Excise Duties on Consumption (DGAIEC), besides others;
- The increase in the number of inspectors working to tackle tax fraud and evasion;
- Thorough control of VAT, particularly in relation to reimbursements and deduction percentages in regard to mixed taxpayers;
- The control of false invoicing.

The most significant legislative measures to be introduced in the tackling of tax fraud and evasion are:

- The acceleration of assessment procedures for taxpayers who do not submit the income tax returns to the tax administration;
- The creation of a set of accessory duties aimed at implanting a data crosschecking system, in order to prevent the fraudulent use of patronage-related tax relief;
- Retailers and service providers exempt from invoicing are now also obliged to issue receipts when selling goods or services to non-taxable persons that request the issue of a receipt;
- Banking secrecy may be lifted in an administrative complaint procedure.

D.2. Simplification and Reduction of the Tax System's Compliance and Administrative Burden

An additional main objective of the Government's intervention in the Tax Administration field will be to reinforce the competitiveness of the national economy through the simplification of the Portuguese tax system and the reduction of red tape and other contextual costs. The reduction of red tape reflects the initiative to remove obstacles, obstructions or unreasonable delays in the procedures regarding projects, processes or acts under the Public Administration's responsibility. Accordingly, the aim is for the Public Administration to adopt good practices.

The measures to be adopted in this field will be primarily directed towards all taxpayers, in certain circumstances (measures that are general in nature), and towards specific groups of taxpayers / users in other circumstances (namely investors, Internet users or users of Tax Administration offices).

The following are some examples of the general measures, benefiting taxpayers in general:

- Reassessment of the tax reporting process;
- Reduction to the response time to a range of specific petitions submitted by taxpayers;
- The development of the taxpayer current account;
- Investment in the field of tax education.

The most significant of the measures to simplify and reduce red tape and other contextual costs, that are more specific in nature are as follows:

- In relation to investors: the conclusion of the overhaul of the service levels of the International Relations area, meaning greater speed in appraising and deciding on tax reimbursements, in the issue of tax residency certificates and in facilitating access to the benefits provided by agreements to avoid double taxation;
- In regards to taxpayer Internet users: the partial filling in of Form no. 3 of the personal income tax return, the continuation of the process of promoting the use of the Internet (which should move towards being the main channel for interaction between the taxpayer and the Tax Administration) as well as the broadening and diversification of access to the Internet channel, through the creation of Internet posts in the most significant Tax Administration offices providing taxpayer assistance.

D.3. Increasing the Tax Administration's effectiveness and efficiency

The Government will also implement both operational and legislative measures in this area.

The operational measures will essentially focus on:

- Streamlining and restructuring Tax Administration processes and procedures;
- Heavy investment in the computerisation of processes, with the inclusion of diverse and new automation mechanisms and the enrichment of databases for the purposes of automatic crosschecking of information;
- crosschecking of information to detect inactive taxpayers;
- The computerisation of procedures related to the New Urban Property Renting Legislation (NRAU).

The most significant legislative amendments, aimed at improving Tax Administration effectiveness and efficiency, are as follows:

- The gradual computerised entry of administrative procedures and tax enforcement processes through amendments to General Tax Code (LGT) and the Tax Procedure and Process Code (CPPT), already started in 2006, which comprise, in particular, the inclusion of the possibility of carrying out a significant number of acts via electronic means;
- The elimination of non-essential formalities in the conduct of administrative procedures and processes, so as to promote greater use of electronic pathways.

D.4. Improving the Equality of the Tax System

The significant developments in the improvement of the tax system's equality include those in the area of tax justice and a set of legislative measures, the most noteworthy of which are the measures concerning tax relief for disabled taxpayers.

In relation to tax justice, 2007 will be the year in which the Tax Justice modernisation process will be consolidated and concluded, exactly as established in the Strategic Plan for Tax Effectiveness and Justice, which was approved and initiated in mid-2005. The following deserve particular mention in the field:

- Increased monitoring and control of the largest tax debtors;
- Reduction of the average time taken to institute tax enforcement proceedings, to notify tax debtors, and, in practice, all the other enforcement acts set out in legislation;
- Focus of collection efforts on the oldest processes and, therefore, with the greatest risk of non-collection;
- Increase the sale of seized property;
- Strengthening and promoting automatic debt compensation mechanisms with tax credits.

The following legislative measures, which aim to improve the equality of the tax system and, in particular, equality for disabled taxable persons, are the most significant:

- The creation of a tax deduction equivalent to 3 times the minimum monthly wage for each taxable person and a minimum monthly wage for each disabled dependent ancestor or descendent, which is augmented by an earned income allowance of 30% on education or rehabilitation expenditures and 25% of expenditure on life insurance premiums;

- The broadening of the scope of the goods on which the reduced VAT rate (5%) is applicable, in order to reduce the cost of purchasing utensils, apparatus or objects for the specific use of disabled persons.

D.5. Reforming the Tax Benefits Code

The Government's commitment to carry out an assessment of the entire tax concession system, as specified in the Government's Programme, is implemented in 2007 through the inclusion of some of the recommendations of the Committee to Reassess Tax Concessions in the 2007 State Budget. These include:

- Reformulating and strengthening the general rule regarding the statute expiration date of tax benefits;
- The creation of a Classifier of all tax benefits in force;
- Adapting the current tax benefits regime.

I.3.3. Summary of the Direct Impact of the Main Budgetary Consolidation Measures

The forecast direct impact of the main budgetary consolidation measures on General Government accounts, based on increased current revenue and the reduction of current primary expenditure, is described in Table I.3.3.

The impact is quantified for each year, by comparison with the situation where no budgetary consolidation has occurred since the end of 2006. In this hypothetical situation without implemented measures, the general situation is one where each item's share of GDP remains unchanged, except for the items in which structural increases in share of GDP are expected – Social Transfers and Personnel Expenditure, in particular.

The improvement of the information available for the measures that have already been implemented or are undergoing implementation, in comparison with the December 2005 update of the SGP, now allows the breakdown of the impact of the savings on Personnel Expenditure and the Gains in Efficiency expected from the reform of the Public Administration.

The savings under Personnel Expenditure result from (i) the reduction of administrative structures under PRACE; (ii) the increased control on contracting new civil servants, through the application of the rule that on average one civil servant is contracted for every two that leave; (iii) restraint in the update of the salary table; e (iv) the extension of frozen career progression and wage top-ups to 2007, until the civil servants' pay, career and employment affiliation system is complete.

Efficiency Gains concentrate the savings made to intermediate consumption resulting from (i) operations to close down, merge and restructure services under PRACE; (ii) investment in shared services' provision, also under the ambit of PRACE; and (iii) the streamlining of public service networks.

The estimated saving on expenditure with *Caixa Geral de Aposentações* (CGA) is the result of the addition of the impact resulting from measures planned in 2005 (no new registrations of civil servants in CGA, increasing contributions from public entities with financial and administrative autonomy with employees covered by the civil servants' social protection pensions scheme, the gradual increase in retirement age from 60 to 65 years of age, the reform of the formula used to calculate the retirement pensions of civil servants that started working for the civil service before 1993) and the measures planned in 2006 (the reform of the civil servants' general social protection scheme, which will include the Agreement on Social Security Reform between the Government and social partners).

The impact on the revenue side is the result of the update of the values contained in the December 2005 update of the SGP, for the following reasons:

- Income tax of private individuals – the correction of the forecast revenue increase due to adjustments to converge the specific income allowances of category H with category A, and increased effectiveness in combating tax evasion and fraud and increased efficiency as a result of the recruitment of new tax inspectors;
- VAT– added revenue for the 2008-2010 period, as a result of the expected return of the component concerning the combat of tax evasion and fraud and increased efficiency as a result of the increase in human resources tasked with inspection;
- Taxes on oil products (ISP) – the correction of the forecast revenue increase in order to take into account the additional fiscal expenditure due to the partial exemption granted to biofuels; since the measure to increase the ISP tax by 2.5 cents/litre ends in 2008, the impact of this alteration is reduced revenue increase in 2009 relative to 2008, and in 2010 relative to 2009;
- Tax on tobacco products – the early implementation of measures that occurred in 2005 generated increased revenue in 2006, in comparison with the revenue forecast in the December 2005 update of the SGP, which is mirrored in the decline in forecast revenue increase for subsequent years.

Table I.3.3 also includes, besides the impact of the abovementioned measures, the estimate of the reduction in the General Government's expenditure regarding payments to motorway concessionaries, resulting from the planned installation of tolls on three of the currently cost-free motorways for users (SCUT) – SCUT Costa da Prata motorway, SCUT Grande Porto motorway and SCUT Norte Litoral motorway – in the second half of 2007.

Table I.3.3. Direct Impact Attributable to the Main Budgetary Consolidation Measures on General Government Current Revenue and Current Primary Expenditure (a)

(2006 prices)

		2007	2008	2009	2010
REVENUE INCREASE					
Taxes (D)	Million euro	495	865	920	845
	% of GDP	0,32	0,54	0,56	0,50
Taxes on income and wealth	Million euro	260	375	400	400
	% of GDP	0,17	0,24	0,24	0,24
VAT	Million euro	0	20	20	20
	% of GDP	0,00	0,01	0,01	0,01
ISP - Tax on oil products (beyond the annual increase to compensate for inflatio	Million euro	140	275	205	130
	% of GDP	0,09	0,17	0,12	0,08
Tax on tobacco products	Million euro	95	195	295	295
	% of GDP	0,06	0,12	0,18	0,17
Social Security Contributions (B.1)	Million euro	120	190	220	230
	% of GDP	0,08	0,12	0,13	0,14
Diversification of Funding Sources	Million euro	60	65	70	70
	% of GDP	0,04	0,04	0,04	0,04
Combat of Contributory Fraud and Evasion	Million euro	60	125	150	160
	% of GDP	0,04	0,08	0,09	0,09
Contributions to Healthcare sub-systems (ADSE) (A.10)	Million euro	100	110	110	120
	% of GDP	0,06	0,07	0,07	0,07
		2007	**2008**	**2009**	**2010**
EXPENDITURE REDUCTION					
Reestructuring Central Government, Human Resources and Public Services (A)	Million euro	1.360	1.710	2.040	2.340
	% of GDP	0,87	1,07	1,24	1,39
Personnel Expenditure	Million euro	950	1.150	1.340	1.510
	% of GDP	0,61	0,72	0,82	0,89
Efficiency Gains	Million euro	410	560	700	830
	% of GDP	0,26	0,35	0,43	0,49
Curbing Social Security Expenditure (B.1)	Million euro	325	810	1.130	1.305
	% of GDP	0,21	0,51	0,69	0,77
General Social Security Scheme	Million euro	70	180	350	405
	% of GDP	0,04	0,11	0,21	0,24
Improving the Efficiency and Combating Fraud of the Social Security System	Million euro	20	25	25	25
	% of GDP	0,01	0,02	0,02	0,01
Caixa Geral de Aposentações (CGA) - measures planned in 2005	Million euro	230	570	720	840
	% of GDP	0,15	0,36	0,44	0,50
CGA - incorporation of the principles of Social Security reform	Million euro	5	35	35	35
	% of GDP	0,00	0,02	0,02	0,02
Curbing Healthcare Expenditure (B.2)	Million euro	170	170	170	170
	% of GDP	0,11	0,11	0,10	0,10
Medicaments co-payment policy	Million euro	115	115	115	115
	% of GDP	0,07	0,07	0,07	0,07
Procurement Agreements	Million euro	30	30	30	30
	% of GDP	0,02	0,02	0,02	0,02
Purchase of pharmaceutical products and clinical material (NHS)	Million euro	25	25	25	25
	% of GDP	0,02	0,02	0,02	0,01
Revenue from the installation of tolls on SCUT motorways	Million euro	25	110	120	125
	% of GDP	0,02	0,07	0,07	0,07
TOTAL DIRECT SAVING (attributable to these measures)	**Million euro**	**2.591**	**3.957**	**4.711**	**5.133**
TOTAL DIRECT SAVING (attributable to these measures)	**% of GDP**	**1,67**	**2,48**	**2,87**	**3,04**
Of which: attributable to revenue increase	Million euro	710	1.160	1.250	1.190
	% of GDP	0,46	0,73	0,76	0,70
Of which: attributable to expenditure reduction	Million euro	1.880	2.800	3.460	3.940
	% of GDP	1,21	1,76	2,11	2,33

Source: Ministry of Finance.

(a) Forecast direct impact in each year, by comparison with the situation where no budgetary consolidation has occurred since the end of 2006.

I.3.4. Summary of the Budgetary Implications of PNACE Measures

Table I.3.4 indicates the expected direct budgetary implications of the seven intervention policies of PNACE, using the information contained in the first PNACE progress report as a reference. It was decided, taking into consideration the time horizon of PNACE, 2005/2008, that the 2008 values for the Microeconomic and Employment policies would be maintained, in general[4], for 2009 and 2010, and the data on expenditure savings contained in Table I.3.3 above would be used for the Macroeconomic policies.

Table I.3.4. Budgetary Implications of the Policies under PNACE (a)
(% of GDP)

	2006	2007	2008	2009	2010
Macroeconomic Policies	**-0.3**	**-1.2**	**-1.8**	**-2.1**	**-2.3**
Economic Growth and Sustainability of Public Finances	-0.4	-1.2	-1.8	-2.1	-2.3
Governance and Public Administration (b)	0.1	0.0	0.0	0.0	0.0
Microeconomic Policies	**0.2**	**0.6**	**0.6**	**0.6**	**0.8**
Competitiveness and Entrepreneurship	0.1	0.1	0.1		
Research, Development and Innovation	0.1	0.2	0.2		
Territorial Cohesion and Environmental Sustainability	0.0	0.3	0.3		
Efficiency of the Markets	0.0	0.0	0.0		
Employment Policies	**0.2**	**0.4**	**0.4**	**0.4**	**0.4**
Qualification, Employment and Social Cohesion	0.2	0.4	0.4		
Total	**0.1**	**-0.2**	**-0.8**	**-1.1**	**-1.1**

Source: Ministry of Finance.

(a) Direct budgetary implications forecast per year, by comparison with the situation where no measures have been taken.

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

N.B.

- The figures associated to the measures eligible for EU funding are duly adjusted (i. e. EU subsidies were deducted), based on the assumption of a 50% subsidy rate;

- The figures in this table were, evidently, included in the budgetary forecasts for 2006-2010 (Section II.3., below and Table 2, in the Appendix).

The table shows that a large amount of the resources assigned to the implementation of PNACE are focused on the Qualification, Employment and Social Cohesion policy. A significant element of this policy, due to its financial dimension, is the New Opportunities Initiative. This initiative aims to contribute to reducing the gap separating Portugal from the most developed countries relative to the basic qualification of the general public, through the generalisation of secondary education, turning it into the minimum level of qualification for the Portuguese. Two main approaches were considered in this context: to avoid, on one hand, failure at school and school drop-out, and on the other to win back the active adult population with little schooling. This measure, which is a joint initiative of the Ministry of Labour and Social Solidarity and the Ministry of Education, highlights, once again, the transversal nature of PNACE and the liaison existing in regard to its design and implementation.

[4] The exceptions are the New Lisbon Airport and the High-Speed Rail Link construction, which are considered in the budgetary implications for 2009 and 2010.

It is also essential to underline the fact that the implementation of many of PNACE measures consist of legislative and administrative initiatives, which explains why the Efficiency of the Markets policy – which includes the adoption of measures to promote market liberalisation, diminish competitiveness obstacles and implement regulatory policies – is not significant in financial terms. This is the case in regard to the drafting of the basic laws for the electricity, natural gas and oil sectors (Decree-Law nos. 29/2006, 30/2006 and 31/2006, of 15 February, respectively).

Chapter

2

II. MACROECONOMIC AND BUDGETARY FORECASTS, 2006-2010

II.1. Assumptions

The macroeconomic scenario underlying this update of the SGP, detailed in Table II.1.1, is based on, for the period from 2006 to 2008, the assumptions underlying the construction of the European Commission's 2006 Autumn Forecasts. It was decided that the forecast interest and exchange rate values would remain broadly unchanged in the final two years of the forecast's time horizon, thus remaining the same as the 2008 values and, in relation to relevant foreign demand to the Portuguese economy, the values would reflect a scenario of growth slowdown. The values ascribed to the price of oil in 2009 e 2010 also reflect the prudent expectation of gradual decline.

This SGP update is further based on a group of specific assumptions regarding the Portuguese economy, some of the most significant of which include the measures and reforms with budgetary impact, some that have already been implemented and others that have been established in this Programme. It is expected that these measures will further strengthen the confidence of economic agents and the Portuguese economy's medium and long-term growth potential.

Table II.1.1. International Environment – Main Assumptions

	2005	2006 (e)	2007 (f)	2008 (f)	2009 (f)	2010 (f)
Relevant foreign demand growth (%)	6.5	9.7	6.8	6.5	6.0	6.0
Oil price (Brent, USD/barrel)	54.4	65.6	66.3	68.0	63.0	60.0
Nominal effective exchange rate for Portugal (a)	-0.2	0.2	0.3	0.1	0.0	0.0
USD/EUR exchange rate (annual average)	1.24	1.25	1.27	1.27	1.27	1.27
Short-term interest rate (annual average, %) (b)	2.2	3.1	3.7	3.6	3.6	3.6
Long-term interest rate (annual average, %) (c)	3.4	3.9	4.2	4.4	4.3	4.3

Sources: European Commission, Economic Forecasts Autumn 2006 and Ministry of Finance. (e) estimate; (f) forecast.
(a) Annual rate of change, as % (positive/negative change means appreciation/depreciation of euro)
(b) 3-month Euribor rate.
(c) 10-year Treasury bonds.

II.2. Macroeconomic Forecasts

It is expected, as forecast in the December 2005 update, that the Portuguese economy will undergo gradual recovery over the Programme's time horizon. GDP is forecast to grow by 3% in 2009 and 2010.

Table II.2.1. Main Macroeconomic Indicators – 2005-2010

	2005	2006 (e)	2007 (f)	2008 (f)	2009 (f)	2010 (f)
GDP (*real growth rates, %)*	**0.4**	**1.4**	**1.8**	**2.4**	**3.0**	**3.0**
Private consumption	2.0	1.0	1.3	2.0	2.3	2.4
Public consumption	1.8	-0.2	-1.3	-1.5	-1.2	-1.1
Investment (GFCF)	-2.9	-2.6	1.9	4.0	6.8	7.0
Exports of goods and services	0.9	8.6	7.2	6.8	7.0	7.2
Imports of goods and services	1.8	2.8	3.7	4.3	5.4	6.1
Unemployment rate (%)	7.6	7.6	7.5	7.2	6.6	6.3
Total employment (growth rate, %)	0.0	0.9	1.0	1.2	1.5	1.5
Inflation rate (%) (a)	2.3	2.9	2.1	2.1	2.1	2.1
Output gap (%) (b)	-2.6	-2.7	-2.4	-1.8	-0.5	0.4

Sources: INE and Ministry of Finance. (e) estimate; (f) forecast.
(a) Consumer Price Index average annual change; (b) (actual output/potential output-1) x100.

Exports should continue to show increased buoyancy in terms of overall demand, though it is forecast that a slight slowdown occurs in this area until 2008, as a result of the forecast slowdown in foreign markets growth. Domestic demand, on the other hand, is expected to undergo moderate expansion, aided by the acceleration of GFCF during the upwards phase of the business cycle. This moderate expansion is in line with the continued pursuit of a gradual reduction in the Portuguese economy's macroeconomic imbalances, particularly in the budgetary and external areas.

It is forecast that public consumption diminish by 1,3% and 1,5% in 2007 and 2008 respectively, essentially due to the different budgetary consolidation measures targeting expenditure that have been implemented and which will start to fully take effect from 2007 onwards.

Moreover, it is expected that the improvement of the balance on goods and services continues to contribute to the reduction of the Portuguese economy's net borrowing. However, a slowdown in the pace of that improvement is forecast, due to the upturn in imports over the forecast horizon, which will be associated to increased domestic demand. The balance on goods and services' contribution to reducing borrowing is still partially cancelled by the prudent assumptions adopted in relation to external transfers (current and capital) and by the forecast deterioration in the income account (Table II.2.2).

Table II.2.2. Current and Capital Accounts – Main Components
(Balances as a percentage of GDP)

	2005	2006 (e)	2007 (f)	2008 (f)	2009 (f)	2010 (f)
Current and capital accounts	**-7,9**	**-7,5**	**-7,3**	**-6,9**	**-6,3**	**-6,0**
Current account	-9,5	-9,3	-9,1	-8,4	-7,6	-7,3
Goods and services	-8,9	-8,0	-7,0	-6,0	-5,1	-4,6
Incomes	-1,7	-2,4	-3,1	-3,3	-3,4	-3,5
Current transfers	1,0	1,1	1,0	0,9	0,9	0,8
Capital account	1,6	1,8	1,7	1,5	1,3	1,2

Sources: INE and Ministry of Finance. (e) estimate; (f) forecast.

The forecast economic growth will make a reduction in the unemployment rate possible, which will occur until 2010, when it should reach an annual average of approximately 6,3%. Employment and productivity are forecast to accompany economic growth, in roughly equal degrees.

As a consequence of INE's correction to the method for calculating the Consumer Price Index (CPI)/ Harmonised Index of Consumer Prices (HICP) in October this year, the estimated inflation rate for 2006 underwent a 0.4 p.p. adjustment, to 2,9%. Given that this correction altered in a lasting manner the level but not the rate of change of the index[5], it is not expected to have any repercussion on the average change of the CPI in 2007 and subsequent years. Therefore, the inflation rate forecast for 2007 (2,1%) remains unchanged, and inflation should remain stable up to 2010. This scenario is based on a context of wage restraint and absence of pressures on productive capacity (the output gap will only start to move into positive terrain in 2010).

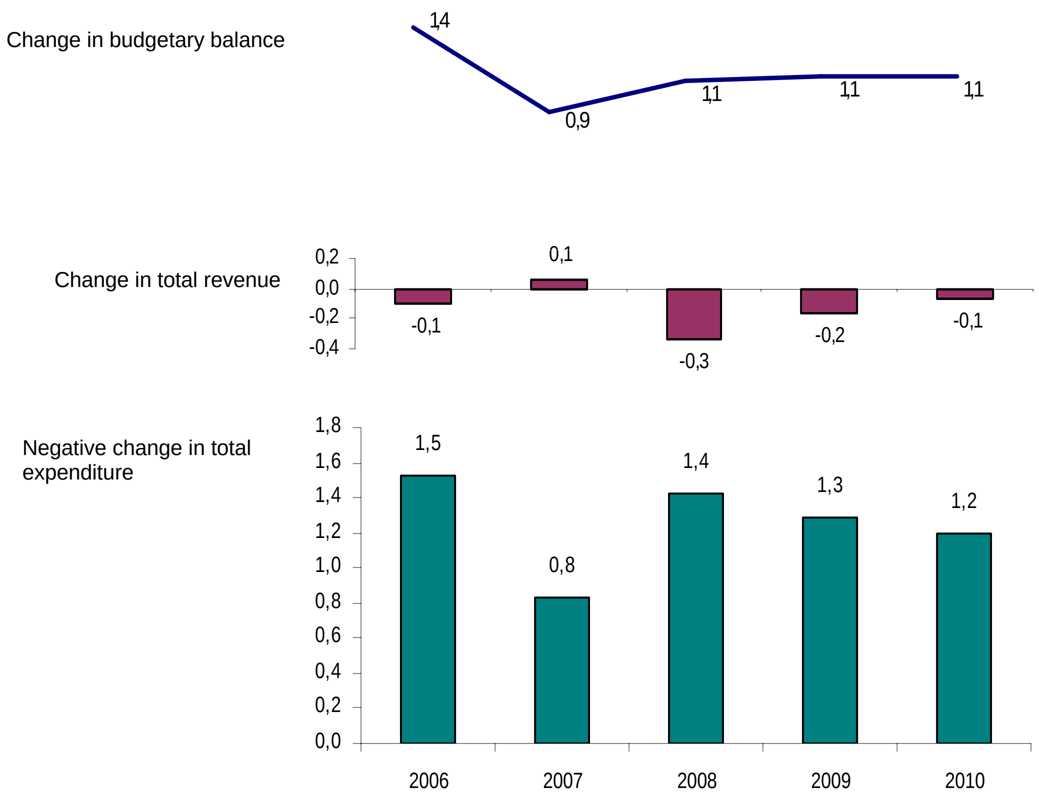
It should also be noted, besides the assumptions defined above, that the outlined macroeconomic scenario is likewise based on cost and profit margin containment assumptions, which are essential in creating the forecast trends for inflation, unemployment, exports and GDP.

II.3. Budgetary Forecasts

Budgetary consolidation in 2006, which was essentially borne by measures to reduce primary expenditure, required very significant endeavour. Consolidation will remain focused on reducing expenditure in following years, with reductions generally exceeding 1 p.p. of GDP. Table 2 in the Appendix shows that all components of primary expenditure reduce their percentage of GDP, which primarily reflects not only the full impact of PRACE, but also, in relation to social benefits, the gradual increase of restraint brought about by the reforms to the (general and civil service) Social Security schemes.

[5] The correction implies in a clearer manner that the pass-through of the increase to the standard VAT rate that took place in 2005 will have been essentially concentrated in the first half of 2006, and so, based on current information, there is no reason to expect this impact to extend to 2007.

Chart II.3.1. Breakdown of the Change in Overall Balance
(as p.p. of GDP)



Source: Ministry of Finance.

The consolidation process, in regard to the association between budgetary policy and business cycle developments, will occur in a context of accelerated economic growth from 2008 onwards, with effective output growing faster than potential output (which will also undergo significant increases - estimated to reach 2% per year by 2010), thereby allowing the output gap to close by 2010.

Also of note is the goal to achieve the Medium-Term Objective (MTO in Stability and Growth Pact nomenclature) for the structural budgetary balance, -0,5% of GDP (Table 4 of the Appendix)[6] in 2010. In order for this to be achieved, the pace of the savings in expenditure made possible by the structural reforms implemented in the meantime must be upheld in 2010, instead of opting for a return to an expansionary fiscal policy during the upwards phase of the business cycle, which would place the hard-won consolidation gains in the public accounts at risk.

Table II.3.1 indicates compliance with the Council's September 2005 recommendations under the Excessive Deficit Procedure in regard to the pace of correction to the structural deficit. In fact, up to 2008 – which is when Portugal once again complies with the maximum public deficit limit established in the Treaty

[6] Pursuant to the Pact, the aim of the MTO is (i) provide a safety margin with respect to the 3% of GDP government deficit ratio; (ii) ensure rapid progress towards the sustainability of public finances, by maintaining prudent levels of public debt; and (iii) allowing room for budgetary manoeuvre regarding the needs for public investment. The MTO of -0,5% of GDP was established by the Portuguese Government in the December 2005 update of the SGP, in accordance with these objectives.

– the structural balance will improve by more than 3 p.p. (1.5 p.p. in 2006 and 0.8 p.p. in each of the two subsequent years).

Table II.3.1. Structural Budgetary Balances
(% of GDP)

	2006	2007	2008	2009	2010
Structural overall balance	-3.4	-2.6	-1.8	-1.3	-0.5
Structural primary balance	-0.5	0.4	1.2	1.7	2.3

Source: Ministry of Finance.
N.B. The structural balance is by definition cyclically-adjusted and excludes any one-off or temporary measures.

Table II.3.2. Change in Structural Budgetary Balances
(Change in p.p. of GDP)

	2006	2007	2008	2009	2010
Structural overall balance	1.5	0.8	0.8	0.5	0.7
Structural primary balance	1.7	0.9	0.8	0.5	0.6

Source: Ministry of Finance.

As regards public debt (see Table 3 in the Appendix, and Table II.3.3), it is forecast to follow a sustained downward trend from 2007, reaching 62,2% of GDP in 2010, which is very close to the reference value established in the Treaty - 60% of GDP.

Table II.3.3. Change in Public Debt
(p.p. of GDP)

	2006	2007	2008	2009	2010
Gross public debt (% of GDP)	67.4	68.0	67.3	65.2	62.2
Change in p.p. of GDP	3.4	0.6	-0.7	-2.1	-3.0
Snow-ball effect	0.5	0.0	-0.3	-0.7	-0.7
Primary balance	1.8	0.7	-0.4	-1.5	-2.5
Others	1.1	-0.1	0.0	0.1	0.2

Source: Ministry of Finance.

II.4. Sensitivity Analysis to Different Macroeconomic Scenarios

This section describes the sensitivity of the main macroeconomic variables to different interest rate and oil price profiles.

The price of oil has shown itself to be very volatile and it constitutes one of the main sources of uncertainty of the foreign economic climate. The balance of risks regarding developments in this variable is fairly balanced, and it is plausible to project upward and downward revisions that are greater than those of the baseline scenario. Thus, alternative scenarios were taken into consideration, in which the price of oil rises or falls 20% against the baseline scenario, with the consequent repercussions on foreign demand and foreign inflation: for example, a scenario of more expensive oil is also a scenario of lower foreign demand relevant to the Portuguese economy.

The generated forecasts are summarised in Table II.4.1. In unfavourable circumstances (more expensive oil and lower foreign demand) there is a moderate rise in the rate of inflation, which is concentrated in the first year (2007), and a weak contractionary impact on output and employment. Increases in foreign deficit reflect above all the decline in terms of trade. Slower growth causes a slower improvement of the budgetary deficit. In favourable circumstances (cheaper oil and higher foreign demand), the forecast result is virtually symmetrical to the previous situation, as would be expected.

Table II.4.1. Sensitivity to Oil Price and Foreign Demand

	2007	2008	2009	2010
Oil more expensive[cheaper] and lower [higher] foreign demand				
GDP (real growth rate, %)	1,6 [2,1]	2,2 [2,6]	2,8 [3,1]	2,8 [3,1]
Private consumption deflator (annual growth, %)	2,7 [1,8]	2,2 [2,2]	2,1 [2,2]	2,1 [2,2]
Unemployment rate (%)	7,5 [7,4]	7,3 [7,0]	6,8 [6,3]	6,5 [6,0]
Current and capital accounts' balance (% of GDP)	-8,3 [-6,4]	-8,3 [-5,6]	-8,0 [-5,0]	-7,7 [-4,6]
General Government net lending (% of GDP)	-3,9 [-3,5]	-2,9 [-2,3]	-1,8 [-1,1]	-0,8 [-0,1]
Gross public debt (% of GDP)	68,2 [67,8]	68,4 [66,0]	66,8 [63,5]	64,1 [60,1]
Differences relative to the baseline scenario				
GDP (real growth rate, %)	-0,2 [0,2]	-0,2 [0,2]	-0,1 [0,2]	-0,1 [0,1]
Private consumption deflator (annual growth, %)	0,5 [-0,5]	0,0 [0,0]	0,0 [0,0]	0,0 [0,0]
Unemployment rate (%)	0,1 [-0,1]	0,2 [-0,2]	0,2 [-0,2]	0,3 [-0,3]
Current and capital accounts' balance (% of GDP)	-1,0 [1,0]	-1,3 [1,4]	-1,5 [1,5]	-1,5 [1,5]
General Government net lending (% of GDP)	-0,2 [0,2]	-0,3 [0,3]	-0,4 [0,4]	-0,4 [0,4]
Gross public debt (% of GDP)	0,2 [-0,2]	1,2 [-1,2]	1,6 [-1,6]	2,0 [-2,0]

Source: Ministry of Finance.

N.B. 20% increase [decrease] in the oil price relative to the baseline scenario, with repercussion on foreign prices and foreign income.

In relation to interest rates, short and long-term rates 1 p.p. above the baseline scenario for all years (2007 to 2010) were considered. In a more optimistic scenario, no rise in interest rates in the Euro area was assumed; therefore, the short and long-term rates keep that same values as those recently attained (3,6% and 3,9%, respectively) over the entire forecast horizon.

Table II.4.2 summarises the main results of these two alternative scenarios. In unfavourable circumstances (higher interest rates) economic growth is slower than that of the baseline scenario and, as a result, the unemployment rate is higher. Lower economic growth and the payment of higher interest on public debt hold back the budgetary consolidation process, in terms of the deficit and in terms of public debt. The negative impact on the current account is essentially due to the worsening of the income account, associated to greater interest payments. In the event that interest rates remain unchanged, the impact on budgetary consolidation is naturally beneficial.

Table II.4.2. Sensitivity to Interest Rates

	2007	2008	2009	2010
Higher [lower] interest rates				
GDP (real growth rate, %)	1,5 [1,9]	2,4 [2,4]	2,9 [3,0]	2,9 [3,0]
Private consumption deflator (annual growth, %)	2,2 [2,2]	2,1 [2,2]	2,1 [2,1]	2,1 [2,1]
Unemployment rate (%)	7,6 [7,5]	7,3 [7,1]	6,7 [6,5]	6,5 [6,2]
Current and capital accounts' balance (% of GDP)	-7,9 [-7,3]	-7,5 [-6,8]	-7,1 [-6,4]	-6,7 [-6,1]
General Government net lending (% of GDP)	-4,1 [-3,7]	-3,0 [-2,5]	-1,9 [-1,4]	-0,9 [-0,3]
Gross public debt (% of GDP)	68,4 [67,9]	68,3 [67,1]	66,6 [64,9]	64,1 [61,8]
Differences relative to the baseline scenario				
GDP (real growth rate, %)	-0,4 [0,0]	0,0 [0,0]	-0,1 [0,0]	-0,1 [0,0]
Private consumption deflator (annual growth, %)	0,0 [0,0]	0,0 [0,0]	0,0 [0,0]	0,0 [0,0]
Unemployment rate (%)	0,1 [0,0]	0,1 [0,0]	0,2 [0,0]	0,2 [0,0]
Current and capital accounts' balance (% of GDP)	-0,6 [0,1]	-0,6 [0,1]	-0,6 [0,1]	-0,6 [0,1]
General Government net lending (% of GDP)	-0,4 [0,0]	-0,4 [0,1]	-0,5 [0,1]	-0,5 [0,1]
Gross public debt (% of GDP)	0,4 [0,0]	1,0 [-0,1]	1,5 [-0,2]	2,0 [-0,3]

Source: Ministry of Finance.
N.B.
- Higher interest rates: short and long-term rates 1 p.p. above those used in the baseline scenario.
- Lower interest rates: short and long-term rates remain at levels similar to those recently in force (3,6% and 3,9%, respectively).

II.5. Comparison with the December 2005 Update

Table 5 in the Appendix compares the real GDP growth, General Government net lending and General Government gross debt of this update to the SGP with the previous update. The real GDP growth estimated for 2006 was adjusted upwards and forecast growth for the following years remained unchanged.

The budgetary deficit targets for the 2006 to 2009 period remained unchanged, while the level of debt as a percentage of GDP was adjusted slightly downwards, maintaining roughly the same time profile.

III. LONG-TERM 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 and on the Report on the Sustainability of Social Security attached to the 2007 State Budget Report.

The forecasts contained herein review those contained in the previous SGP update (December 2005), in order to include the impact of the reforms underway (see detailed description in Chapter I) in the public social security scheme and in CGA, which is the civil servant scheme, since these reforms encompass the progressive unification of the two systems.

Two scenarios or sustainability calculations up to the 2050 horizon, presented in the Appendix, Tables 6a and 6b, were drawn up. The first scenario – the EPC scenario – incorporates the basic assumptions defined by the Ageing Working Group (AWG), a sub-group of the Economic Policy Committee (EPC) that assists ECOFIN. The second scenario – the domestic scenario – is based on the Report on the Sustainability of Social Security, which is attached to the 2007 State Budget Report. Both scenarios used the official figures of *Instituto Nacional de Estatística* for the Gross Domestic Product, to the year 2005.

The EPC scenario assumes, in particular, that real GDP grows by 1% per year from 2030. The domestic scenario entails a more optimistic long-term macroeconomic perspective, in which GDP increases by 2% per year, in real terms, from 2030.

Both scenarios incorporated the impact of the following measures, for which the underlying legislation has been passed or is in the approval phase (see detailed description in Chapter I):

1. Sustainability Factor;
2. Pension Update Rule;
3. Faster Transition to the New Formula for Calculating Pensions;
4. Improved Efficiency of the System to Combat Fraud;
5. Diversification of Funding Sources.

Table II.5. Long-Term Sustainability Indicators
(% of GDP)

	Horizon: 2050	S1	S2	RPB
SGP December 2006 (with reform of Social Security)	**EPC Scenario**	**0.6**	**2.6**	**4.8**
	Domestic scenario	**-1.7**	**-3.6**	**-1.3**
SGP December 2005 (without reform of Social Security)	EPC scenario	3.5	7.2	8.4
	Domestic scenario	1.6	3.2	4.8

Source: Ministry of Finance.

Table II.5. contains the three indicators that have been used by the European Commission to assess the long-term sustainability of public finances.

The first indicator (S1) is the permanent improvement to the primary balance, in p.p. of GDP, that would be necessary for public debt not to surpass 60% of GDP in 2050. In the most pessimistic scenario (EPC) the reform currently underway allows that requirement to be significantly reduced, from 3.5 p.p. to 0.6 p.p.; i.e. primary expenditure not sensitive to ageing will still have to be reduced by a further 0.6 p.p. of GDP.

The second indicator (S2) is the improvement to the primary balance, also in p.p. of GDP, that would comply with the government's intertemporal budget constraint. This is, in other words, the present value of primary surpluses must be equal to the current value of public debt, both at present levels. A permanent cut of 2.6 p.p. of GDP is now required in the EPC scenario, as opposed to a 7.2 p.p. cut if the reform is not implemented.

The RPB (required primary balance) is an indicator based on S2 and it measures the average cyclically-adjusted primary balance during the first five years of the forecast that guarantees, at the very minimum, compliance with the government's intertemporal budget constraint. A primary surplus of 4.8 p.p. of GDP is required in the most demanding scenario – the EPC one.

These calculations, which incorporate the reforms that the Government is implementing in the general and civil servant social security schemes, with the agreement of the majority of social partners, suggest that even under the most pessimistic assumptions – EPC – Portugal may tackle the long-term sustainability of both public finances and the social security system proper based on the principle of solidarity with a significantly lower risk.

IV. Institutions, Processes and Budgetary Rules

The institutional framework of fiscal policy is nowadays taken to be one of the most significant determinants of the performance of that same policy. That framework is supported in the set of numerical or procedural rules that guide the different stages of the budgetary process, as well as in the possible existence of independent institutions acting in the sphere of fiscal policy-making. It is widely accepted that well-designed rules contribute to the success of budgetary consolidations and to prevent pro-cyclical action in times of prosperity. Good design in relation to numerical rules comprises, besides the correct specification of the variables involved and respective numerical limits, monitoring arrangements and transparent and credible enforcement mechanisms that guarantee a high level of effective compliance.

IV.1. State Budget Process and Drafting

The State Budget cycle starts with the budget preparation and ends with the presentation of accounts, the opinion of the Court of Auditors and its despatch to Parliament. Accordingly, a Budget cycle lasts for around three years.

According to that established in the Budget Framework Law[7], the Government must submit the draft State Budget to Parliament on or before 15 October of each year. The draft Budget's preparation requires the involvement of all Central Government and Social Security services are involved during the period prior to submittal to Parliament. However, the first steps in the Budget's preparation start a long time before.

In December of the year prior to the submittal of the draft Budget the Government presented the SGP to Parliament and the European Commission. In the SGP, the Government set out the general framework of fiscal policy for the following years and the budgetary balance targets, in accordance with the forecast domestic and Community macroeconomic developments. Thus, the SGP sets out the path that the main fiscal variables, such as revenue and expenditure, will follow, as well as the policy measures that make that path feasible.

Afterwards, the Government must submit the Plan's Main Options and the Budgetary Policy Steering Report, by the end of April of the following year. The latter document analyses the most recent budget implementation results and provides details of the policy options explained in the Stability and Growth Programme. This Budgetary Policy Steering Report will be invested with increased importance after the implementation of performance budgeting[8], since this will constitute a pre-budget, multi-year in nature, that provides for the transition between, on one side, the global objectives defined for General Government and aggregately established for the Central Government as a whole, and on the other, the objectives at the programme and ministerial unit level.

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[7] Law no. 91/2001, of 20 August, republished through Law no. 48/2004, of 24 August.

[8] The "Performance Budgeting" Report, which sets out a phased implementation project, to 2010, was submitted to Parliament in June 2006 (see Box 2).

BOX 2. THE PERFORMANCE BUDGETING PROJECT

In 2006, the Government commenced a multi-year project to reorganise the budgetary process along the lines of performance budgeting, with the establishment of budgetary rules and objectives. This project, which was already outlined in the Budget Framework Law, has the potential to deliver comprehensive improvement not only in regard to the efficient use of public resources but by also making political decision-makers more accountable to citizens.

An aspect of the improvement of the institutional framework of fiscal policy that the Government deems to be very important and which has been the target of growing international interest is performance budgeting - which uses performance data to draft and implement a budget. Some countries have already started the process of structuring the state budget around budget programmes – according to the missions or priorities of the State – which have objectives, indicators and targets associated to them, and with the end aim of assessing public policies and the services responsible for these policies.

Accordingly, performance budgeting allows public expenditure to be assigned more efficiently and with greater transparency, both intertemporally (i.e. multi-yearly) and between different missions, programmes and measures. Thus, it is possible to establish coherent liaison between the public policies that the Government intends to implement over a specific multi-year horizon and the macroeconomic stance to be impressed on budgetary policy and, in particular, on the principal aggregates of public expenditure.

The Government submitted a report to Parliament, in June 2006, that set out the phased implementation, up to 2010, of the model for structuring the state budget according to programmes. The schedule takes into account that experience from other countries shows the need for groundwork lasting a few years in certain areas, such as the systematisation of the State's missions, the establishment of programme drafting, implementation and assessment rules, the definition of the necessary legislative amendments and the design of numerical rules for public expenditure. It is envisaged that this groundwork makes it possible that pilot programmes be launched in 2009, with the respective definitive implementation in the State Budget for 2010.

The draft Budget is drawn up, in process terms, in reverse order, taking as a starting point the revenue, expenditure and balance stipulated in the objectives defined in the Stability and Growth Programme for General Government. From these figures, and using the underlying assumptions of the draft Budget, the amount of the general expenditure of the State is calculated.

Once the general expenditure of the State is calculated, this value has to be divided amongst the specific expenditure of the different ministries, operational expenditure and expenditure to be made under the Central Government Development Expenditure and Investment Programme (PIDDAC).

The Council of Ministers approves the budget allowances of each ministry at the start of August, and the assignment of those allowances amongst the different services commences. At this time the Budget General Directorate (DGO) issues a memo specifying the rules that the services' budgets must comply with. These rules cover, in particular, personnel expenditure, and own and assigned revenue budgeting. In relation to budgeting PIDDAC, the instructions have been defined by the Department of Prospective and Planning, a task that is being transferred to DGO under PRACE.

The services must upload their budgets to the IT system before the start of September. Once this is performed, the process of verifying and harmonising the budgeted values starts. Lastly, data is complied to permit consolidated accounts to be drawn up, on both a budgetary accounting and national accounting basis. The State Budget Report is drawn up at the same time as this process. This Report presents and justifies the proposed fiscal policy and it includes the underlying information stipulated in the Budget Framework Law. The Government approves the final version of the draft State Budget before submitting it to Parliament.

The Parliament commences the parliamentary discussion of the draft State Budget with a general discussion in plenary sitting. Since November 2006, on completion of the public recruitment process of the unit's three members, Parliament has been able to call on the support of the Budget Technical Support Unit - UTAO, a body, under parliamentary control, that has budget-related technical duties, including the analysis of the draft budget and subsequent amendments (see Box 3). Once the budget is generally approved, the discussion and vote on the Government's proposal and the proposals for amendment advanced by members of parliament follows. Nevertheless, all items related to the creation, alteration or extinction of taxes as well as all matters concerning loans and funding must compulsorily be put to the vote of Parliament in plenary sitting. Parliamentary discussion ends with a comprehensive final vote that must be undertaken no later than 45 days after the draft is submitted to Parliament.

BOX 3. CREATION OF A BUDGET TECHNICAL SUPPORT UNIT – UTAO

There follow excerpts from Parliamentary Resolution no. 53/2006, published in the Official Gazette (*Diário da República*) on 7 August 2006.

"Parliament has decided, pursuant to article 166, no. 5, of the Portuguese Constitution the following:

...

A Budget Technical Support Unit (UTAO) is created to provide technical support to the specialised committee on budgetary and financial matters, under the direct administration of said commission.

...

UTAO is charged with drafting technical studies and documents on public budgetary and financial management, in the following areas:

a) The technical analysis of the draft State Budget Law and its amendments;

b) Technical assessment of the State General Accounts;

c) Technical monitoring of budget implementation;

d) Technical analysis of Stability and Growth Programme updates;

e) Technical study of the budgetary impact of legislative initiatives under discussion that the Speaker of Parliament considers warrant the analysis of the specialised committee on budgetary and financial matters..."

The amendments made to the draft State Budget by Parliament are input to the system when the Law is passed. The Government must, in the year of implementation, approve and publish a decree-law containing the range of norms necessary for the implementation of the State Budget, before the end of the second month after which the State Budget has come into effect. This decree-law must also establish the disclosure of information requirements of all General Government sub-sectors. Budgetary amendments under the Government's remit are made while the Budget is being implemented, such as the increase of budget allowances due to the increase of own revenues or the incorporation of balances from previous years, or other amendments permitted by law, in accordance with the established rules.

The Budget General Directorate publishes a Monthly Bulletin, with monthly reports on the budget implementation of the State sub-sector and quarterly reports on the implementation of Autonomous Services and Funds, in addition to drafting tables for quarterly publication in the Official Gazette that detail the amendments made to the State Budget. The scope and quality of the disclosed information regarding budget implementation has increased greatly, due to the added focus on this area and improved inter-institutional liaison (see Box 4, in this regard).

The General State Accounts is drafted when the year ends. The General State Accounts contain the budget implementation data of all services belonging to Central Government and Social Security. The General State Accounts are submitted to Parliament by 30 June of the year following that to which they refer. Parliament must assess the General Accounts before the end of the year. The General Accounts are also submitted to the Court of Auditors.

In parallel, the Portuguese Authorities report the General Government balances and accounts to Eurostat, under the scope of the Excessive Deficit Procedure, in accordance with the European System of National and Regional Accounts (ESA 95), in regard to the current year as well as the four previous years. *Instituto Nacional de Estatística* is responsible for drafting the General Government national accounts relative to previous years, though, under the Institutional Cooperation Agreement, both the Bank of Portugal's Statistics Department and the Budget General Directorate participate through the discussion of the procedures used to classify operations.

BOX 4. DISCLOSURE OF INFORMATION REGARDING GENERAL GOVERNMENT BUDGET IMPLEMENTATION

The regular disclosure of accounts and information regarding the budget implementation of General Government is crucial in the transparency of public accounts and in the timely control of budget implementation. In this context, the Government considers the improvement in quality and in the scope of the information regularly published to be a priority.

The Budget General Directorate made significant changes to its Monthly Bulletin during 2006, so as to improve the information disclosed with regard to budget implementation. In addition to the structural alterations made to the monthly disclosure of information regarding State and Social Security budget implementation, information on the National Health Service began to be published each quarter, as a supplement to the information already published on the remaining autonomous services and funds. The Monthly Bulletin also began to include quarterly information on the budget implementation of Local and Regional Government, and a monthly implementation report of *Caixa Geral de Aposentações* was instituted, as a supplement to the monthly Social Security implementation report. Lastly, the monthly publication of the physical data relative to *Caixa Geral de Aposentações* was instigated.

Thus, in 2006, the entire universe of General Government was reported quarterly, on a budgetary accounting basis. The improvements to be made in the field of information reporting will be less visible during 2007 and subsequent years, given that the focus will not be on increasing the scope but instead on improving the quality of the reported data.

During 2007, the national statistical authorities, in collaboration with the Budget General Directorate, should begin to publish the quarterly General Government national accounts as well as the stock of public debt calculated according to national accounts procedures, as a supplement to the information published monthly in the Budget General Directorate's Monthly Bulletin. This objective, which it is expected will be implemented mid-2007, results from the Institutional Cooperation Agreement between INE's Macroeconomic Statistics Department, the Bank of Portugal's Statistics Department and the Budget General Directorate, entered into at the start of 2006.

IV.2. Numerical Fiscal Rules

The European Commission carried out in the Public Finances in EMU 2006 report, in liaison with member states, an exhaustive survey of the numerical fiscal rules existing in different countries. Two such rules were identified in the case of Portugal, both of which targeting budget balances: one in relation to local government and the other concerning autonomous services and funds. The new financial laws on Local and Regional Government (ARL), recently passed in Parliament, modified the rule applicable to municipalities (establishing a debt rule instead of a budget balance rule) and created a new budget balance rule for the Autonomous Regions.

This section describes the key aspects of Portugal's three numerical fiscal rules, with particular focus on the new provisions that were included as a result of the recently passed Local Finance Law (LFL) and Autonomous Regions Finance Law (LFRA).

Budget Balance Rule for Autonomous Regions

The new LFRA provides for the annual stipulation of indebtedness ceilings by the State Budget Law, based on national accounts-compatible concepts, for the Autonomous Regions, which must prevent debt service (interest and debt repayments) from exceeding 25% of the current revenue recorded in the previous year (excluding transfers and co-payment from the State).

The 2007 State Budget set these ceilings by prohibiting any increase to each region's net indebtedness, defined as the difference between total financial liabilities (irrespective of their form) and total financial assets. This regulation, which is stricter than what would stem from the debt service ceiling referred to above and in line with similar regulations in previous budgets, constitutes a budget balance rule – more specifically, and on a national accounts basis, a balanced budget rule.

Despite the fact that the definition of annual indebtedness ceilings through referral to the State Budget was already enshrined in the previous LFRA (Law no. 13/98, of 24 February), the new law introduces or reinforces aspects encouraging systematic compliance with those ceilings. In this vein, the monitoring and control mechanisms have been improved: information disclosure obligations and penalties for non-compliance are now established in the LFRA proper (these had, up to this point, been solely established in budgetary legislation with a one-year time horizon), and regional statistical services are made co-responsible for calculating regional budget balances and debt. Pre-defined penalties are also confirmed, considering the Budget Framework Law, in the event of infringement of the indebtedness limits. These penalties consist in a reduction in transfers from the State, equal in value to the excess of debt verified, in the year subsequent to that of non-compliance.

The discipline resulting from budget balance rules applicable to ARL is generally enhanced by the transparency surrounding the revenues of the sub-sector, as well as through the full accountability of the same in regard to the debt it issues. Both considerations are safeguarded in the new LFRA. The law, in addition to reinforcing the principle of attributing to the regions the tax revenue they generate, also establishes limits to the growth of transfers from the State to the regions (leading to a gradual reduction of the respective share of GDP), and includes a gradual phasing-out of the sums transferred under the regional Cohesion Fund as the Regions converge towards the country's average GDP per capita. The new law further establishes the general principle that the debt issued by the Regions cannot be guaranteed by the State ("no bail-out" clause). Therefore, the associated interest rates will more clearly reflect risk assessment by the financial markets, which will serve as an additional incentive for discipline and solvency of regional public finances.

Municipality Debt Rule

The new LFL establishes an indebtedness ceiling individually applicable to each municipality. This ceiling is based on the concept of net municipal indebtedness (defined in terms that are compatible with ESA-95, corresponding to the difference between total liabilities - no matter what the form – and total assets), which may not exceed, at year's end, 125% of the total municipal revenue in the previous year[9]. By the same token, other ceilings are established, as a percentage of revenue too, for short-term loans and credit facilities, and for medium and long-term loans. Thus, the new law introduces, in the terminology of numerical fiscal rules, a debt rule.

Successive State Budgets since 2003 have been including the annual principle of not increasing net indebtedness of municipalities as a whole, which is classifiable as a budget balance rule, and which is now replaced by a debt rule applicable to each and every municipality[10]. The reasons for this change are tied to the objectives to make local governments more accountable on an individual basis and also to promote multi-year activity and investment planning. For example, a given municipality will have a stronger incentive to accrue savings over a number of years (i.e. record positive balances) as it can then use them to execute large-scale projects (generating a negative balance) without being subject, as has occurred up to the present, to an apportionment of debt issue capacity. Despite the fact that it is not possible to exactly forecast the behaviour of the budget balance for local government as a whole under the new rule, it is expected that budgetary discipline will improve, including in the short-term. This is because close on one-third of municipalities currently possess a level of indebtedness greater than that permitted, and so they will be subject to quantified debt reduction objectives (explained below), or, in other words, to register budget surpluses.

The LFL, like the LFRA, contains numerous provisions that promote the monitoring and effective compliance with the established fiscal rule. A general principle of reduction in each subsequent year by at least 10% of the total excessive debt is established with regard to municipalities that exceed the indebtedness ceiling. Pre-defined penalties have been established for exceeding the ceilings. These penalties comprise a reduction in transfers from the State sub-sector to the municipality in question, equal in value to the

[9] The revenues are defined as those from municipal taxes, the municipal financial equilibrium fund (FEF), income tax share, Municipal Surcharge and profit sharing in local companies.

[10] The previous LFL (Law no. 42/98, of 6 August) indirectly established indebtedness limits by enshrining debt service ceilings (interest and repayments). The specification of these ceilings proved to be insufficiently disciplining, thereby leading to the establishment of the abovementioned budget balance rule from 2003 onwards.

excess of debt verified, in the following year. Local governments are required to provide, in good time, precise financial information: the LFL establishes information disclosure requirements and penalties for non-compliance, which, prior to this act, had been solely provided for in budgetary legislation with a one-year time horizon. Lastly, the reinforcement of budgetary accountability and discipline, through the provisions referring to municipalities' margin of choice regarding greater or lesser share of the income tax paid by the respective residents and through the general principle prohibiting the State from taking responsibility for liabilities of municipalities and parish councils ("no bail-out" clause), warrant particular mention.

Budget Balance Rule for Autonomous Funds and Services

The 2001 Budget Framework Law (Law no. 91/2001, of 20 August) establishes in article 22 that the budget of each service or autonomous fund must generate a zero or positive balance[11], thereby enshrining a budget balance rule applicable to Autonomous Funds and Services (FSA, a sub-sector of Central Government) that has not undergone significant changes since then[12].

Despite the fact that the rule is defined on a budgetary accounting basis, there is convergence towards the national accounts concept of budget balance, since the revenue and expenditure relative to financial assets and liabilities as well as balances carried from previous years are not taken into consideration.

The zero or positive balance rule has proven to foment budgetary discipline in most of the FSA, and the sub-sector as a whole has recorded positive balances, on a national accounts basis, in recent years. Also warranting note in this field is that the use of balances carried from previous years (i.e. prior-year savings in general) to fund expenditure is not generally permitted, and requires the express authorisation of the Minister of Finance. The monitoring of budget implementation in this sub-sector has also undergone improvement – for example, all of the FSA must provide monthly data on budget implementation within just 15 days of the close of the month in question.

* * *

In brief, part of the Portuguese Government's budgetary consolidation strategy has consisted of an intensified focus on improving the institutional framework of fiscal policy. As regards numerical fiscal rules, this endeavour has represented a progressive expansion of the universe of public finances covered by these rules and, in particular, the creation of means and mechanisms aimed at guaranteeing high levels of effective compliance – either through the improved and more timely monitoring of the budget implementation of the entities involved, or through the existence of penalties that are automatically enforced in the event of non-compliance.

The abovementioned emphasis on better monitoring and enforcement is in total harmony with last October's ECOFIN Council Conclusions on fiscal rules and institutions. The preparatory work relative to performance budgeting, which provides a medium-term framework for public expenditure, as well as the existence of a clear and unequivocal political commitment to the consolidation and reform of Portugal's public finances, are also in harmony with those conclusions.

[11] Article 25 of the most recent version of the referred to Law (no. 48/2004, of 24 August).

[12] Some of the FSA have been exempted from complying with this rule (*Caixa Geral das Aposentações* is one such example, which belongs to the Social Security sub-sector in a national accounts context. Some of the FSA that come under the NHS are other examples of such exemption).

Appendix

Statistical Tables

Table A.1a. Macroeconomic Prospects

	ESA Code	2005 level (10⁶ euros)	2005 rate of change	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Real GDP[1]	B1*g	143.564,9	0,4	1,4	1,8	2,4	3,0	3,0
2. Nominal GDP	B1*g	147.378,4	3,0	3,7	4,5	5,1	5,6	5,6
Components of real GDP								
3. Private consumption expenditure	P.3	94.156,5	2,0	1,0	1,3	2,0	2,3	2,4
4. Government consumption expenditure	P.3	29.896,8	1,8	-0,2	-1,3	-1,5	-1,2	-1,1
5. Gross fixed capital formation	P.51	31.001,0	-2,9	-2,6	1,9	4,0	6,8	7,0
6. Changes in inventories and net acquistion of valuables (% of GDP)	P.52 + P.53	479,2	0,7	0,8	1,0	1,0	1,0	1,0
7. Exports of goods and services	P.6	41.157,5	0,9	8,6	7,2	6,8	7,0	7,2
8. Imports of goods and services	P.7	53.126,1	1,8	2,8	3,7	4,3	5,4	6,1
Contributions to real GDP growth								
9. Final domestic demand		-	1,0	0,0	1,0	1,9	2,7	2,9
10. Changes in inventories and net acquistion of valuables	P.52 + P53	-	-0,2	-0,1	0,0	0,0	0,0	0,0
11. External balance of goods and services	B.11	-	-0,4	1,4	0,8	0,5	0,2	0,1

[1] Real GDP is measured at previous year prices.

Table A.1b. Price Developments

	ESA Code	2005 rate of change	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. GDP deflator		2,7	2,3	2,6	2,6	2,6	2,6
2. Private consumption deflator		2,5	3,2	2,2	2,2	2,1	2,1
3. Export price deflator (goods and services)		2,3	4,5	2,3	2,1	2,1	2,2
4. Import price deflator (goods and services)		3,9	5,6	2,3	1,3	1,0	1,5

Table A.1c. Labour Market Developments

	ESA Code	2005 Level	2005 rate of change	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Employment (thousand individuals)		5.136,0	0,0	0,9	1,0	1,2	1,5	1,5
2. Employment (thousand individuals, adjusted with hours worked)		4.910,1	0,1	0,9	1,0	1,2	1,5	1,5
3. Unemployment rate (%)			7,6	7,6	7,5	7,2	6,6	6,3
4. Labour productivity, persons (10^3 euros)[1]		28,7	0,4	0,5	0,8	1,2	1,5	1,5
5. Labour productivity (10^3 euros, adjusted with hours worked)		30,0	0,3	0,5	0,8	1,2	1,5	1,5
6. Compensation of employees (10^6 euros)	D.1	74.479,0	3,2	4,6	3,5	3,4	3,8	4,0

[1] GDP per worker

Table A.1d. Sectoral Balances

% of GDP	ESA Code	2005	2006	2007	2008	2009	2010
1. Net lending / borrowing vis-à-vis the rest of the world	B.9	-7,9	-7,5	-7,3	-6,9	-6,3	-6,0
of which: - Balance of goods and services		-8,9	-8,0	-7,0	-6,0	-5,1	-4,6
- Balance of primary incomes and transfers		-0,6	-1,3	-2,1	-2,4	-2,5	-2,6
- Capital Account		1,6	1,8	1,7	1,5	1,3	1,2
2. Net lending / borrowing of the private sector	B.9/ EDP B.9	-1,8	-2,9	-3,7	-4,3	-4,9	-5,7
3. Net lending / borrowing of general government	B.9	-6,0	-4,6	-3,7	-2,6	-1,5	-0,4

Table A.2. General Government Budgetary Prospects

	ESA Code	2005	2005	2006	2007	2008	2009	2010
		Level (10^6 euros)	% 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	-8.894,5	-6,0	-4,6	-3,7	-2,6	-1,5	-0,4
2. Central government	S.1311	-8.937,6	-6,1	-4,7	-3,9	-2,8	-1,7	-0,5
3. Local government	S.1313	-436,9	-0,3	0,0	0,0	0,0	0,0	0,0
4. Social security funds	S.1314	479,9	0,3	0,1	0,2	0,2	0,2	0,2
General government (S13)								
5. Total revenue	TR	61.522,9	41,7	41,7	41,7	41,4	41,2	41,1
6. Total expenditure	TE	70.417,4	47,8	46,3	45,4	44,0	42,7	41,5
7. Net lending / borrowing	EDP B.9	-8.894,5	-6,0	-4,6	-3,7	-2,6	-1,5	-0,4
8. Interest expenditure	EDP D.41	4.028,9	2,7	2,9	3,0	3,0	3,0	2,9
9. Primary balance		-4.865,6	-3,3	-1,7	-0,7	0,4	1,5	2,5
Selected components of revenue								
10. Total taxes (10=10a+10b+10c)		35.046,7	23,8	24,4	24,7	24,7	24,7	24,6
10a. Taxes on production and imports	D.2	22.214,1	15,1	15,5	15,5	15,6	15,7	15,7
10b. Current taxes on income, wealth, etc.	D.5	12.787,5	8,7	8,9	9,2	9,1	9,0	8,9
10c. Capital taxes	D.91	45,1	0,0	0,0	0,0	0,0	0,0	0,0
11. Social contributions	D.61	18.443,6	12,5	12,2	12,2	12,1	12,1	12,1
12. Property income	D.4	739,0	0,5	0,5	0,4	0,4	0,3	0,3
13. Other (13=14-(10+11+12))		7.293,6	4,9	4,6	4,4	4,2	4,1	4,1
14=5. Total revenue	TR	61.522,9	41,7	41,7	41,7	41,4	41,2	41,1
p.m.: Tax burden (a) (D.2+D.5+D.61+D. 91-D.995)		51.761,8	35,1	35,7	36,2	36,2	36,2	36,1
Selected components of expenditure								
15. Collective consumption	P.32	12.274,6	8,3	8,0	7,6	7,3	7,0	6,7
16. Total social transfers	D.62 + D.63	41.160,9	27,9	27,6	27,1	26,4	25,6	24,9
16a. Social transfers in kind	P.31 =D.63	19.148,8	13,0	12,7	12,1	11,6	11,1	10,7
16a1. Social benefits in kind	D.631	5.193,0	3,5	3,5	3,4	3,3	3,2	3,2
16a2. Transfers of individual non market goods and services	D.632	13.955,8	9,5	9,1	8,7	8,3	7,9	7,5
16b. Social benefits other than in kind	D.62	22.012,1	14,9	15,0	15,0	14,8	14,5	14,2
17.=8. Interest expenditure	EDP D.41	4.028,9	2,7	2,9	3,0	3,0	3,0	2,9
18. Subsidies	D.3	2.353,2	1,6	1,2	1,1	0,9	0,9	0,8
19. Gross fixed capital formation	P.51	4.183,1	2,8	2,5	2,3	2,3	2,4	2,6
20. Other (20=21-(15+16+17+18+19))		6.416,8	4,4	4,1	4,3	4,1	3,9	3,8
21=6. Total expenditure	TE	70.417,4	47,8	46,3	45,4	44,0	42,7	41,5
p.m.: Social benefits (16b+16a1)	D.62+D.6311+D.63121+D.63131	27.205,1	18,5	18,5	18,4	18,1	17,7	17,4

(a) Excluding imputed social contributions (D612).

Table A.3. General Government Debt Developments

% of GDP		2005	2006	2007	2008	2009	2010
1. Gross debt		64,0	67,4	68,0	67,3	65,2	62,2
2. Change in gross debt ratio		5,4	3,3	0,6	-0,7	-2,1	-3,0
Contributions to change in gross debt							
3. Primary balance		3,3	1,7	0,7	-0,4	-1,5	-2,5
4. Interest expenditure		2,6	2,7	2,9	2,9	2,9	2,8
5. Stock-flow adjustment		1,3	1,1	-0,1	0,0	0,1	0,2
of which: - Differences between cash and accruals							
-Net accumulation of financial assets		0,0	-0,3	-0,1	-0,3	-0,2	-0,1
of which: *- privatisation proceeds*		0,4	0,8	0,5	0,4	0,3	0,2
- Valuation effects and other							
p.m. implicit interest rate on debt		4,5	4,4	4,5	4,5	4,5	4,5

Table A.4. Cyclical Developments

% of GDP	ESA Code	2005	2006	2007	2008	2009	2010
1. Real GDP growth (%)		0,4	1,4	1,8	2,4	3,0	3,0
2. Net lending of general government	EDP B.9	-6,0	-4,6	-3,7	-2,6	-1,5	-0,4
3. Interest expenditure	EDP D.41	2,7	2,9	3,0	3,0	3,0	2,9
4. Output gap		-2,6	-2,7	-2,4	-1,8	-0,5	0,4
5. Cyclical budgetary component		-1,2	-1,2	-1,1	-0,8	-0,2	0,2
6. Cyclically-adjusted balance (2-5)		-4,9	-3,4	-2,6	-1,8	-1,3	-0,5
7. Cyclically-adjusted primary balance (6+3)		-2,1	-0,5	0,4	1,2	1,7	2,3

Table A.5. Divergence from Previous Update

	ESA Code	2005	2006	2007	2008	2009	2010
Real GDP growth (%)							
Previous update		0,5	1,1	1,8	2,4	3,0	
Current update		0,4	1,4	1,8	2,4	3,0	3,0
Difference		-0,2	0,3	0,0	0,0	0,0	
General government net lending (% of GDP)	EDP B.9						
Previous update		-6,0	-4,6	-3,7	-2,6	-1,5	
Current update		-6,0	-4,6	-3,7	-2,6	-1,5	-0,4
Difference		0,0	0,0	0,0	0,0	0,0	
General government gross debt (% of GDP)							
Previous update		65,5	68,7	69,3	68,4	66,2	
Current update		64,0	67,4	68,0	67,3	65,2	62,2
Difference		-1,5	-1,3	-1,3	-1,1	-1,0	

Table A.6a. Long-term sustainability of public finances – EPC base scenario (a)

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	43,1	47,8	41,5	41,9	41,9	47,9
of which: age-related expenditure	23,0	27,1	27,2	28,4	28,9	33,0
Pension expenditure	8,4	11,0	11,3	12,7	13,4	16,5
Social security pensions	5,6	7,5	8,0	9,4	11,2	16,2
Old-age and early pensions	3,8	5,4	5,9	7,2	8,8	13,1
Other pensions (disability, survivors)	1,8	2,1	2,1	2,2	2,4	3,1
Occupational pensions (CGA - public sector workers' pension scheme)	2,8	3,5	3,3	3,4	2,2	0,3
Health care	5,3	6,3	6,5	6,4	6,3	6,9
Long-term care	0,3	0,5	0,5	0,5	0,6	0,9
Education expenditure	5,1	4,8	4,5	4,4	4,3	4,6
Other age-related expenditure	3,9	4,5	4,5	4,4	4,3	4,2
Interest expenditure	3,1	2,7	2,9	2,0	1,6	3,5
Total revenue	40,2	41,7	41,2	41,2	41,2	41,2
of which: property income	0,0	0,0	0,0	0,0	0,0	0,0
of which: from pensions contributions (or social contributions if appropriate)	9,4	10,4	10,3	9,6	9,3	9,2
Consolidated public pension fund assets (assets other than governement 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	3,9	0,4	3,0	2,2	1,0	1,0
Total participation rates (aged 20-64)	76,6	78,8	80,7	82,3	82,1	82,7
Males	85,2	85,5	86,5	86,8	85,9	86,3
Females	68,4	72,4	75,1	77,7	78,2	79,1
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

(a) EPC - Economic Policy Committee.

Table A.6b. Long-term sustainability of public finances – National base scenario

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	43,1	47,8	41,5	42,4	42,0	36,8
of which: age-related expenditures	23,0	27,1	26,9	28,5	28,4	25,4
Pension expenditures	8,4	11,0	11,2	12,7	13,0	12,4
Social security pensions	5,6	7,5	7,9	9,3	10,6	11,9
Old-age and early pensions	3,8	5,4	5,9	7,2	8,4	9,6
Other pensions (disability, survivors)	1,8	2,1	2,0	2,1	2,2	2,4
Occupational pensions (CGA - public sector workers' pension scheme)	2,8	3,5	3,3	3,4	2,4	0,4
Health care	5,3	6,3	6,4	6,4	6,3	5,4
Long-term care	0,3	0,5	0,5	0,5	0,6	0,7
Education expenditure	5,1	4,8	4,4	4,4	4,3	3,6
Other age-related expenditures	3,9	4,5	4,5	4,5	4,3	3,3
Interest expenditure	3,1	2,7	2,9	2,1	1,9	-0,3
Total revenue	40,2	41,7	41,2	41,2	41,2	41,2
of which: property income	0,0	0,0	0,0	0,0	0,0	0,0
of which: from pensions contributions (or social contributions if appropriate)	9,4	10,4	10,2	9,4	8,9	8,7
Consolidated public pension fund assets (assets other than governement liabilities)	0,7	1,9	2,8	4,6	5,2	3,0
Assumptions						
Labour productivity growth	1,1	0,4	1,5	2,0	2,2	2,5
Real GDP growth	3,9	0,4	3,0	2,0	2,0	2,0
Total participation rates (aged 20-64)	76,6	78,0	80,2	81,2	81,4	81,3
Males	85,2	84,6	85,9	85,7	85,1	84,9
Females	68,4	71,6	74,6	77,0	77,5	77,8
Unemployment rate	4,1	7,4	6,8	5,5	5,5	5,5
Population aged 65+ over total population	16,4	17,0	17,7	20,3	24,3	31,9

Table A.7. Basic Assumptions

	2005	2006	2007	2008	2009	2010
Short-term interest rate (annual average)	2,2	3,1	3,7	3,6	3,6	3,6
Long-term interest rate (annual average)	3,4	3,9	4,2	4,4	4,3	4,3
USD/Euro exchange rate (annual average)	1,24	1,25	1,27	1,27	1,27	1,27
Nominal effective exchange rate (annual change)	-0,2	0,2	0,3	0,1	0,0	0,0
World excluding EU, GDP growth	5,5	5,7	5,2	5,2	4,5	4,5
EU GDP growth	1,7	2,8	2,4	2,4	2,3	2,3
Growth of relevant foreign markets	6,5	9,7	6,8	6,5	6,0	6,0
World import volumes, excluding EU	7,9	9,1	8,3	7,9	7,9	7,9
Oil prices (Brent, USD/barrel)	54,4	65,6	66,3	68,0	63,0	60,0