PORTUGUESE REPUBLIC

Stability and Growth Programme

2010 - 2013

March 2010

Avª. Infante D. Henrique, 1
1149-009 LISBOA
• Telephone: (+351) 21.881.6820 • Fax: (+351) 21.881.6862

http://www.min-financas.pt

Index

Boxes Index

Tables Index

Figures Index

Executive Summary

The current document updates the Stability and Growth Programme (SGP) of the Portuguese Republic for the period 2010-2013, in line with the obligations to the European Union in compliance with the Code of Conduct of the Pact that establishes the format and content of the Stability Programmes.

The SGP, following the general elections held in Portugal in September 2009 and the approval of the State Budget for 2010, in the Portuguese Parliament on 12 March, is sent to the European Commission after the consultation of the social partners and political parties and after its presentation and assessment by the National Parliament.

Unavoidably, the Portuguese economy has been hit by the international economic and financial crisis. Economic activity in Portugal was strongly affected by the spread of the effects of the crisis, primarily during 2009, though also significantly in 2008. This crisis also affected the main Portuguese trading partners. After a null growth in 2008, and despite following closely the first Euro area countries to initiate economic recovery in the second quarter of 2009, the Portuguese GDP recorded a negative growth of 2.7% in 2009, which, notwithstanding, is still better than the Euro area or the EU-27 average. At the same time, the unemployment rate increased significantly, registering an annual average of 9.5%.

Inevitably, the decline of Government revenues and, in general, the automatic stabilisers – in addition to the concerted measures by the various Member States of the Europe an Union to stimulate the economy and support businesses, the unemployed and households – had a negative impact on the General Government accounts of all countries. Portugal was no exception and, therefore, the process of fiscal consolidation that had been in progress with remarkable success since 2005 was interrupted in 2008, largely due to a significant reduction of tax revenues. Thus, between 2007 and 2009, the Portuguese General Government deficit increased by 6.7 percentage points (p.p.) of GDP, in line with the growth registered in the European Union, the countries of the OECD and of the G-20. General Government debt, over the same period, registered a similar growth to that seen in other countries, standing now at 77.2% of GDP, but still below the Euro area average.

Due to the crisis effects on General Government accounts, and while maintaining a set of policies essential to the necessary promotion of economic growth and employment, this SGP determinedly defines a clear and serious budgetary consolidation strategy, with the goal of reducing the General Government deficit to 2.8% of GDP by 2013 and controlling the growth of General Government debt, in order to reverse its current trend and reduce its ratio to GDP by 2013. The Portuguese Government makes this commitment aware that a serious and consistent fiscal consolidation process, aimed at achieving the sustainability of public accounts, is a necessary condition for the strengthening of confidence and sustained economic growth, contributing to the correction of external macroeconomic imbalances and promoting the competitiveness of the Portuguese economy.

This SGP, in order to ensure that this exercise has solid and credible foundations, adopts a particularly prudent macroeconomic scenario. Thus, gradual but modest economic recovery is expected, reflected in output growth of 0.7% in 2010, 0.9% in 2011, 1.3% in 2012 and 1.7% in 2013. Accordingly, the economic stabilisers contribution to the process of consolidation and, in particular, of the revenue generated by the growing economic activity, is set at realistic and trustworthy levels.

It should be emphasized that given the prevailing domestic and international economic environment and the uncertainties that still exist, the recently approved State Budget for 2010 already envisages a reduction of the General Government deficit to 8.3% of GDP this year. Thus, the Portuguese Government decided to initiate the process of reducing the General Government deficit this year, and intensify that reduction in subsequent years by a further 5.5 p.p., in order to achieve the aforementioned target of 2.8% of GDP in 2013.

Table 1. Budgetary balances and General Government debt
(% of GDP)

	2010	2011	2012	2013
Net Lending of Gen. Government	-8.3	-6.6	-4.6	-2.8
Primary balance	-5.1	-2.8	-0.6	1.3
Structural balance[(a)]	-7.3	-5.6	-3.8	-2.3
Structural primary balance[(a)]	-4.1	-1.8	0.3	1.8
Public debt	86.0	89.4	90.7	89.8

Notes: (a) Including, in 2010, anti-crisis measures.
Source: Ministry of Finance and Public Administration.

More precisely, taking into account that the measures adopted in the State Budget for 2010 will result in the reduction of General Government deficit by 1 p.p. of GDP and that the macroeconomic scenario implies an additional contribution of 2 p.p. associated to a moderate economic dynamism in the period 2011-2013, this SGP, in order to achieve the established target, further adopts the necessary measures to reduce the deficit by an additional 3.5 p.p. of GDP, as shown in Table 2.

In line with what the Portuguese Government has shown being capable of, since 2005 and until the onset of the international crisis, the adopted fiscal consolidation strategy is primarily based on cutting public and tax expenditure, and on the additional correction of the growth of public debt through a broad privatisation program, opting to maintain a general framework of stability for tax structure and favouring the recovery of economic activity, the competitiveness of firms and the sustainability of employment. In fact, the distribution of the contributions to the reduction of the General Government deficit by 3.5 p.p. of GDP, through the direct effect of the measures established in the SGP, shows a clear priority for reducing expenditure, which contributed with 2.7 p.p., while the improvement of revenue represents a contribution of 0.8 p.p..

As regards the reduction and control of expenditure, particularly current expenditure, the SGP, besides the phasing out of the temporary measures adopted to tackle the effects of the international crisis, takes in-depth measures to curb all the main headings of expenditure: compensation of employees, social expenditure and intermediate consumption. It also takes action in relation to interest expenditure and capital expenditure.

Hence, it is established that compensation of employees must be reduced to 10% of GDP by 2013. The following measures, among others, will be adopted to achieve this goal: i) strengthening the control of admissions to the General Government through the enhanced implementation of the recruitment rule of only one new public employee for at least every two public employees leaving; ii) strong wage restraint; iii) conclusion of the revision of special bodies and careers of the General Government.

As regards social expenditure, the measures that will be adopted include: i) the definition of expenditure ceilings on social benefits of the non-contributory Social Security scheme, in particular on the Social Integration Income; ii) the speeding up of the convergence of the civil servants pension scheme (CGA) with that of the General Social Security scheme; iii) changing the unemployment benefit scheme, with the aim of promoting a faster return to work; iv) the rationalisation and control of health expenditure, in order to ensure the financial sustainability of the National Healthcare Service (NHS).

The allocation conditions for non-contributory social benefits will also be redefined, through the extended use of the so-called "means-testing" ("*condição de recursos*") and its more thorough application, considering the total actual income of the beneficiary, including financial income as well as wealth, so that the effort of the State and taxpayers with non-contributory social benefits supports those who truly need such assistance.

The envisaged measures as regards intermediate consumption, particularly operating expenditure, include: i) 40% reduction of expenditure on the acquisition of material and equipment established in the Military Funding Programme, for each year; ii) the definition of a ceiling for outsourcing expenditure, concerning studies, expert opinions, projects and consultancy; iii) promotion of the shared management of resources, including in the health sector; iv) management improvements in Education and Justice, both the management of the network and processes and the management of each unit.

Moreover, a reduction of interest expense is also envisaged, by controlling the growth of public debt by means of a broad privatisation programme in the State-Owned Company Sector.

As regards capital expenditure, despite the role that public investment will continue to have in strengthening economic growth, in the country's modernisation and promotion of the Portuguese economy competitiveness, the envisaged measures comprise the postponement for two years of the Lisbon-Porto and Porto-Vigo high-speed rail projects (thus removing any budgetary impacts of these projects until 2013), as well as not making any new commitments to road infrastructure concessions, thus establishing a framework for the gradual return of public investment to pre-crisis levels. The zero indebtedness rule for regional and local government entities will also be adopted, excepting under emergency situations or when intended to finance projects with EU co-funding.

All these expenditure control and reduction measures will undoubtedly benefit from the positive effects of the structural reforms carried out in Portugal in the recent years, especially the reforms in Social Security and in General Government. Furthermore, they will be accompanied by new initiatives aimed at improving and modernising the existing budgetary framework, including the revision of the Budgetary Framework Law. One of the goals of this revision is to promote a pluriannual material and financial programming and to enforce the implementation of expenditure rules and ceilings.

A second set of measures targets the reduction of tax expenditure, in terms also intended to enhance the equality of the Portuguese tax system and to fairly distribute the effort inherent to the consolidation process. Therefore: i) capital gains on securities are no longer exempt from taxation, and are now taxed at the rate of 20%; ii) global thresholds are set for personal income tax allowances and benefits, according to the taxable income, excluding the first two income tax brackets and not encompassing tailored allowances, concerning taxpayers, dependents and relatives in ascending line and persons with disabilities; iii) the specific personal income tax allowance for pensions above €22500 per year will be reduced, in order to ensure convergence with the tax obligations of assets with similar income.

The measures to improve contributory revenue and other current revenue are: i) the expansion and enhanced monitoring of the contributory base of Social Security, through the entry into force of the new Contributory Code and combating contribution fraud and evasion; ii) the introduction of tolls on motorways currently shadow toll (SCUT), including both those already subject to a decision and others currently under evaluation, depending on verification of the defined criteria; iii) the creation of an extraordinary personal income tax rate of 45% for taxable income above € 150000, with the fundamental aim of promoting a fair distribution of effort associated with the consolidation process. These measures to improve revenue, combined with the effect of the automatic stabilisers, should contribute to the recovery of tax revenue, which is expected to occur gradually, so 2013 levels (as percentage of GDP) will stand close to those registered before the financial crisis.

The privatisation programme, in articulation with a modern vision for the role of the State-Owned Company Sector in safeguarding the public interest, will represent a powerful contribution to the correction of the growth of public debt and the indebtedness of the economy, thus leading to a reduction of interest expenditure. The estimate income over the period is €6 billion, and the programme includes companies of the financial, energy, transport, communications and paper sectors, among others.

In addition, a group of measures are envisaged for the State-Owned Company Sector, aimed at reducing the indebtedness of the sector and improving its sustainability. The most important are : i) establishing annual growth ceilings for the indebtedness of non-financial State-Owned Enterprises, until standing at 4% in 2013; ii) the revision of the expenditure on pension systems and health plans; iii) align the State-Owned Company Sector with wage restraint and reduction of operating costs measures adopted in the General Government; iv) promote the internal restructuring and reorganization of the enterprises in order to foster efficiency and cut expenditure.

It should be noted that the planned fiscal consolidation path to 2013, in particular the improvement of the primary balance, will allow the curbing of the upward trend public debt has been following since 2008, under the economic and financial crisis. A reduction of the public debt to GDP ratio is even expected in 2013, the year when the primary balance will return to a positive terrain. The abovementioned privatisation operations should also make a significant contribution to reducing the public debt to GDP ratio, since revenue from the privatisation operations will be allocated to the amortisation of debt. The dynamic effect, which is given by the difference between the growth of the implicit interest rate on debt and nominal GDP, will also have a positive contribution to debt dynamics, since the recovery of the economy in nominal terms should be higher than the forecasted rise of interest rates. A framework of stability is therefore foreseen, as well as a positive contribution from the public sector, over time, to reduce the indebtedness of the Portuguese economy *vis-à-vis* the rest of the world.

As mentioned above, this SGP is, in fact, a commitment with a serious and clear strategy for the fiscal consolidation process, always accompanied by a core sense of fairness and equality in the distribution of the efforts deemed necessary. It is a strategy that is also intended to be appropriate to the delicate situation of the economic recovery process. Moreover, the consolidation of economic growth, with its positive repercussions in stimulating the labour market, is an integral part of the strategy for fiscal consolidation. Hence, the option chosen has been to maintain the stability of the tax structure and to still retain, at this stage, a contribution from public investment or from public initiative investments to stimulate the economy and support employment, which is expected to be increasingly supplemented by private investment, as confidence is strengthened.

The recovery of economic growth will focus on external demand, which implies the strengthening of the export sector and the internationalisation of the Portuguese economy, particularly among small and medium-sized enterprises, aiming to penetrate new markets and further improve the added value of our exports. Accordingly, improvements in exports and continued commitment to renewable energy will be the main pillars for fostering the competitiveness of the Portuguese economy and the strategy to ensure the structural adjustment of its external imbalances. Additionally, it must be stressed that the SGP is in articulation with public policy reforms aimed at modernising the economy and the State and improving the underlying competitiveness of the Portuguese economy, in areas such as the improvement of qualifications, investment in science and technology, the simplification of administrative processes, procedures and practices, and cutting the red-tape and other context costs of companies, or the improvement of transport and logistics infrastructure, in order to ensure that the Portuguese economy can effectively access foreign markets.

Nonetheless, the consolidation of economic growth and gradual improvement to the structural conditions underlying competitiveness of the Portuguese economy will only lead to sustained growth of the economy and employment if accompanied by a successful fiscal consolidation and a reduction of the level of indebtedness of the Portuguese economy. These are the objectives of this Stability and Growth Programme and the rationale of its specific and rigorous measures, for a stronger economy.

Table 2. Main Impact of the Public Finances Consolidation Measures, from 2011 onwards

	2011	2012	2013
	% of GDP Direct effects resulting from comparison with no policy changes scenario [(1)]		
DECREASE OF CURRENT EXPENDITURE			
Compensation of Employees			
Strong wage constraints and the reinforced implementation of the "2 out for 1 in" recruitment rule, in order to reduce the share of GDP of compensation of employees expenditure to 10% in 2013 - nominal decrease of at least €100 million per year	0.20	0.42	0.63
Social Expenditure			
Definition of ceilings and decrease of expenditure			
Social benefits of the non-contributory Social Security schemes (nominal value freeze and compulsory means testing as elegibility condition for all the non-contributory benefits, ceiling for transfers from the State Budget of €7100 million in 2011, €7000 million in 2012 and €6900 million in 2013, including a ceiling of €400 million for the Social Integration Income in 2011 and €370 million in 2012 and in 2013)	0.30	0.45	0.55
Management and control of health expenditure - internal control; implementation of public service contracts and incentive mechanisms in the National Healthcare Service; medicine policy, electronic prescriptions; and supplementary diagnostic and therapeutic services	0.20	0.30	0.39
Speed up the convergence of the civil servants pension scheme (CGA) with the Social Security general scheme, including the frontloading of the new rule to penalise early retirement and the the full transition, already between 2012 and 2013, to the retirement age at 65 years old	0.04	0.05	0.07
Intermediate Consumption Expenditure			
Reduction and rationalisation of operating expenditure, defining ceilings for outsourcing expenditure, with projects, studies, expert opinions and consultancy (€90 million per year) and for military equipment expenditure (revision of the Military Funding Programme with a 40% redution in the scheduled amounts for each year)	0.20	0.20	0.20
Interest Expenditure			
Reduction of the cost of the general government debt as a result of privatisation operations	0.03	0.07	0.10
DECREASE OF CAPITAL EXPENDITURE			
Postponement for two years of the Lisbon-Porto and Porto-Vigo high-speed rail links, in order to avoid any financial impact until 2013	0.00	0.14	0.20
Non-commitment to new road infrastructure concessions and gradual return of investment to pre-crisis levels	0.26	0.45	0.60
INCREASE OF REVENUE			
Reduction of tax allowances and benefits (tax expenditure)	0.46	0.46	0.47
Capital gains on securities subject to 20% personal income tax rate	0.14	0.14	0.14
Limitation of personal income tax allowances and benefits	0.26	0.26	0.26
Reduction of the specific personal income tax allowance for pensions exceeding €22500/year	0.06	0.06	0.07
Other measures to strengthen revenue			
Broadening and control of the Social Security contributory base, and temporary special (until 2013) income tax rate of 45% on incomes above €150000	0.18	0.28	0.37
TOTAL FISCAL SAVINGS (attributable to these measures)	**1.87**	**2.82**	**3.56**
Of which: attributable to the increase of revenue	0.64	0.74	0.84
attributable to the decrease of expenditure	1.23	2.08	2.73
of which: attributable to the decrease of primary expenditure	1.20	2.02	2.63
PRIVATISATIONS in the energy sector (Galp Energia, EDP, Ren, Hidroeléctrica Cahora Bassa), shipbuilding and defence sectors (Estaleiros Navais de Viana do Castelo, Edisof, EID and Empordef IT), air transport (ANA and TAP), rail sectors (CP Carga and EMEF), financial sector (BPN and Caixa Seguros), communications sector (CTT), paper sector (Inapa), and mining sector (Sociedade Portuguesa de Empreendimentos), as well as the concession to operate CP railway routes.			
Effect in reducing Public Debt	0.99	0.79	0.65
STATE-OWNED ENTERPRISES			
Establishment of indebtedness ceilings - impact of the slowdown of the indebtedness growth rate	0.70	0.79	0.93

(1) As specified in Box IV.2.

Source: Ministry of Finance and Public Administration.

Chapter 1

I. Economic Outlook

I.1 Recent Developments of the Portuguese Economy

In 2008 and 2009, particularly between the last quarter of 2008 and the end of the second quarter of 2009, the world economy faced an economic crisis only comparable to the 1929 crisis. The recent crisis first hit the most advanced economies, which, in 2009, recorded a decline of about 3.2% in GDP, after a 0.5% growth in 2008 (0.6% and -4 % in the Euro area in 2008 and 2009, respectively), spread to the emerging economies and developing countries. China and India are exceptions to this trend, continuing to register relatively high real GDP growth rates, though lower than in previous years. In response to this environment, trade declined significantly in 2009 (-12.3%), conflicting with the average growth of 6.6 % between 2000 and 2008.

The spread of the crisis in international financial markets to the real economy, the decline of the real estate construction segment in the USA and in some European economies (UK, Spain and Ireland) and the reduction of the price of raw materials (oil and non-energy goods), with a negative impact chiefly on emerging economies, all contributed to this environment. The increase in uncertainty, the deterioration of growth prospects and worldwide demand, the rapid deterioration of the labour market and the existence of more restrictive conditions on contracting loans, due to the asymmetrical distribution of liquidity and rise of risk premiums incorporated into loan interest rates, were factors that favoured economic decline in most countries.

Portugal, a small open economy, was not immune to the direct and indirect repercussions of a crisis of this nature. The economic situation of other countries, especially among Portugal's main trading partners (Spain, Germany, France, Italy and UK), played a decisive role in the real contraction of the Portuguese economy in 2009, particularly by the negative impact on the flow of international trade.

Figure I.1. Openness of the economy
(Nominal y-on-y, 3 month moving average)

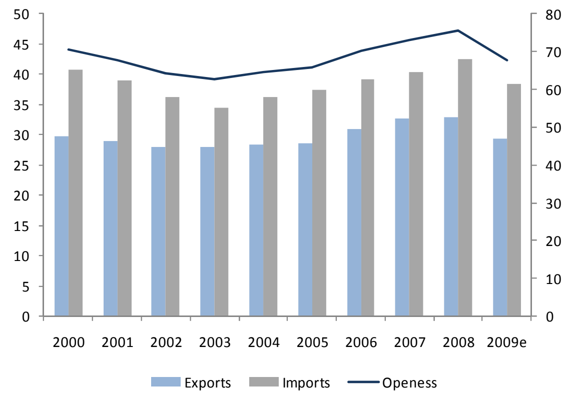
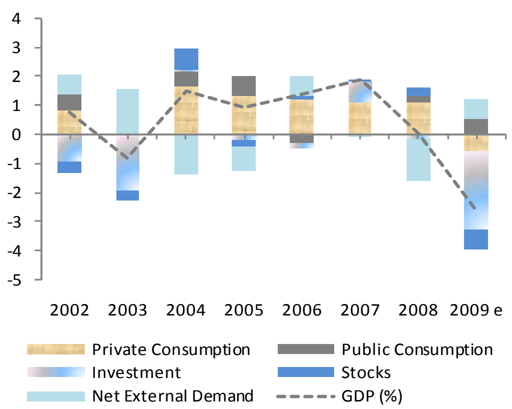


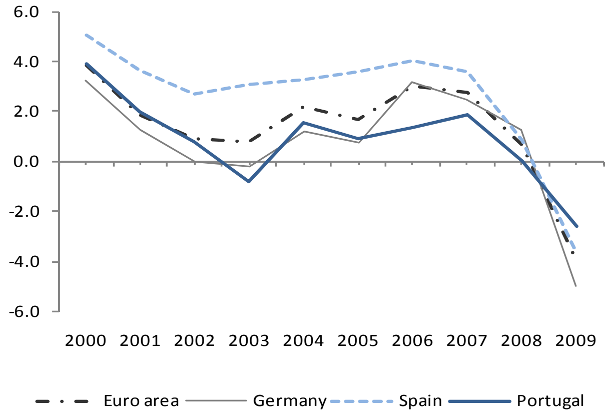
Figure I.2. Contributions to GDP growth
(p.p.)



Source: INE.

On the expenditure side, the variables that recorded the most significant decline were exports and investment. However, since imports also registered a noticeable decline, and given the greater share of this component in the balance of goods, the net external demand's contribution to the change in output was positive. Moreover, the stimulus measures, provided in coordination with other EU governments, helped private consumption to register a decline that was not as significant as initially forecasted, though registering a negative dynamic (real year-on-year rate of change of -0.8%). Hence, GDP in 2009 fell by 2.7% in real annual terms, after recording a null growth in 2008. This is a better result compared with that seen in the Euro Area (-4%) and among Portugal's main trading partners.

Figure I.3. GDP – Portugal and some of its trading partners
(Real y-on-y growth rate, %)



Sources: INE and Eurostat.

On the supply side, the contraction in manufacturing began in 2008 and lasted throughout 2009, having the industrial production index for manufacturing recorded a year-on-year decline of 9.9% (compared with -4% in 2008). In the construction sector, which has shown real falls in recent years, there was a counter-cyclical behaviour, caused by the impact of the implementation of the programme to stimulate the economy, in particular the programme to upgrade secondary schools.

The services sector also registered substantial shrinkage during 2009 (negative year-on-year decline of 12.2%, *versus* 0.4% in 2008), which also encompassed retail trade (-5.5% in 2009, in year-on-year terms, after a growth of 2.4% in 2008).

Figure I.4. Industrial production indexes
(Y-on-y growth rate, 3 month moving average)

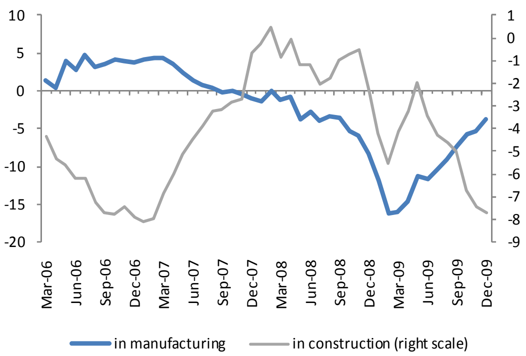
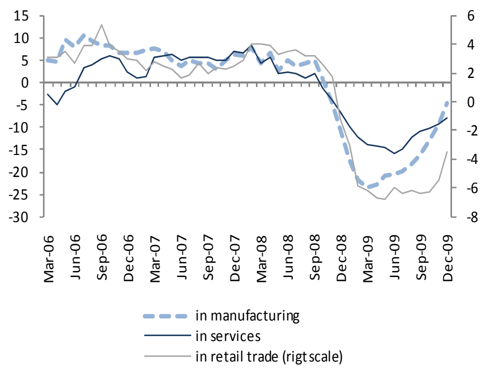


Figure I.5. Turnover index
(Y-on-y growth rate, 3 month moving average)



Source: INE.

The labour market reflected this shrinkage of the real economy. Following the improvement recorded in 2008, a heavy decline was recorded in 2009 – the unemployment rate rose to 9.5%, on average, and total employment fell by 2.8% from the previous year. This increased synchronization between the contraction of economic activity and the increase of the unemployment rate demonstrates the magnitude, scope and speed at which this crisis spread through all sectors of activity.

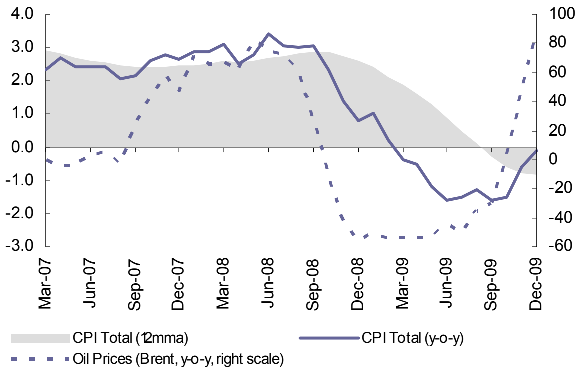
Table I.1. Labour force, employment and unemployment
(Y-on-y rates of change, %)

	2007	2008	2009	2008				2009			
				I	II	III	IV	I	II	III	IV
Labour force	0.6	0.1	-0.8	0.2	0.8	-0.3	-0.2	-0.4	-1.0	-1.1	-0.5
Total Employment	0.2	0.5	-2.8	1.1	1.4	-0.1	-0.2	-1.8	-2.9	-3.4	-3.0
Unemployment Rate (%)[1]	8.0	7.6	9.5	7.6	7.3	7.7	7.8	8.9	9.1	9.8	10.1

Note: (1) Unemployed population/Labour force.
Source: INE, Quarterly Employment Survey.

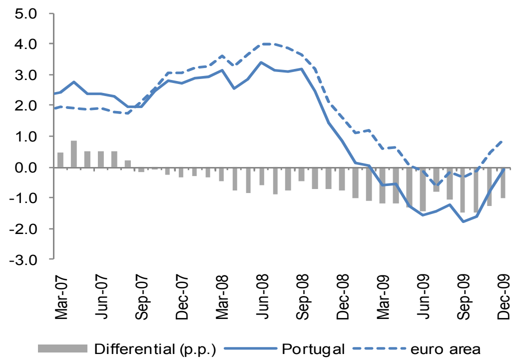
The years of 2008 and 2009 were atypical in terms of price behaviour. Prices registered continuous growth between the second half of 2007 and the third quarter of 2008, due to raw materials and energy product price trends on international markets. At the end of that period, this price trend was reversed, with prices retreating heavily and continuing to fall throughout 2009. This trend, together with the significant slowdown in economic activity in Portugal, moulded prices performance in 2009: the CPI decreased by 0.8% from 2008, following an increase of 2.6% in the previous year.

Figure I.6. Consumer price index and oil spot price
(Rates of change, %)



Source: INE.

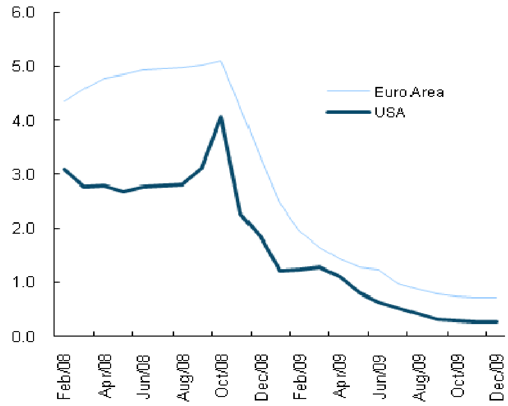
Figure I.7. HICP – Portugal and Euro Area
(Y-on-y rates of change, %)



Sources: INE and Eurostat.

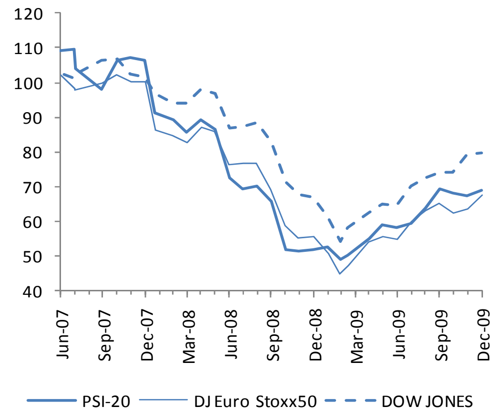
The implementation of economic and financial policies by governments and central banks of various countries led to a gradual improvement of the situation in international financial markets and to a reduction of risk premiums, which, however, have remained higher than they were before the start of the financial crisis.

Figure I.8. Short-term (3-month) interest rates
(Y-on-y rates of change, %)



Sources: European Central Bank and IGCP.

Figure I.9. Stock market indexes
(April 2007=100, end of period)



Source: Bloomberg.

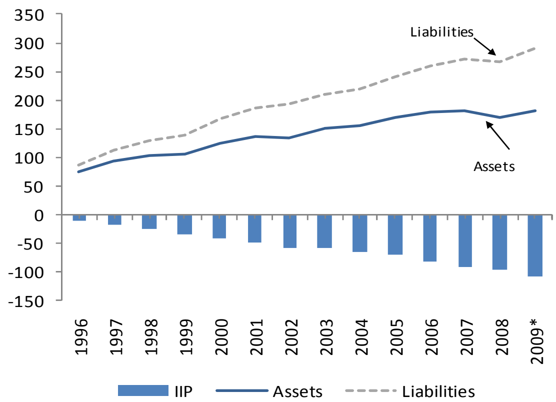
The economic data, reflecting this articulated effort to combat the effects of the economic and financial crisis, have gradually become less negative from mid-2009 onwards, pointing to a recovery of economic activity and international trade in the second half of the year for most of the more advanced economies.

I.2 Financing of the Portuguese Economy

Portugal's participation in the Economic and Monetary Union, since its inception in 1999, had a significant impact over the economy in what concerns the change in the economic environment in which agents operate. The extinction of the exchange rate risk, jointly with a decrease in nominal and real interest rates, induced to, on the one hand, a reduction of restrictions on the access to capital and, on the other, an increase in the possibilities of assets portfolio diversification.

In this new context, the Portuguese economy financial openness to the exterior broaden, as shown by the increase of holdings of financial assets issued by non residents, as well as by the higher foreign indebtedness, both presenting a more pronounced trend (Figure I.10).

Figure I.10. International investment position (IIP)
(% of GDP)



Note: *2009 data corresponds to the third quarter.
Source: Banco de Portugal.

Alongside with these developments, the Portuguese banking system was already undergoing significant changes to its regulatory framework, namely through privatization and liberalization processes which, simultaneously with this sector's significant technological progress, have led to an increase in credit market competition. Banks, in turn, have played a very important role in the transmission of these new market conditions to the different sectors of the economy, thus fulfilling their role as financial intermediates. Despite the late development of the financial system, when compared to other European countries, this evolution set a good ranking position for Portugal in what concerns the financial intermediation degree, carried out by Other Monetary Financial Institutions (OMFI)[1]. This indicator has been increasing, in a comprehensive way, particularly in countries that belong to the Euro area.

This new macro-financial framework allowed economic agents to have access to financing in more favourable market conditions, than those previously applied in the Portuguese economy. This enabled the sharing of inter-temporal risk, namely the smoothing of consumption and the investment over the life cycle, compensating for expected changes in income. In aggregate terms, the more broadened access to credit induced a significant reduction in the saving rate, while consumption kept growing faster than GDP. This development led to an increase in Portuguese indebtedness, reflected in the International Investment Position (IIP) evolution (Table 2).

Table I.2. International investment position, by institutional sector

(% of GDP)

	Monetary Financial Inst.	General Government	Other sectors
1996	16.8	-13.3	-14.2
2002	-32.0	-34.2	8.8
2009	-43.6	-52.8	-12.1

Source: Banco de Portugal.

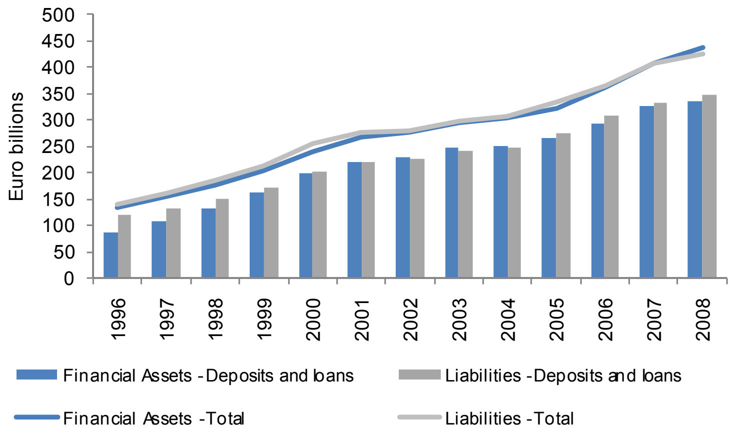
Regarding the IIP by institutional sector, this net external indebtedness has been mainly achieved by General Government entities, on the one hand, and by MFIs, on the other. However it is important to emphasize that the MFIs went from a creditor position in the late 90 to a debtor position, due to its role in financial intermediation.

Concerning the public case, this development represents a growing demand for external financing by General Government entities, in a context where the monetary financing of the deficit is no longer possible. Again, the integration of the Euro area has brought benefits, allowing a wider market for the Portuguese Government debt demand and, therefore, a more competitive State funding. The action taken by *Instituto da Gestão da Tesouraria e do Crédito Público, IP*, with respect to the debt placement in international markets, led to the issue of higher amounts, ensuring the benchmark securities trade, which must be quoted by the market makers. The issue of benchmark securities is essential to ensure a net yield curve, particularly in the 10-years segment, the benchmark of capital markets in the Euro area.

Regarding the MFIs, this sector external indebtedness was intended, primarily, to finance other sectors of the economy. As shown in the figure below, the net financial assets of the MFIs remained relatively stable over the period, which means that the increase in foreign liabilities was offset with the significant increase in assets (Figure I.11).

[1] Measured by the ratio between the sum of financial assets and liabilities of OMFI and the sum of financial assets and liabilities for the economy.

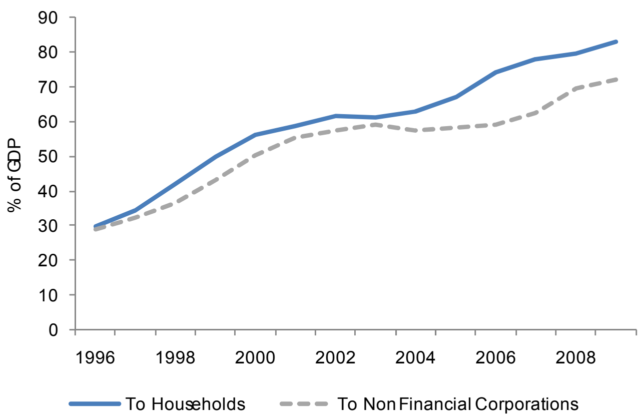
Figure I.11. Main components of OMFI balance sheet



Source: Eurostat.

Indeed, the assets of the Portuguese banking sector, especially the loans to the private non-financial sector, have been rising considerably, reflecting the fact that the money borrowed in the Euro area market was channelled into households and non-financial corporations (Figure I.12).

Figure I.12. Evolution of banking internal loans



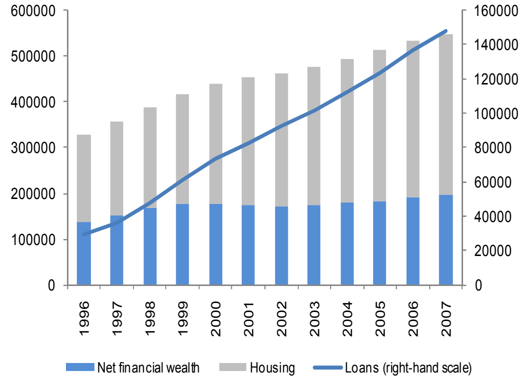
Source: Banco de Portugal.

Furthermore, in the case of households the more favourable financial conditions have, in a large extent, increased their debt levels, mainly aiming private housing purchasing (Figure I.13). In fact, the loans granted by MFIs with this purpose have been representing, since 1996, over 70% of total loans, reaching about 80% at the end of 2009. The *Inquérito ao Património e Endividamento das Famílias*[2] micro-data concluded that this increase in debt levels resulted largely from a greater number of families having access to credit, thus facing lower liquidity constraints, rather than an increase in indebtedness levels for families who already held credit.

Comparing Portugal's data with other European Union countries, it seems that the increase in households loans was widespread, despite the fact that Portugal was one of the countries registering a higher increase (Figure I.14).

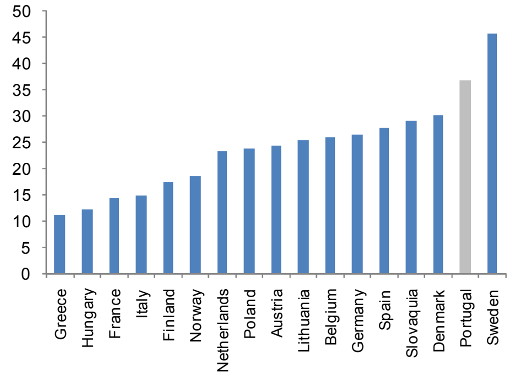
[2] Survey on households' wealth and indebtedness conducted by INE and Banco de Portugal.

Figure I.13. Households wealth and loans
(Million €)



Source: Banco de Portugal.

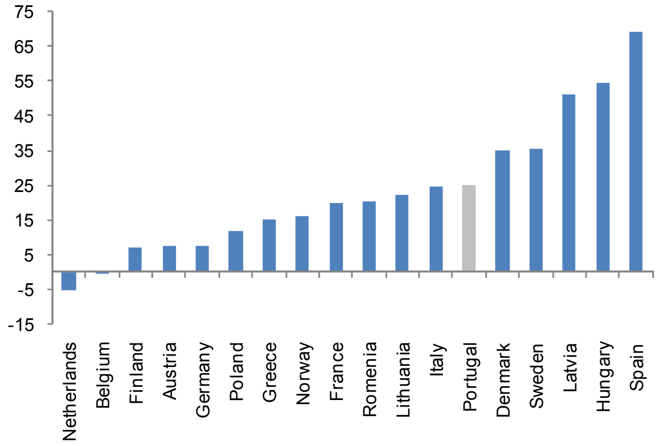
Figure I.14. Differential in households loans
(2008-1999, p.p. of GDP)



Source: Eurostat.

In what concerns the non-financial corporations, the higher use of bank credit was to finance their own activity, even though the own funds remained as the main source of financing.

Figure I.15. Differential in non-financial corporations loans
(2008-1999, p.p. of GDP)



Source: Eurostat.

As regards the international context, the increase of non-financial corporations loans was more heterogeneous than in the case of individuals, with Portuguese values approaching the European average (Figure I.15).

I.3 Medium-Term Scenario (2010-2013)

I.3.1 External Technical Assumptions

The prospects for 2010 and 2011 comprehensively indicate a significant improvement in the world economic activity. World GDP, according to the International Monetary Fund, should increase, respectively, by 3.9% and 4.3% in real terms, anchored on the sharp recovery of the emerging and developing economies, in a context where the recovery of the advanced economies should occur at a slower pace. The gradual recovery of the world economy should be accompanied by moderate prices development over the medium-term horizon, though a slight increase is forecasted due to the expected increase of raw material prices.

In summary, the assumptions for the external environment point to the recovery of the international economic climate, with a gradual overcome of the financial and economic crisis.

There are still, however, some risks that may affect the strength of the recovery, which are related to the possible stagnation of domestic demand in advanced economies.

The scenario of a significant rise in oil prices caused by supply not keeping pace with growth in worldwide demand, especially from China, is also considered a potential risk. It must be noted that the recent crisis halted investment in new oil rigs intended to increase oil supply capacity. Moreover, at a time of sharply rising unemployment and worsening social tensions, there may be more pressure for a rebound effect of trade and financial protectionism.

Nonetheless, there are reasons to believe that this potential risk might be mitigated, considering:

a) The remoteness of a scenario of collapse of the international financial system (similar to that of the 1930s);

b) The marked improvement in expectations of financial market operators;

c) The strong possibility that consumption, investment and, hence, GDP grow higher than expected in the short to medium term.

In this context, the growth in relevant foreign markets[3] for Portugal and an increase in interest rates are envisaged for the near future. Also expected to occur is (i) the increase in oil prices; (ii) the appreciation of the euro against the dollar and (iii) the rise of the inflation rate, in line with expected increase of raw materials and oil prices.

The table bellow summarises the main external assumptions underlying the macroeconomic scenario. These assumptions reflect information available as at 26 February 2010.

Table I.3. International environment – main assumptions

	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
Growth of relevant external demand (%)	2.5	-14.7	1.7	4.5	4.5	4.6
Oil price (Brent, USD/bbl)	96.4	62.5	76.6	82.0	84.8	86.5
Short-term interest rate (annual average, %) (a)	4.6	1.2	1.2	2.4	2.9	3.2
Long-term interest rate (annual average, %) (b)	4.6	4.3	4.5	5.1	5.3	5.2
Nominal effective exchange rate for Portugal (c)	1.3	-0.9	0.0	0.0	0.0	0.0
USD/Euro exchange rate (annual average)	1.471	1.393	1.434	1.470	1.460	1.450

Notes: (f) forecast.

Notes: (a) 3-month Euribor rate; (b) 10-year treasury bonds; (c) Annual average rate of change in % (positive/negative change means appreciation/depreciation of the euro).

Sources: Ministry of Finance and Public Administration, EC, IMF and OECD.

[3] Relevant foreign markets – it is an indicator calculated by the Ministry of Finance and Public Administration based on the forecasts of real growth of imports of the Portuguese main trade partners, weighted by the relative importance that those countries have on the Portuguese exports. In the case of Portugal the following countries were considered: Spain (26.5%), Germany (13.3%), France (12.4%), Angola (8.1%), UK (5.6%), Italy (3.8%), The Netherlands (3.7%), USA (3.6%), Belgium (2.4%), Sweden (1.2%), Brazil (1%) and China (0.8%), which amount for more than 80 % of the Portuguese exports.

I.3.2 Prospects for the Portuguese Economy for 2010-2013

The high degree of uncertainty that still characterises the worldwide recovery of the economic and financial activity demands further caution as far as the design of the macroeconomics forecasts are concerned.

The recovery of the Portuguese economy is envisaged for 2010, with an estimated growth of 0.7% in this year. This improvement should be seen in the context of the recovery of relevant foreign markets, reflected in the growth of exports for this year.

Table I.4. Main economic indicators
(Rates of change, %)

	2008	2009(e)	2010(f)	2011(f)	2012(f)	2013(f)
GDP and Expenditure Components (real terms)						
GDP	0.0	-2.7	0.7	0.9	1.3	1.7
Private Consumption	1.7	-0.8	1.0	0.8	0.9	1.0
Public Consumption	1.1	3.5	-0.9	-1.3	-1.4	0.2
Investment (GFCF)	-0.7	-11.1	-0.8	1.0	1.6	1.8
Exports of goods and services	-0.5	-11.4	3.5	4.1	4.5	4.6
Imports of goods and services	2.7	-9.2	1.7	1.9	1.9	2.0
Price Developments						
CPI (a)	2.6	-0.8	0.8	1.9	1.9	2.0
Labour Market Developments						
Employment	0.4	-2.8	-0.1	0.1	0.4	0.6
Unemployment Rate (%)	7.6	9.5	9.8	9.8	9.5	9.3
Apparent labour productivity	-0.4	-0.1	1.3	0.8	0.9	1.2
Current and Capital Account Balances						
Net lending / borrowing vis-à-vis the rest of the world	-10.3	-9.4	-9.3	-9.1	-8.7	-8.3
- Current account balance	-12.1	-10.6	-10.8	-10.8	-10.6	-10.1
of which Balance on goods	-12.1	-10.0	-10.3	-9.9	-9.5	-8.9
- Capital account balance	1.8	1.2	1.6	1.7	2.0	1.8

Notes: (e) estimate; (f) forecast.
Note: (a) Consumer Price Index average annual change.
Sources: INE and Ministry of Finance and Public Administration.

Furthermore, private consumption should register a positive growth of around 1%, above GDP growth. This development is expected to be associated with the increased consumption of durable goods, in line with the pro-cyclical behaviour of this variable.

Investment in 2010, despite recovering markedly from 2009, should continue to register a negative real growth. The expected recovery of investment is associated with the envisaged significant improvement of the economic sentiment (in line with the recovery of economic activity), which will have a positive impact on the growth of private investment. Private investment will provide the positive contribution to overall investment in 2010, replacing public investment as the driving force of this aggregate.

International trade, following the sharp fall in 2009, should recover significantly, with both exports and imports expected to register positive year-on-year growth rates. In particular, both exports of goods and of services should register a real growth, with the goods component expected to evolve relatively more favourably. It is expected that imports, in line with the recovery of global demand and reflecting the more favourable development of other expenditure components, register, in 2010, a real growth of around 1.7%. This behaviour will primarily be due to the development of goods imports, as services imports should decline from the previous year.

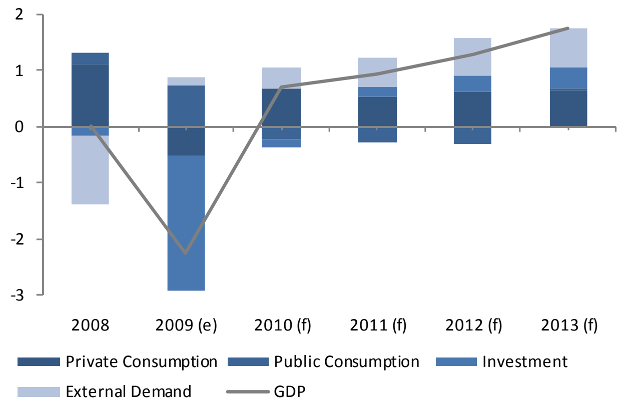
These developments should lead to an increase of the goods account deficit, mainly by means of the price effect, since an acceleration of the imports deflator is expected. The envisaged worsening of the Portuguese economy's net borrowing situation in 2010 should also be influenced by the deterioration of the income account, in consequence to the increase of external borrowing and to the forecasted increase in interest rates.

In the labour market, employment is still expected to register a marginal fall, which should drive the unemployment rate to an average of 9.8% in 2010, reflecting a negative evolution in the first half of the year that is expected to be offset in the second half.

The inflation rate should increase to 0.8% in 2010. This forecast is based on assumptions concerning the evolution of raw material prices on international markets and also on the expected economic recovery of Portugal and of its main trading partners.

The 2009 spread of the financial crisis to the real economy, in Portugal and in its main trading partners, eased in the second half of the year, which may lead to the conclusion that the recession of the world economy has bottomed out. Nonetheless, the existence of some structural imbalances, particularly in the Portuguese economy, may hamper a faster recovery.

Figure I.16. Contributions to GDP growth
(Percentage points)



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

Moreover, the necessary budgetary consolidation effort, in order to reduce the General Government budget deficit and set it below 3% of GDP in 2013, will have repercussions on economic growth. Thus, a gradual recovery of economic activity is expected for the period 2011 and 2013 – real GDP is expected to grow 0.9%, 1.3% and 1.7% in 2011, 2012 and 2013, respectively.

The main drivers of GDP growth will be the improvement of exports (in line with the dynamics demonstrated by the growth of the relevant foreign markets) and, to a certain extent, of investment, particularly private investment. On the other hand, the budgetary consolidation measures and the high unemployment rate will lead to a certain curbing of private consumption, with growth stabilising at around 0.9%. Public consumption, in contrast, should shrink on average, as a result of adjustments to be made in order to correct the General Government deficit by 2013.

The Portuguese economy's net borrowing *vis-à-vis* the rest of the world should increase up to 2011, after which this macroeconomic indicator is expected to be corrected, largely due to the improvement of the trade balance deficit and the process of budgetary consolidation in progress. The worsening of the net borrowing in the first part of this period should primarily be the result of the decline of the income account, largely due to the probable rise in interest rates over the projection horizon.

The labour market is expected to improve after 2011, in an environment of gradual economic recovery. The unemployment rate is expected to follow a downward path between 2011 and 2013, when it should reach 9.3% (a value still above the 2008 figure). In the medium-term, employment should follow the dynamic of economic recovery and grow on average 0.4% between 2011 and 2013. The assumption for the growth of labour productivity in this period is 0.9%, on average.

In the medium-term scenario, price developments are expected to stabilise at around 1.9%, on average, between 2011 and 2013, in consequence of the increase of the inflation rate to 0.8% in 2010. This behaviour reflects the forecasted evolution of raw material and energy product prices on international markets.

Chapter

2

II. Budgetary Consolidation Measures

The State Budget for 2010, taking into consideration the prevailing domestic and international economic context and the uncertainties that still exist, envisages an immediate reduction of the General Government deficit to 8.3% of GDP.

In the following years (2011 to 2013), the General Government deficit will need to be reduced by 5.5 percentage points (p.p.) in order to achieve the goal of 2.8% of GDP in 2013. In terms of structural balance, a 1 p.p. reduction is achieved in 2010 and a reduction of 5 p.p. in 2011 to 2013.

The strategy to reduce the General Government deficit and curb the growth of General Government debt is primarily based on:

- The reduction and control of public expenditure;
- The decrease of tax expenditure;
- Broadening and frontloading the privatisation plan.

The measures established in the Stability and Growth Programme 2010-2013 will permit a 2.7 p.p. of GDP reduction of the share of total expenditure and a 0.8 p.p. improvement in the revenue. The main contributions to the reduction of the General Government deficit will, thus, be: the reduction of expenditure (49%), the improvement of revenue (15%), and also the benefits from the economic recovery and the operation of the automatic stabilisers (36%).

Fiscal consolidation based on reducing and curbing expenditure cannot overlook its structure, particularly the structure of current expenditure. The most significant and critical results for the success of the fiscal consolidation will have to be based on the reduction and control of the most significant expenditure components.

Figure II.1. Current expenditure breakdown, 2005
(% of GDP)

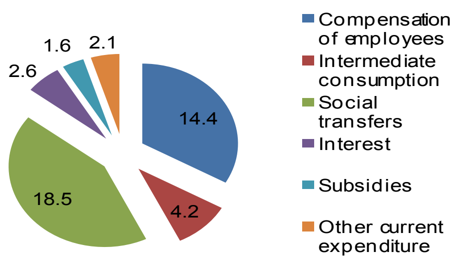
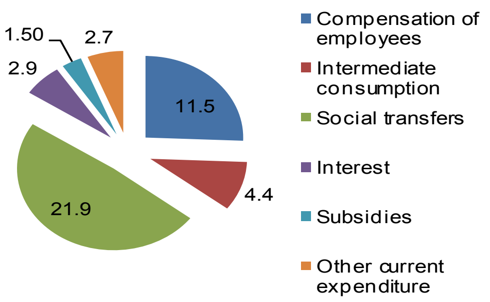


Figure II.2. Current expenditure breakdown, 2009
(% of GDP)



Source: Ministry of Finance and Public Administration.

The weight of current expenditure in GDP remained stable between 2005 and 2008 (43.4% *versus*. 43.3%), rising to 44.9% in 2009, as a result of the effects of the economic and financial crisis. From 2005 to 2009, its structure has undergone significant changes:

- Compensation of employees has declined in percentage of GDP from 14.4% to 11.5%;
- Social benefits have grown in weight of GDP from 18.5% to 21.9%.

Compensation of employees and social benefits jointly accounted for 75% of current expenditure between 2005 and 2009. The share of compensation of employees decreased from 33% to 26% and the share of social benefits increased from 42% to 49%.

The structural reforms measures initiated in the previous governmental mandate have already contributed to this curbing of current primary expenditure, and the increase of their importance is envisaged over the projection horizon of the current programme. In particular, the reform in the General Government is reflected in the development of the compensation of employees heading, while the reform in Social Security, extended to the *Caixa Geral de Aposentações* (CGA) sub-system contributes to the curbing of expenditure on pensions, which is one of the main components of social benefits expenditure. The impact of these reforms can be estimated by the difference between the obtained/forecast values, taking into account current legislation and the values that would have been obtained under the rules in force prior to the implementation of the reform measures (Table II.1).

Table II.1. Estimated savings of the main structural reforms of the previous governmental mandate
(Percentage points of GDP)

	2009	2010	2011	2012	2013
Reform in the General Government	0.2	0.5	0.7	0.9	1.2
Reform in Social Security	0.1	0.2	0.2	0.3	0.4

Source: Ministry of Finance and Public Administration.

In the no policy change scenario, compensation of employees would develop according to the following assumptions: i) the number of public employees remains unchanged under an admissions rule of 1 new employee for every employee leaving and ii) the 1.3% contribution of wage drift towards the annual increase of compensation of employees remains unchanged.

In relation to expenditure on pensions, the assumptions of the counterfactual scenario of no reform measures in the public pension system, in force since 2007, also correspond to the development observed to that date: i) annual update of pensions according to wage developments; ii) the rule for calculating new pensions in the Social Security is not implemented early; iii) the penalty rate for early retirement in the Social Security is 4.5% per year; and iv) non-implementation of the sustainability factor (in force since 2008).

The following Table summarises the main measures to reduce the General Government deficit to 2.8% of GDP by 2013.[4]

[4] The major impacts of these measures are quantified in Table 2.

Table II.2. Mains Measures of Public Finances Consolidation

Compensation of employees	- Strong wage constraints and the reinforced implementation of the "2 out for 1 in" recruitment rule, in order to reduce the share of GDP of compensation of employees expenditure to 10% in 2013 - nominal decrease of at least €100 million per year.
Social Expenditure	- Mandatory "means testing" (*condição de recursos*) as elegibility condition for all non-contributory social benefits '- Nominal freeze of most non-contributory benefits
	- Decrease of expenditure on social benefits of the non-contributory Social Security scheme (ceiling for transfers from the State Budget of €7100 million in 2011, €7000 million in 2012 and €6900 million in 2013, including a ceiling of €400 million for the Social Integration Income in 2011 and €370 million in 2012 and in 2013)
	- Changes to Unemployment Benefit - i) revision of the relationship between the unemployment benefit and the net income previously earned by the worker; ii) decrease to the wages threshold at which job acceptance is compulsory
	- Management and control of health expenditure - internal control and implementation of public service contracts and incentive mechanisms in the National Healthcare Service; medicine policy; electronic prescriptions; supplementary diagnostic and therapeutic services; and focus of the National Health Plan (2011-2016) on the financial sustainability of the National Healthcare System
	- Speed up of the convergence of the civil servants pension scheme (CGA) with the Social Security general scheme, including the frontloading of the new rule to penalise early retirement and the full transition, already between 2012 and 2013, to the retirement age at 65 years old
Intermediate Consumption Expenditure	- Reduction of operating expenditure by means of: i) definition of anual ceilings for outsourcing expenditure, with projects, studies, expert opinions and consultancy (€90 million between 2011 and 2013); ii) 40% redution in the scheduled amounts for military equipment expenditure in each each year of the Military Funding Programme; and iii) rationalisation of the State's fleet of vehicles and improvement in the efficiency of the National Public Procurement System
	- Improvements in the management of Education and Justice, including the management of networks and processes as well as of units
Public Investment	- Postponement, for two years, of the Lisbon-Porto and Porto-Vigo high-speed rail links, in order to avoid any financial impact until 2013; non-commitment to new road infrastructure concessions and gradual return of investment to pre-crisis levels
	- Rule of zero indebtedness for regional and local governments, excepting under emergency situations or, in terms to be defined, to finance EU co-funded projects
Reduction of tax allowances and benefits	- Capital gains on securities subject to 20% personal income tax rate
	- Global ceilings on personal income tax allowances according to the taxable annual income
	- Global ceilings on personal income tax benefits according to the taxable annual income
	- Freezing of the value of personal income tax allowances index-linked to the Guaranteed Monthly Minimum Allowance
	- Reduction of the specific personal income tax allowance for pensions exceeding €22500/year
	- Withdrawal of personal income tax benefits on personal injury and life insurance policies
	- Progressive concentration of the vehicle scrapping incentive in the purchase of electric vehicles and high environmental performance vehicles
	- Strengthening of the taxation of fringe benefits in the context of personal and corporate income tax
Other measures to strengthen revenue	- Setting up of a special (temporary, until 2013) personal income tax rate of 45% for taxable annual income exceeding €150000.
	- Broadening and control of the Social Security contributory base, through the entry into force of the contributory code and strengthening the measures to combat contributory fraud and evasion through, in particular, the cross-referencing of data with the Tax Administration and automatic enforced payment procedures
	- Introduction of tolls on current toll free motorways (SCUT), including both those already subject to a decision and others currently under evaluation
Privatisations	- Privatisations in the energy sector (Galp Energia, EDP, REN and Hidroeléctrica Cahora Bassa), shipbuilding and defence sectors (Estaleiros Navais de Viana de Castelo, Edisoft, EID, Empordef IT), air transport (ANA and TAP) and rail sectors (CP and EMEF), financial sector (BPN and Caixa Seguros), communications sector (CTT), paper sector (INAPA), and mining sector (Sociedade Portuguesa de Empreendimentos), as well as the concession to operate CP railway routes.
State-Owned Enterprises and Shareholdings	- Selectivity in investment and establishment ceilings to the growth of State-owned enterprises' indebtedness of 7% in 2010, 6% in 2011, 5% in 2012 and 4% in 2013
	- Public services contracts with all transport companies and revision of public service contracts in the media sector before the end of 2010
	- Alignment with the rules established for General Government as regards wage increases and the management of vehicle fleets
	- Revision of health and pension funds without contributory support
	- Creation of purchase centres in each company and for each sector
	- Cashflow Unit for non-financial enterpises of the State-Owned Enterprises Sector
	- Assessment and revision of the financing model of *Estradas de Portugal*
Reform of the Budgetary Framework	- Creation of a pluriannual budgetary framework, with defined expenditure ceilings and programme budgeting, to be proposed in the review of the Budgetary Framework Law in 2010

Source: Ministry of Finance and Public Administration.

In addition to the specific measures detailed in the following sections, there are a number of measures of special note which, due to their transversal nature, will generate savings on various items of expenditure and revenue.

Firstly, the **strengthening of the budgetary framework**. A pluriannual framework of expenditure with the setting of annual thresholds is essential to provide stability to the budgetary goals, transparency and to reinforce the accountability of the budget implementing bodies. In this context, it will be prepared a proposal to amend the Budgetary Law Framework in 2010.

Secondly, the generalisation of **means testing *("condição de recursos")*** with the establishment of stricter eligibility conditions for all non-contributory social benefits. The application of means testing, which will not only focus on income subject to personal income tax, but have a broader perspective that encompasses the financial income and wealth of the beneficiary, is an important advance in steering social expenditure towards the citizens that really need support.

Thirdly, the implementation of **rule of zero indebtedness for regional and local government entities**, based on article 87 of the Budgetary Framework Law, excepting under emergency situations or, in terms to be defined, in order to finance EU co-funded projects. The intention of the implementation of this rule is to enhance the contribution of these entities to the General Government effort to reduce and control public expenditure – particularly in relation to compensation of employees and capital expenditure – and correct the growth of General Government debt.

In fourth place, the **control of expenditure of the Autonomous Services and Funds** under the direct administration of the State will be strengthened, even when that expenditure is funded by own income. This control will be exercised by the respective management bodies, in strict collaboration with the Ministry of Finance and Public Administration.

In fifth place, **new budgetary discipline rules** are forthwith established, pursuant to which: i) the taking on of new expenditure commitments, or the decrease of own revenues, which are the basis of requests for budgetary reinforcement, now entail the submission, prior to authorisation of the request, by the member of the Government to which the body or service is accountable, of a plan that sets out the reduction, in a sustainable manner, of the corresponding expenditure in the relevant budgetary program; ii) changes to personnel structures that result in an increase of employment posts require the prior and reasoned authorisation of the member of the Government that the service or body is accountable to, provided that its coverage in the budget is duly proven, and also require recognition of its future sustainability by the member of the Government responsible for finances; iii) increases in share capital of State-Owned Companies and other financing by the State are dependent to on their inclusion in the relevant activity plans and commitments to improve management and expenditure control.

Finally, under the Confidence Agreement with the higher education system, **the contribution of higher education institutions to reduce and control the compensation of employees and intermediate consumption** will be reinforced.

II.1 Measures with Impact on the Decrease of Current Expenditure

The budgetary consolidation strategy is essentially based on the reduction and curbing of expenditure. Given its structure, particularly that of current expenditure, the most significant interventions will be made in the most influential headings and it is in these that the most decisive results are expected. These measures involve, in particular, intervention in the following fields:

- Compensation of employees;
- Social benefits, including the rationalisation of health expenditure;
- Intermediate consumption;
- Interest expenditure resulting from privatisation operations.

II.1.1 Compensation of Employees

Compensation of employees will be reduced to 10% share of GDP by 2013, through a decrease of at least €100 million per year.

The reform carried out in the General Government in the period 2005-2009 which, besides having contributed to equipping the State with a structure better able to serve its objectives, provided better quality in the provision of public services and greater efficiency in the use of available resources, represented one of the pillars of the budgetary consolidation strategy initiated in 2005 and again resumed in 2010, by helping control the growth of compensation of employees. The Restructuring Programme for the State's Central Administration (PRACE), controlling the recruitment of new employees, promoting internal mobility, and performance assessment are examples of some of the adopted initiatives with a structural impact in this area.

PRACE, concluded in 2007, allowed central organic units to be reduced by approximately 36.1% and the number of managerial posts to shrink by around 25%. The policy of reducing employee numbers through the successful application of the external recruitment rule of one new employee for every two leaving, as well as the strengthening of mechanisms to control the admissions and recruitment of personnel, permitted a reduction of approximately 73000 between 2005 and 2009, equivalent to about 10% of the 747880 employees existing at the end of 2005. Between 2005 and 2008, Portugal registered the most significant decline of these aggregate indicators among all EU countries.

In relation to human resources management, the new civil service employment scheme has been undergoing implementation, the aim of which is to align the incentives of managers and workers with the need to proceed with the effort to improve the services provided to citizens and businesses, within a framework to increase efficiency in the use of the available resources. The new employment contract scheme for civil servants, the new disciplinary regulations for civil servants, the reduction to three general careers (instead of the 1700 careers that previously existed), the new single compensation table and a stronger culture of performance assessment, based on differentiation, were implemented.

In the performance field, the reform of the assessment system strengthened the culture of evaluation and accountability in the General Government, allowing career progression and the award of performance bonuses to depend on management by objectives and the above-referred performance differentiation. It is a new paradigm that was designed and implemented between 2005 and 2007 and which has nowadays been wholly assimilated by most services. This assimilation is demonstrated by widespread application of the assessment system to employees and managers and, for the first time in recent decades, to all services of the State's Central Administration, which resulted in 20% of the services and bodies being graded as excellent in 2009, in accordance with law. Since career progression and bonuses are subject to maximum quotas among the universe of eligible employees and according to the budgeted funds available each year, it became possible to reduce and control the effects of wage drift that these components represented in the past.

Against the backdrop of consolidating the reform of the assessment system, the consolidation of the culture of evaluation in the General Government will now be undertaken, setting the rules for the award of management bonuses to senior managers against a framework of greater autonomy and accountability of the same. Also, in relation to senior management positions, the automatic changes of remuneratory position will be eliminated by virtue of its continuous practice for periods of three consecutive years.

In summary, two fundamental aspects of the development of compensation of employees envisaged for the 2010-2013 period are to be emphasized. Firstly, the set of reforms undertaken in the previous term in office deserve highlight – the control of admissions, mobility programme, performance assessment and differentiation, revision of careers and progression scheme – which made structural changes to the evolution of these expenditures. Indeed, the rationalisation of human resources carried out during the Government's previous term in office was structural in nature and therefore has a permanent effect that is reflected in a lower compensation of employees' growth rate than would have been the case if these reforms had not been implemented. It is, therefore, a rationalisation effect that is materially relevant and long-lasting.

Secondly, there is also a set of interventions in progress that contribute to strengthening the rationalisation of compensation of employees. In particular, the following measures will be implemented in the period from 2010 to 2013, and which aim to provide greater control of the development of expenditure on compensation of employees:

- Strengthening the rule of hiring one new public employee for at least every two leaving, clarifying and extending its scope of application to cover the admission of public employees in all sectors of the State's Central Administration. This should be, as a good practice for rationalising human resources in the General Government also applies to Local Government;
- The conclusion of the revision process for careers and special bodies, consolidating the full application of the above-referred principles of rationalising the management of human resources in the General Government and ensuring the adoption of assessment systems based on the differentiation of performance (quota mechanism), as well as the appropriate financial sustainability of that revision;
- Strong wage constraints. The award of performance bonuses will be maintained as recognition of the importance of the assessment system in the reform of the General Government.

Increased mobility through the reinforcement of training, reviewing the respective scheme and launching a programme aimed at public employees. This programme will be adapted in terms of content, form and duration to the different needs of employees and the services, depending on qualifications and the established goals, with the general aim being to acquire transversal skills that foster the raising of productivity and suitability.

II.1.2 Social Expenditure

Social Security Schemes

The intention in the field of social benefits is to apply an expenditure development control policy, so that their share in GDP remains within sustainable limits for the Portuguese economy and ensures the equilibrium of General Government accounts.

These expenditures will record a reduction from 21.9% of GDP in 2009 to 21.4% of GDP in 2013, equivalent to a decrease of 0.5 p.p. of share of GDP.

The intervention to 2013 will follow a line of action that, keeping the characteristics of our model of social protection, strengthens the instruments of discipline in the application. The main guidelines will be those involving: i) the unification of procedures and increased application discipline in relation to means-tested solidarity benefits; ii) the strengthening of the rules on accepting job offers in relation to benefit payments that replace income from paid employment, and the rules concerning solidarity benefits for the working age population; and iii) the elimination of the exceptional measures created in the employment and social policies areas.

Three measures that contribute to the effort to rationalise expenditure are of note in this field:

- The definition of an expenditure ceiling for social benefits of the non-contributory Social Security scheme, including the Social Integration Income;
- The change of the unemployment benefits scheme with the aim of promoting a faster return to work;
- The speed up the convergence of the civil servants pension scheme (CGA) with the Social Security general scheme, in line with the measures already adopted in the State Budget for 2010.

Reduction of Expenditure on Social Benefits of the Non-contributory Social Security Scheme

In the social benefits heading, in addition to the allocation of the revenue of 1 p.p. of the standard VAT rate (calculated each year, based on the VAT revenue forecast in the State Budget), a ceiling is set for the transfer from the State Budget to Social Security for the purpose of funding non-contributory benefits. In particular, the transfer from the State Budget to Social Security, budgeted for 2010 in the amount of €7498.7 million, will not break through the nominal ceilings of €7100 billion in 2011, €7000 million in 2012 and € 6900 million in 2013, in which the ceiling for the Social Integration Income is included: €400 million in 2011 and €370 million in each of 2012 and 2013.

The implemented expenditure of Social Integration Income in 2009 was €507.8 million, and the expenditure budgeted for 2010 is around €495.2 million.

The definition of the ceiling for expenditure on social benefits of this nature is accompanied by the strengthening of mechanisms to supervise and control the allocation and eligibility criteria, by means of:

- Increasing home monitoring of beneficiaries of the Social Integration Income;
- Half-yearly check of the income of beneficiaries and the mandatory validation of the benefit allocation conditions;
- Penalisation of false declarations and benefits that result in an undue payment of these benefits;
- Improved data cross-checking with the tax databases, in order to assess wealth and capital income;
- Activation of the beneficiaries of unemployment benefit, i.e. strengthening of the insertion of beneficiaries of working age in academic and vocational qualification and professional insertion programmes, in order to promote their independence from the benefit;
- Supervision and penalties for undue denial of employment by beneficiaries of these benefits.

This measure is supplemented by the control of expenditure on non-contributory social benefits, inherent to the definition of its growth threshold, through the maintenance of the nominal value for most of the non-contributory benefits up to 2013. Thus, these social benefits will have an update rule through the application of the Social Support Index (IAS), and this pegging to this Index will keep the nominal value to 2013.

Change of the Unemployment Benefit Scheme

The mechanisms for the allocation and maintenance of Unemployment Benefit are reviewed, with the introduction of the following:

- Review of the relationship between unemployment benefit and the net income previously earned by the worker;
- Decrease in the threshold of wages of job offers that require the acceptance of the job.

The intention of these measures is to create an incentive for the beneficiary of the unemployment benefit to find employment more quickly.

As regards the acceptance of job offers by the beneficiary, the current system establishes "suitable employment" as: i) guarantees in the first six months of allocation of unemployment benefit a gross income equal to or greater than the value of the unemployment benefit plus 25%; ii) guarantees from the seventh month a gross income equal to or greater than the value of the unemployment benefit increased by 10%. The criterion will be enhanced by reducing the acceptance thresholds for wages.

Update Rule for Pensions of the General Social Security Scheme

The inflation indexing rule is used for the update of pensions, pegging the pension to the economic growth recorded and the value of the pension to be updated. This rule, which was established in the 2006 reform in Social Security, made a decisive contribution to controlling expenditure on pensions and, therefore, the sustainability of this scheme.

Speed up the Convergence of the CGA (Civil Servants Pension Scheme) with the Social Security General Scheme

The Government held discussions with the social partners and political forces during 2006 to seek a broad consensus on the best reform strategy to meet the challenges that faced the Social Security at that time. The upshot of these discussions was the creation of the Framework Social Security Law[5] which contains measures such as the new pension scheme[6], the revision of the Social Security funding model[7] and the implementation of the Public Capitalisation Scheme[8].

The control of the development of pension expenditure has been achieved through measures focused on the reform in the two subsystems of public social security: the Social Security subsystem, which covers private sector employees and public employees recruited since 2006, and the *Caixa Geral de Aposentações* (CGA) subsystem, which encompasses all other public employees.

[5] Law No. 4/2007 of 16 January.
[6] Decree-Law No. 187/2007 of 10 May.
[7] Decree-Law No. 367/2007 of 2 November.
[8] Decree-Law No. 26/2008 of 22 February.

The highlight of the measures considered are: i) the introduction of the sustainability factor, which ties the value of new pensions to the evolution of average life expectancy at 65 years of age (legal retirement age); ii) the introduction of the new pension update rule, indexing pensions to the development of consumer inflation, according to the value of the pension and the real GDP growth rate; iii) the faster transition to the new pension calculation formula, which considers the entire contributory career and discriminates the pension accrual rate in conformity with the value of the reference remuneration. A further highlight is the Public Capitalisation Scheme, which is a voluntary subscription scheme for individual accounts, intended to allow the beneficiaries of the compulsory social protection schemes to boost the value of their retirement income.

The reforms undertaken in the social security systems, in particular the establishment of the sustainability factor, the pension updating rules, and the fostering of active ageing, have contributed to reducing the risk of non-sustainability associated with the development of public expenditure sensitive to the ageing of the population. In fact, in recognition of the impact of this set of measures implemented in 2006, Portugal's classification by the European Commission as a high-risk country in terms of the sustainability of public finances was reduced to medium-risk[9].

The mechanisms to converge the CGA scheme with the General Social Security scheme are currently undergoing more far-reaching development, as a means of increasing the sustainability of the Social Security system and discipline in estimating labour costs in the General Government[10]. Accordingly, the convergence of the pension fund of the CGA with that of the General Social Security scheme will be speeded up, including the frontloading of the new rule to penalise early retirement and the rule to set the retirement age at 65 years old, so that they may come into effect between 2010 and 2013.

Determining the Pension Value for Beneficiaries Encompassed by the Retirement Legal Framework

Law No. 52/2007 of 31 August defined the value of the retirement pension of beneficiaries of the CGA scheme registered before 31 August 1993 as being the product of two components: the first corresponds to the length of service up to 31 December 2005 and the second concerns the length of service after 31 December 2005, with the rules in force applying for each respective period. Thus, for the first component, the relevant remuneration is defined pursuant to the Retirement Legal Framework, while the reference remuneration for the second component takes into account the entire contributory career since 1 January 2006. The Retirement Legal Framework established that the relevant remuneration would be the final remuneration earned at the retirement date; nonetheless, since this first component refers to the length of service up to the end of 2005, the remuneration to be considered should be that referring to the end of that same year.

Accordingly, the value of the new retirement pensions awarded from 2010 should be calculated taking into account the remuneration earned in 2005, updated to the date of retirement according to the rules in force. This is a break from the practice that has been followed to date, which considers relevant remuneration to be that earned at the retirement date.

9 See Chapter VI for more information on this subject.
10 The adaptation of the main General Social Security scheme reform measures to the CGA scheme was enshrined in Law No. 52/2007 of 31 August and Law No. 11/2008 of 20 February, which have been in force since January 2008.

Early Retirement Pension Scheme

It was established in relation to the convergence of the scheme applicable to beneficiaries of the CGA with the General Social Security scheme, that the value of the early retirement pension, namely the value of the reduction rate of the pension, will be the same in both schemes. Since May 2007, the applicable rate in the General Social Security scheme is the multiplication of the number of years in advance of the statutory age for retirement by the monthly rate of 0.5%. This rate will also be applied to all beneficiaries of the CGA, but in accordance with Article 4 of Law No. 11/2008 of 20 February, only on those pensions applied for from 1 January 2015. It was established that the current annual rate of 4.5% would remain in force until the end of 2014. However, this provision is now to be revised in order to implement this changeover earlier, adopting the new penalisation scheme for early retirement in 2010.

These two changes, compared to the situation existing to date, will contribute to greater equality among the pension schemes as well as strengthen the sustainability of the public pension system.

Health System

The rationalization of expenditure and the reform of health policy encompass several initiatives. In this context, a coordinated set of measures have been adopted to curb costs and improve efficiency in the provision of healthcare with the aim of strengthening the medium-term financial sustainability of the National Healthcare Service (NHS).

The principal structural measures, with impacts at the macro level, are: i) strengthening the public service contracts process with healthcare providers; ii) electronic centralisation of budget control information; iii) implementation of a strict medicine policy; and iv) the introduction of mechanisms to monitor medicines spending, whether hospital or outpatient environment.

Increased efficiency at the micro level of expenditure on health has been achieved by: i) the restructuring of the primary care network (health centres/family health units); ii) the restructuring of the secondary care network (hospitals); and iii) the development of the integrated continued care network. Further operational highlights include the implementation of the 24-Hour Health Service, the reinforcement of the strategic planning processes of hospitals and the use of shared services.

The impact of these reforms has been impressive and the financial situation of the NHS has been close to equilibrium since 2006.

The continuation of reforms in the National Healthcare Service in the period from 2010 to 2013 now embraces:

- Internal control of the NHS;
- Definition and implementation of public service contracts and incentive mechanisms;
- National Health Plan 2011-2016;
- Rationalisation of expenditure on medicines, medical material and supplementary diagnostic and therapeutic services.

Internal Control of the National Healthcare Service

The aim is for the Ministry of Finance and Public Administration to gather and publish information on a monthly basis on the budget implementation of the National Healthcare Service (NHS). In this regard, it is important that the Central Administration of the Health System (ACSS) strengthen the exercise of powers conferred through the Restructuring Programme for the State's Central Administration (PRACE) and, in the hospitals in the corporate public entity universe of the State, these functions have to be performed in articulation with the Finance and Treasury General Directorate.

This internal control of the NHS will result from protocols between the Ministry of Finance and Public Administration and the Ministry of Health. Therefore, the Ministry of Health will published a Monthly Implementation Bulletin (relative to month n-2), which will be sent to the Ministry of Finance and Public Administration for consideration, in particular, in the Budget General Directorate Bulletins. This document summarizes and complements the monthly monitoring reports for the various types of entities of the NHS that ACSS prepares, and which are essential elements in the analysis of economic and budgetary developments. This control will also include articulated work by the two ministries to act together in monitoring the corporate public entities of the Health area, in the capacity of shareholder.

Public Service Contracts and Incentive Mechanisms

In relation to the public service contracts (to be developed or already developed), the terms of their definition and implementation with hospitals, local health units and the Regional Health Authorities must be considered, with the aim of obtaining gains from the best practices and most efficient actions. Accordingly, the focus must be on adjustment incentive mechanisms for more effective and efficient performance, whether in financial terms or gains and access to health.

Special focus will be placed on negotiating, implementing and monitoring public-private partnership contracts.

The revised methodology for allocating resources to the local health units will start being applied in 2010. This methodology will entail risk-adjusted capitation, with incentives, including the greater relative share of funding, associated with the rational prescription of medicines and economic and financial sustainability and quality.

The funding method for corporate public hospitals will also be revised, with the reinforcement of the areas of gains in health and economic and financial sustainability, along with the update of the efficient price levels per revised group of hospitals. Public service contracting will continue to be carried out by the local health authority in compliance with the established health policy priorities and financial constraints.

The methodology for allocating resources to the local health authorities will be further developed, adjusting resources to population size and the specific mortality risk of the populations in order to encourage the redirecting of funding based on health needs. The public service contract method for local health authorities with Health Centre Groupings will be developed and implemented; these new general primary healthcare contracting processes will start up in 2010.

National Health Plan 2011-2016

One of the focuses of the National Health Plan 2011-2016 (NHP) is the financial sustainability of the National Healthcare Service, in accordance with recommendations recently published by the World Health Organization.

Accordingly, the NHP 2011-2016 aims to promote the local planning of health needs and services and reorientate the health system towards the primary healthcare field, which should take a leading role in the integrated management of illness, health promotion and management of the clinical referral and steering of users of the system, in order to guarantee the sustainability of the NHS.

Guidelines will be developed for the clinical treatment and referral of patients in five diseases areas with a major impact on health, in order to achieve consensus as regards the need for the rational prescribing of medicines and supplementary diagnostic and therapeutic services for such diseases.

The problem of sustainability of the Portuguese NHS will also adopt an international outlook, considering the effort to stabilize the growth rate of expenditure *per capita* and the functions that the NHS is expected to perform, including those in the field of continued healthcare.

The application of cost-benefit and economic and financial sustainability analyses will be expanded to all health programmes and measures.

Rationalisation of National Healthcare Service Expenditure: Pharmaceutical Products, Medical Material and Supplementary Diagnostic and Therapeutic Services

Measures that contribute in the short, medium (SGP horizon) and long-term to lower the level and slowdown the growth rate of public expenditure on health, in particular:

- Medicines Policy, with the adoption of measures to curb the growth of expenditure on medicines;
- Revision of agreements concerning Supplementary Diagnostic and Therapeutic Services.

In the medicine policy field, a number measures focused on reducing expenditure are noteworthy. Expenditure on outpatient medicines will be curbed at 1% through the promotion of generic medicines and rationalisation of the medicines' policy. Expenditure on hospital medicines should not grow by more than 2.8% in 2010, through the dissemination of good practices and increased negotiations with the pharmaceutical industry, especially in relation to more expensive medicines (e.g. HIV-AIDS, oncology and rheumatology).

The electronic prescription of medicines and resulting dematerialisation, beginning in 2010, through the computerization of the prescription medicine circuit, from the prescription through to the reconciliation of invoices, will provide relevant gains in efficiency and control.

The State's co-payment of the price of medicines for pensioners with an income not exceeding 14 times the value of the Social Support Index is changed to 100% for medicines with a retail price that is among the five lowest prices of the homogeneous group in which they are classified, provided that such price is equal to or less than the reference price of that group.

The price of new generic medicines to receive co-payment support will have to be 5% less than the price of the cheapest generic available on retail. This measure will ensure a reduction in the price of new generic medicines launched on the market. Moreover, the intention is to reduce the number of generics in each group, while opening up business opportunities for the launch of generics in new homogeneous groups.

A reference co-payment is also defined based on the application of the co-payment rates to the reference price, irrespective of the medicine's price. The financial impact of the measure will largely depend on market dynamics, though it does strongly encourage the reduction of prices.

In order to create the conditions for the implementation of the sale of medicines in single doses in Portugal, Ordinance No. 697/2009 of 1 July should be reviewed in order to adjust the dispensing of medicine in situations of acute illness and ensure safeguards in issues such as counterfeiting and the handling and packaging of medicines.

Other measures include the application of the medicine price update rules for those under €15, the update of the reference price of medicines resulting from the 30% reduction of the price of generic medicines, the review of prescription and billing format to the local health authority for home-based respiratory care and the strengthening of assessment frameworks for new medicines and other new technologies (in particular, clinical consumption) in the National Healthcare System.

Expenditure on supplementary diagnostic and therapeutic services will not rise by more than 1.8% in 2010, through the incentive for internal production in the NHS, the change to healthcare provider agreement rules and the correct implementation of protocols. The review of prices will be undertaken in the areas where the price of supplementary diagnostic and therapeutic services is on average higher than that in the NHS, and systematic audits of supplementary diagnostic and therapeutic services billing will be carried out, using information obtained through the new Invoice Reconciliation Centre of the NHS, which is expected to be operational from June.

As regards human resources, monthly monitoring will be undertaken by both the Ministry of Health and the Ministry of Finance and Public Administration, with data broken down by service and organisation for the development of compensation of employees in the National Healthcare Service. Systematic audits will be carried out in relation to the hiring for the NHS of human resources through companies, with particular focus not only on monitoring compliance with law as regards the occupation of posts, particularly by retired health professionals, conflicts of interest and job insecurity, but also to centrally control remuneration ceilings for the provision of such services.

In the field of shared services and dematerialisation of processes in Health, the shared services company will be in operation. This company was created in December 2009 and will provide services in a shared manner to the units of the NHS in the areas of logistics, procurement, human and financial resources.

In relation to the dematerialization and simplification of processes, the electronic checking of invoices of the NHS is introduced.

More generally, the control of health expenditure will involve:

- Definition of rules for determining the pluriannual budgeting of public expenditure on health, following the principles of sustainability, efficiency of public expenditure and accountability;
- Definition of the financial and healthcare provision responsibilities of the State, the NHS, the ADSE (civil servants' system), public health and State-Owned Enterprises' subsystems, private subsystems in public-private partnerships and contracted healthcare providers;
- Implementation of different types of audits, either in specific areas or directed at entities/fields where the growth of costs in the NHS is most evident.

II.1.3 Intermediate Consumption Expenditure

Expenditure in this area is reduced through the definition of ceilings of €90 million in 2011, 2012 and 2013 for outsourcing expenditure on projects, studies, expert opinions and consultancy, and a 40% reduction in the financial framework of the Military Funding Law. Another area of intervention comprises the rationalisation of public procurement and shared services processes.

The major areas of intervention are:

- Operating expenditure;
- Military equipment expenditure;
- Management improvements in Education and Justice.

Operating Expenditure

In relation to the control of operating costs the focus is on reforms in the General Government, the shared management of resources, the rationalisation of expenditure on shared services in Health and the State's fleet of vehicles, as well as the establishment of an expenditure ceiling on outsourcing for projects, studies, expert opinions and consultancy.

Reforms in the General Government: Shared Management of Resources

Savings in intermediate consumption will result, in part, in the continuation of reforms in the General Government.

In 2007, the restructuring of the General Government included the start of the provision of shared services in the fields of management of financial, human and material resources, which included the central management of public procurement, in particular the vehicle fleet of the State. The shared services provided for in the Restructuring Programme for the State's Central Administration (PRACE) seek to generate further reductions to the administrative structures and costs related to the management of resources in the General Government.

The GeRFiP solution, i.e. the shared management of financial resources, is already in implementation in the Ministry of Finance and Public Administration, the Portuguese Court of Auditors and the Supreme Judicial Council and its expansion to all the bodies of the Central Administration is scheduled to occur by the end of 2012. The GeRHuP solution, i.e. the shared management of human resources, is under development and will be progressively made available to all bodies of the Central Administration from January 2011, with the diffusion of the wages calculation component expected by the end of 2012 and all remaining modules by the end of 2013.

The GeRALL programme for the development and dissemination of shared services in the areas of integrated financial and human resources management is ongoing. This programme is intended for the State’s Central Administration, and it may subsequently be extended to the local and regional government.

The goal of this programme, besides the introduction of shared services, is to standardise management processes and improve the quality of the information available.

The implementation of the National of Public Procurement System has allowed the rationalisation of expenditure on goods and services. Under the PRACE programme, the National Public Purchasing Agency was established with the objective of: i) contributing to the rebalancing of General Government accounts, rationalising expenditure on transversal goods and services and generating savings; ii) contributing to the modernisation, efficiency and effectiveness of the General Government, through the professionalization and centralisation of procurement; and iii) promoting economic competitiveness among the suppliers to the State.

This new system of public procurement has had positive results, particularly in relation to the simplification and speeding up of acquisition procedures and the actual entry into the era of electronic purchasing. The savings from the implementation of the system have already reached €75 million.

The continued modernisation of acquisition procedures and the increased efficiency of the National Public Procurement System require the adoption of an additional set of measures, namely:

- The capacity building of the Ministerial Public Procurement Units (UMC): the transfer of the purchasing functions of the different entities to the UMC of the relevant Ministry, with the migration of the human resources to these units. This will allow the effective centralisation of procurement and public contract procedures, with the consequent increase to negotiating power favouring the achievement of savings;
- Compulsory Annual Purchase Plans (carried out by entities tied to the National Public Purchasing Agency and sent to the respective UMC): this is a measure to ensure procurement accountability and planning, aiming to rationalise and manage General Government expenditure;
- Promote the enlargement of the entities incorporated in the National Public Purchasing Agency: a measure that will impact on expenditure in an indirect manner;
- Promote the increased use of Framework Agreements by the entities tied to the National Public Purchasing Agency;
- Maintain the prices of the goods and services contracted under Framework Agreements under constant monitoring.

Another significant reform in progress in relation to the control of intermediate consumption expenditure is the performance assessment process. The inclusion of the reduction of the service's expenditure as an indicator for the assessment of the service's performance will allow services and, therefore, the respective managers and employees to be rewarded. Firstly, the reduction of expenditure will be a criterion for assessing the performance of managers. Secondly, part of the savings made on intermediate consumption expenditure may revert to the workers of that service.

The rationalisation of operating costs also benefits, in relation to service provision contracts, from the introduction of the requirement for prior authorisation of the member of the Government responsible for finances for the conclusion of agreements with companies that provide temporary workers, thus safeguarding transparency and compliance with law in relation to the management of human resources.

Expenditure on the State's Fleet of Vehicles and the Definition of a Ceiling for Outsourcing Expenditure Relative to Studies, Projects, Expert Opinions and Consultancy

The National Public Purchasing Agency took over the centralised management of the State's fleet of vehicles in 2009. The purpose of the new management model for the State's fleet of vehicles is to eliminate waste resulting from the *ad-hoc* management of a fleet composed of around 28 000 vehicles, which is scattered, heterogeneous and aged (average age of 11 years). The main principles in this field are thus the control of budget expenditure, the vehicle user being responsible for the same, the simplification and automation of information reporting and procedures, and the preference for a fleet composed of vehicles with a high environmental performance.

Under this management model, by 31 December 2009 1572 vehicles had been scrapped compared to 477 new vehicles purchased, which corresponds to a financial impact of €7.5 million, including savings on maintenance costs.

The rationalisation of the State's fleet of vehicles is strengthened in the period 2010-2013 by:

- Scrapping rule for the acquisition of vehicles: "at least 3 vehicles are scrapped for every new one acquired", compared to the "1 for 1" rule existing to date, except where vehicle acquisition refers to new needs. The measures have impacted on the resizing of the State's fleet of vehicles (in the region of 11% at the end of 2010) and rejuvenation of the fleet, with the consequent positive environmental and economic effects. In harmony with the effort that has been undertaken, at least 3 vehicles must compulsorily be scrapped for each new vehicle purchased;
- Creation and implementation of vehicle pools: define the typical structure of vehicles required per ministry/entity, with the aim of reducing the costs and size of the State's fleet. The creation of pools will allow the least used vehicles of one body to be reallocated to others under the control of the same ministry.

In terms of expenditure on outsourcing, relative to projects, studies, expert opinions and consultancy, a ceiling of €90 million is established for 2011, 2012 and 2013. This ceiling controls the growth of this expenditure, which totalled €90.4 million in 2009 and is budgeted at €95.5 million for 2010, 50% of which is blocked.

Military Equipment Expenditure

General Government investment in the armed forces, equipment, weapons and research and development, with direct impact on the modernisation and operational execution of the National Forces System is implemented through the measures and capabilities contained in the Military Funding Law.

The measures established in this law are subject to long-term financial planning, covering a total of 18 years divided into three six-year periods. The Military Funding Law, including the financial schedule, is reviewed on a regular basis and as provided for in the law proper.

Accordingly, the necessary review of the Military Funding Law to occur in 2010 will take into account new expenditure ceilings, with a 40% reduction in the financial framework established by the law currently in force, as well as zero new commitments. These measures, which are necessary and exceptional, will allow a direct cut in the budget expenditure of €186 million in 2011, €228 million in 2012 and €170 million in 2013.

Management Improvements in Education and Justice

This set of measures, which aims to improve efficiency in the management of infrastructure and public services in structural domains, contributes to the public resources rationalisation effort.

In relation to the improvement of the schools network, the restructuring of basic education schools will continue through the creation of school centres. This reorganisation will also promote better learning conditions and child socialisation. The measure also includes the restructuring of the State schools of the second and third cycles of basic education and secondary schools, through the merger of schools into groupings.

Another measure related to the management of schools involves the adjustment of the national curricula and timetables of the second and third cycles of basic education.

In the Justice field, various measures to improve process and human resources management are envisaged.

In order to increase the efficiency of the public service of Justice, and during 2010-2013, a series of measures will be carried out, aiming to rationalise the resources available to the Justice area, and draw up and implement an operational efficiency programme for Justice. The following will be required to implement this programme:

- The development of new tools and working methods, notably aiming to reduce the average time of the investigation and inquiry phases;
- Optimisation and flexibility in the allocation of resources between courts;
- The creation of mechanisms to measure productivity, monitoring and publishing the relevant results;
- The increased rationalisation and management capacity of courts.

The implementation of this programme requires that the effort to appraise Justice and, in particular, its human resources, is continued.

It is proposed, with regards to the Criminal Procedure Code, that in the revision of the Code sentences are produced orally, as a measure to simplify the administrative and judicial process and which will result in an exponential increase in the speed of proceedings. This will lead to a faster conclusion of cases by judges and court officials and, consequently, increases the system's response capacity with the same level of human resources. An extension of simplified proceedings in criminal matters is also proposed, increasing the scope of the jurisdiction of this speedier procedure. As occurs with the previous measure, this will improve system response with the same resources.

The amendment of the Civil Procedure Code will be proposed in 2010, in order to simplify and cut the red tape of the different procedures in the Code, making them faster, clearer and more effective.

In relation to legal proceedings, the main measures in the computerisation and simplification fields are:

- Enhance the simplification of debt collection proceedings, with particular emphasis on the implementation of court orders in relation to enforcement proceedings;
- Give impetus to proceedings promoting the effectiveness of enforcement, increasing the number of enforcement officers with appropriate training, creating adequate conditions for the work of the Commission for Enforcement Effectiveness to advance;
- Expand the network of justices of the peace, as well as their competences, and introduce management mechanisms and goals that permit a suitable organisation of work and the standardisation of procedures and practices;
- Promote and disseminate mediation and arbitration as alternative ways of settling disputes, which are faster, cheaper and simple;
- Improve the arbitration system, in accordance with international standards, making the sector more competitive and creating greater transparency and confidence among economic agents;

- Create alternative dispute resolution or pre-litigation mechanisms, particularly where tax matters and administrative offences are concerned, creating the basis for swifter and more effective tax justice;
- Improve the efficiency of processes' management, through the increased use and modernisation of communication and information technology, with particular focus on consolidating the CITIUS PLUS project, which is the computer programme supporting the dematerialisation of legal processes.

II.1.4 Interest Expenditure

The privatisation program of the State-Owned Enterprises Sector reduces the General Government debt and, therefore, the cost of that debt, which reflects positively on the budgetary consolidation effort. The revenue from privatisation operations between 2010 and 2013 is estimated at €6000 million, which will help reduce General Government debt and, in turn, will result in savings on interest expenditure of 0.03%, 0.07% and 0.1% of GDP, respectively, in 2011, 2012 and 2013.

II.2 Measures with an Impact on the Decrease of Capital Expenditure

The share of capital expenditure will stabilise in 2013 at 2.9% of GDP. This result will be achieved by not making new commitments to road infrastructure concessions, the postponement for two years of the Lisbon-Porto and Porto-Vigo high-speed rail links, in order to delay any financial impact until 2013, and the gradual return to pre-crisis investment levels.

II.2.1 Public Investment

Against the backdrop of the economic and financial crisis and its recessionary effects on the economy and employment, the Government has implemented, especially since the end of 2008, a set of extraordinary measures to stimulate the economy and support the poorest households and those most affected by the crisis. The budgetary stimulus program "Investment and Employment Initiative" has, in addition to an anti-cyclical effect, strengthened and accelerated the implementation of structural reforms under the Lisbon Strategy, through interventions in schools, energy (renewables, energy efficiency and transport networks), technological infrastructure, support to businesses and employment.

The Portuguese Government, like other EU and OECD countries, used public investment in this way as one of the components to stimulate the economy and strengthen confidence in the economic recovery. Following i) the public investment peak reached in 2009, because of the need to combat the recessionary effects of the crisis; ii) the signs of gradual economic recovery from the second quarter of 2009 onwards; and iii) the need to restore the balance of General Government accounts for the period 2010-2013, there will occur the gradual return of public investment to pre-crisis levels. Moreover, it is expected that the recovery of the economy and the effects of the investments by General Government encourage the private investment component.

In any case, a sudden withdrawal of public investment in the economy is not advocated, particularly since the continuation of this type of investment in a context where the economy is below potential output, is recognised as being the most effective instrument for restoring confidence, supporting economic recovery and promoting job creation.

The means of reconciling the need to maintain a public investment policy with budgetary consolidation is to use criteria that address the long-term sustainability of public finances. This combination will require necessary discipline in the analysis, prioritisation, selection and monitoring of public investment. Thus, the Government not only considers the contribution of projects to the goals of growth, competitiveness, improving the quality of life and increasing cohesion, but also the sustainability of General Government accounts, the development of General Government debt and the net borrowing requirement of the economy *vis-à-vis* the rest of the world.

Therefore, the Government will reschedule, with immediate effect, the following specific projects:

- Not establishing new commitments to road infrastructure concessions;
- The postponement for two years of the Lisbon–Porto and Porto–Vigo high-speed rail links.

These measures will be implemented over forthcoming years and, in conjunction with the creation of the Central Public-Private Partnerships Monitoring Unit, will be monitored by the Ministry of Finance and Public Administration. It is expected that this will lead to positive change in the composition of General Government capital, making its mobilisation more challenging. The savings in capital expenditure are expected to stand at 0.26%, 0.59% and 0.8% of GDP in 2011, 2012 and 2013, respectively.

II.3 Measures with Impact on the Decrease of Tax Expenditure

This set of measures is aimed at reducing the tax expenditure of the State, by setting a ceiling/cap on the amount of tax benefits, the taxation of capital gains on securities (bonds, shares and debt securities) under personal income tax, and the reduction of specific allowance for pensions above €22500 per year.

These measures ensure the tax equality by distributing the effort to balance the General Government accounts among all taxpayers, particularly those in the higher tax brackets. The tax brackets for lower incomes are not affected.

II.3.1 Taxation of Capital Gains on Securities

Pursuant to the Personal Income Tax Code, capital gains arising from the sale of shares held for more than 12 months or bonds and other debt securities are excluded from taxation. Capital gains arising from the sale of shares held for less than 12 months are subject to a special rate of 10%.

This benefit will be extinguished and all capital gains on securities taxed at the rate of 20%, identical to that proposed in the draft State Budget for 2010 for most capital income. However, this measure does not apply for investors who do not obtain capital gains in excess of €500 per year.

II.3.2 Thresholds on Tax Benefits and Allowances

Global ceiling on personal income tax allowances according to taxable annual income

Personal income tax allowances are currently similar for all taxpayers, irrespective of the income bracket for tax purposes.

The global value of allowances will be differentiated taking into account the taxable income of taxpayers. Hence, thresholds (corresponding to a percentage of taxable income) will be established for each one of the income brackets.

The first two personal income tax brackets, tailored allowances (relating to taxpayers, dependents and relatives in ascending line) established in Article 79 of the Income Tax Code, as well as those relating to persons with disabilities, are excluded from this transversal rule.

Global ceiling on personal income tax benefits according to the taxable annual income

Tax benefits can currently be deducted from the taxable amount of personal income tax in varying amounts, regardless of the income bracket of the taxpayers.

The global value of the tax benefits that are deducted will be limited according to the taxable income of taxpayers, with thresholds established for this purpose for each income bracket (corresponding to a percentage of taxable income). This measure is similar to a rule currently in force for corporate income tax.

Freezing of the value of personal income tax allowances index-linked to the Guaranteed Monthly Minimum Allowance

The Personal Income Tax Code establishes a set of deductions currently index-linked to the guaranteed monthly minimum allowance. But Law No. 53B/2006 of 29 December – which establishes the Social Support Index (IAS) and new rules for the updating of pensions and other benefits of the social security system – envisages that the IAS is the indexing used for the revenue of the State's Central Administration.

Therefore, it is proposed that the value of these allowances will be indexed to the IAS. However, until it reaches the same value as the guaranteed monthly minimum allowance in force in 2010, the established value for allowances remains unchanged; then it follows the value of the IAS from that time.

Withdrawal of personal income tax benefits on personal injury and life insurance policies

The premiums of personal injury and life insurance policies currently benefit from a personal income tax allowance with a maximum threshold of €128 applicable to married taxpayers. The withdrawal of this tax benefit is envisaged.

Progressive concentration of the vehicle scrapping incentive in the purchase of electric vehicles and high environmental performance vehicles

Currently the tax incentive for the scrapping of vehicles at the end of their service life can be applied to the purchase of vehicles with emissions of up to 140 g/km, and according to the State Budget for 2010 this limit has been set at 130g/km.

The use of the scrapping incentive will be progressively restricted to the purchase of electric vehicles and high environmental performance vehicles with emissions up to 100 g/km, which are becoming more numerous in the market.

Strengthening of the taxation of fringe benefits in the context of personal and corporate income tax

The wages or any other form of remuneration above a set reference threshold earned by directors, shareholders or managers of companies that have negative turnover, will be taxed at a special autonomous rate.

Also envisaged is the reinforcement of special taxation on fringe benefits, especially aimed at companies that pay allowances, assign vehicles to employees, or engage in other forms of remuneration (such as non cash payments), with the aim of discouraging such remuneratory practices and combating tax fraud and tax evasion.

II.3.3 Reduction of the Specific Personal Income Tax Allowance for Pensions exceeding €22500/year

The specific personal income tax allowance, currently at €6000 for pensions exceeding €22500/year, is reduced and the specific allowance currently in force for pensions below that value is maintained. The aim of this measure is to ensure greater convergence between the deductions made by employed workers and those of pensioners, focusing this effort in particular on higher value pensions.

II.4 Measures with Impact on the Increase of Tax Revenue and Other Current Revenue

II.4.1 Special Personal Income Tax Rate on Taxable Annual Income exceeding €150000

Currently, pursuant to the Personal Income Tax Code, incomes exceeding €64623 are taxed at the rate of 42%.

A new personal income tax rate of 45% is now envisaged, which will be applicable to the taxpayers who have an annual taxable income in excess of €150000.

This measure will contribute, above all, to a fairer division of the effort to consolidate public finances.

II.4.2 Broadening and Control of the Social Security Contributory Base

Entry into force of the Contributory Code

The sustainability of the Social Security schemes has been successfully promoted in recent years, through the new pension scheme, the revision of the Social Security funding model and the implementation of the public capitalisation scheme.

In 2011, the strengthening of the sustainability of Social Security will continue through measures that promote the increase of revenue, like the entry into force of the Contributory Code[11]. This Code shall extend the contributory base, thus improving the social protection of workers and it shall also harmonise contribution rates depending on the material scope of social protection granted. The gradual broadening of the contributory base, the change of special rate schemes and also the gradual payment of 5% by entities hiring self-employed workers will thus increase contributory revenue.

Fight against Contributory Fraud and Evasion

The fight against contributory fraud and evasion will continue over the period 2011-2013, comprising the reinforcement of mechanisms on the implementation of various measures.

An enormous automated process to fight against contributory evasion will be put into operation through the issue of Unofficial Statements of Wages by the Social Security when it is found that a certain employee is encompassed in an incomplete manner on the employer's Statement of Wages.

The development of the cross-checking of data with the Tax Administration in relation to statements of compensation of employees submitted by businesses for tax purposes will be another field of intervention.

An automatic and monthly procedure to collect debts from employers that are overdue by more than 90 days will be initiated, with the corresponding execution of the legal mechanisms for the enforced collection of those debts.

Furthermore, operating procedures for the timely enforcement of the payment of contributory debts of self-employed workers and for benefits unduly paid to beneficiaries of the Social Security system will be implemented.

Social Security will accordingly be allocated more resources in the area of enforcing the payment of debts, in order to assure a more efficient and effective response.

II.4.3 Introduction of Tolls

Tolls on currently shadow toll motorways (SCUT) will be introduced: the *Norte Litoral SCUT* concession, the *Grande Porto* SCUT concession and the *Costa da Prata SCUT* concession. Tolls will be introduced on all other motorways if the criteria for introduction are met.

The evaluation and review of the funding model of *Estradas de Portugal* will be carried out, with the aim of rationalisation and ensuring its sustainability in a context where the national road infrastructure is nearing completion.

[11] Law No. 110/2009 which, in accordance with the provisions of Law No. 119/2009, postponed its entry into force to the start of 2011.

II.5 Measures to Correct the Growth of General Government Debt and Net Borrowing Requirements

II.5.1 Privatisations

The privatisation of the State-Owned Enterprises reduces the General Government debt and, consequently the costs of that debt which reflects positively on the fiscal consolidation effort. Between 2010 and 2013 the revenue from privatisation is expected to amount to €6000 million, which will contribute to reducing the General Government debt.

In a framework of pluriannual planning of the privatisation operations, the sale of shares included in the so-called accessory portfolio will be generally promoted in the period 2010-2013, as well as encompassing a range of different companies in the areas of energy, shipbuilding and repair, information technology and communication, the postal service, airport infrastructure, air and rail transport. The sale of assets held abroad will also occur, such as shareholdings in HCB – *Hidroeléctrica de Cahora Bassa, SA*, in Mozambique, and in *Sociedade Mineira do Lucapa, Lda*, in Angola, indirectly held through *Sociedade Portuguesa de Empreendimentos, SPE*, SA.

Table II.3. Privatisations of the State-Owned Enterprises, 2010-2013

Company	Sector	Shareholding of the State
Sale of the State's shareholding in full		
BPN	Financial	100.0%
INAPA – Investimentos, Participações e Gestão, S.A.	Paper	32.7%
Edisoft		60.0%
EID	Defence	38.57%
Empordef TI		100.0%
Sociedade Portuguesa de Empreendimentos SPE. S.A.	Mining	81.1%
Hidroeléctrica de Cahora Bassa, S.A.	Energy	15.0%
Partial sale of the State's shareholding		
GALP Energia, SGPS, S.A.		8.0%
EDP – Energias de Portugal, S.A.	Energy	25.73%
REN – Redes Energéticas Nacionais, S.A.		51.08%
Estaleiros Navais de Viana do Castelo, S.A.	Shipbuilding	100.0%
CP – Carga, S.A.	Transport	100.0%
TAP, SGPS, S.A.		100.0%
CTT – Correios de Portugal, S.A.	Communications	100.0%
ANA – Aeroportos de Portugal, S.A.	Transport	100.0%
Caixa Seguros	Financial	100.0%
EMEF – Emp. de Manutenção de Equip. Ferroviário, S.A.	Transport	100.0%
Concessions		
CP - operation of routes	Transport	100.0%

Source: Ministry of Finance and Public Administration.

The entry of private capital in companies where the State is currently the only shareholder is a key element to foster efficiency gains, through the challenges that the new adopting philosophy of private management will pose to the new shareholders, in order to obtain a return on the capital invested. In this way, the State will also benefit, since it will share the risk and also take advantage of a market oriented management and will perhaps be better prepared to face the challenges of market liberalisation, as in the case of the postal services and energy transmission. Moreover, the sale of equity holdings in sectors where the State is already in a minority position will foster an even greater dispersion of capital, with increased free float, thus contributing to strengthening the liquidity of the securities on the stock market.

Therefore, the unlocking to private capital for new enterprises is envisaged, which, notwithstanding prior restructuring operations, are being considered for privatisation, thus contributing to the promotion of greater efficiency and productivity in the sectors concerned, and the essential reduction of General Government debt.

The Government, in the State Budget for 2010, established the estimated revenue from privatisation of €1200 million, equivalent to 0.73% of GDP. The operations in subsequent years will generate the revenue indicated in the following table.

Table II.4. Privatisations revenues, 2010-2013

Year	% of GDP	million euros
2010	0.73	1,200
2011	1.09	1,870
2012	0.89	1,580
2013	0.73	1,350

Source: Ministry of Finance and Public Administration.

In the energy sector, the privatisation operations to be carried out are of *Galp Energia, SGPS, SA*, where the State indirectly still holds 8% in *EDP – Energias de Portugal, SA*, in which the shareholding is 25.73% and *REN - Redes Energéticas Nacionais, SA*, where the shareholding is currently 51.08% and where the State will retain a shareholding that will safeguard the public interest.

In the shipbuilding and defence sectors, the shipyard company *Estaleiros Navais de Viana do Castelo*, SA, will be unlocked to private investment, and the State's shareholding in the following companies of the technological nucleus of the defence sector and controlled by *Empordef SGPS, SA*, will be sold: i) *Edisoft, SA*; ii) *EID, SA;* and iii) *Empordef IT, SA.*

Under the framework model approved by the Council of Ministers Resolution No. 20/2007 of 14 February, stating that the privatization of *ANA – Aeroportos de Portugal, SA,* and the design, construction, financing and operation of the new Lisbon airport is performed in a single operation, to be carried out through international tender procedure, the privatisation of *ANA* will be undertaken.

At the same time the capital of *TAP – Transportes Aéreos Portugueses, SA,* will be unlocked to a strategic partner who will contribute to strengthening the competitiveness of the company and the growth and development of its business model under sustainable conditions.

Following the gradual liberalisation of the railway, the privatisation of the freight service will be undertaken, in addition to restructuring of the suburban and long distance passenger transport operations as well as the manufacture and maintenance of rolling stock.

In the financial area, all of the capital of *BPN – Banco Português de Negócios, SA,* will be reprivatised and the insurance universe of the CGD Group will be reorganised and partly (re)privatised.

In the communications sector, the capital of *CTT – Correios de Portugal, SA,* will be unlocked to private investment and in the paper sector it will be promoted the sale of the State's shareholding of 32.7% in *INAPA – Investimentos, Participações e Gestão, SA*, indirectly held by the State.

II.5.2 State-Owned Enterprises and Shareholdings

A set of measures in the State-Owned Enterprises Sector will be adopted, which will be positively reflected in the reduction of primary expenditure, since the rationalisation of resources targeted by these measures will reduce the need for Government transfers to the State-Owned Enterprises Sector, namely:

- Greater selectivity in investments and establishment of debt thresholds;
- Public service contracts;
- Alignment of the State-Owned Enterprises Sector with the General Government in relation to wage constraint and the fleet of vehicles;
- Revision of the pension and health plans without contributory support;
- Purchases of State-Owned Enterprises;
- Funds Centralization in the *Instituto de Gestão de Tesouraria e do Crédito Público, I.P* (Portuguese Treasury and Government Debt Agency) by non-financial State-Owned Enterprises.

The State will issue guidelines within 6 months to carry out the reorganisation and restructuring of the State-Owned Enterprises Sector in order to improve its efficiency.

Selectivity in Investment and Establishment of Net Borrowing Thresholds for the State-Owned Enterprises Sector

The State-Owned Enterprises Sector is very diverse and heterogeneous, covering all types of enterprises and business sectors and in many cases, producing essential public services.

Without questioning the validity and importance of the role played by the State-Owned Enterprises, it is essential to underline the need for greater selectivity in public investment and mould the growth in the level of indebtedness of the State-Owned Enterprises to the reality of the country and combine the commitment to modernization and development with maintaining investment and debt at sustainable levels.

The above criteria will also apply to the investments of State-Owned Enterprises, raising the requirements on debt and improving the return on investments made, not only for the enterprises individually considered, but also for the country.

As well as greater selectivity of investment to be undertaken by General Government, the requirements of exactitude and the selectivity of investment to be carried out by the State-Owned Enterprises will be strengthen, ensuring the sustainability and volume compatible with the financing capacity and the debt ability of enterprises and the State.

Accordingly, a ceiling for the annual growth of net borrowing of non-financial enterprises is established, with reference to an average annual growth rate of about 5.5% (half of the recorded in the period 2007-2009) until a more sustainable level of 4% is reached in 2013.

Table II.5. Threshold on indebtedness of State-Owned non-financial Enterprises

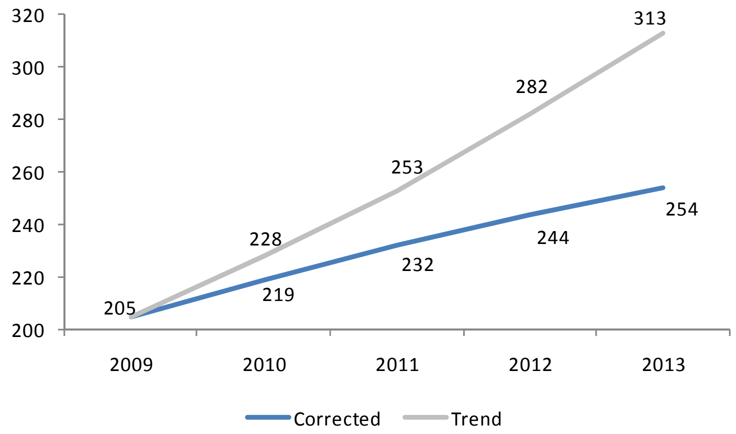
Year	Threshold
2010	7%
2011	6%
2012	5%
2013	4%

Source: Ministry of Finance and Public Administration.

After the net borrowing of State-Owned Enterprises grew at an average annual rate of 11% from 2002 to 2009, it is necessary to set a threshold for its annual growth, which should be gradually reduced to a more sustainable level (4%) in the short term.

The net borrowing ceiling will be applied by group of companies under the jurisdiction of each ministry (not covering the enterprises structurally not in deficit) and it should not affect the raising of EU funds, and each ministry is responsible, in conjunction with the Ministry of Finance and Public Administration, for the management of the overall ceiling, in order to give flexibility to the definition and implementation of sectoral policies.

Figure II.3. State-Owned Enterprises indebtedness, 2009-2013
(Index values, 2002=100)



Source: Ministry of Finance and Public Administration.

Changes will be made to the provisions of the Public Manager Statute and the management contracts, with the aim of strengthening the legal framework in this area so that, notwithstanding civil liability or any other that may arise there from, the failure to comply with established net borrowing ceilings is considered fair cause for removal from the post.

Public Service Contracts

Following what has been done in relation to the public service provided in other sectors, notably in the Health and Culture areas and private transport operators, public service contracts will be concluded with all transport companies and infrastructure managers by the end of 2010 and the public service contracts in the media sector will be revised.

Alignment of the State-Owned Enterprises and Public Institutes with the General Government

Following the guidelines already approved by the Government, wage increases in State-Owned Enterprises should follow, in the period 2010-2013, what is defined each year for the General Government.

Thus, in 2010, under the wage negotiations under way or being initiated and relating to the year in question, the Management Board of the State-Owned Enterprises must comply with the guidelines adopted for wage adjustments in the Central Administration, refraining from negotiating clauses with a monetary impact in subsequent years. These guidelines take precedence over any decisions that may have already been passed by companies, along a different line, but which have not yet implemented.

The Ministry of Finance and Public Administration may, in exceptional and duly reasoned circumstances, together with the ministry in charge of the sector, authorise different procedure in order to ensure equal treatment between wage developments in the General Government and the entities of the State-Owned Enterprises Sector, in a pluriannual perspective.

The purchase of new vehicles for use by managers and other senior staff, as well as vehicles for general services, are subject to rules similar to those established for the General Government, with the objective of reducing expenditure and CO2 emissions.

Revision of Health and Pension Fund Costs

The harmonisation of the funds, given the extreme heterogeneity of those undergoing implementation, in particular the nature, purpose, coverage and funding scheme, shall be undertaken in the course of this year, based on the principle of complementarity of those funds.

Thus, existing plans that do not comprise "defined contributions" will be closed to new subscribers and shall also be adapted, through negotiation and without losing the acquired entitlements.

Accordingly, the State-Owned Enterprises concerned should establish new pension and health funds open to new employees, which must compulsorily entail a "defined contribution" and be subject to regulation and supervision of the Portuguese Insurance Supervisory Authority.

To that end, the State-Owned Enterprises shall submit a report to the Ministry of Finance and Public Administration by 31 May on the measures taken and planned and relevant implementation calendar and estimated financial impact.

Procurement in the State-Owned Enterprises Sector

In the context of rationalisation of the procurement policy for goods and services of State-Owned Enterprises, purchase centres should be established for each enterprise and each sector, covering the procurement of common goods and services.

Furthermore, the shareholder will decide, for enterprises that have not yet done so, on whether to subscribe to the framework agreements concluded by the National Public Purchasing Agency.

Funds Centralization in the Portuguese Treasury and Government Debt Agency *(Instituto de Gestão de Tesouraria e do Crédito Público, IP*) for non-financial State-Owned Enterprises

As part of the financial management of enterprises, the cash surpluses of enterprises of the State-Owned Sector must compulsorily transfer that amount to the State's Central Treasury, through the IGCP, thus contributing to the reduction of the net borrowing requirements of the Republic, in addition to having a positive impact on the net cost of that same debt.

Chapter 3

III. Competitiveness and Sustained Growth

Before the international economic and financial crisis Portugal underwent a period of structural reforms and fiscal consolidation which enhanced economic growth, sustained by the increase in exports and investment. Yet, over the last decade, Portugal has registered economic growth below potential, a persistent external deficit and the accumulation of both General Government and private debt.

However, during the same decade, and particularly in the period preceding the international economic crisis, the share of non-European markets has grown and there was an improvement in the technological profile of Portuguese exports, alongside with improvements in the business environment (stimulated in part by the reforms done by the Government), the functioning of markets, the qualification of the labour force, the use of natural resources, in research and innovation capacity and in infrastructure, which contribute to increase the competitiveness of the country.

In particular, the improvement of the balance of non-energy goods and services in the three years preceding the crisis shows a remarkable recovery of competitiveness, because it was not due to recessionary conditions and reduced demand, but coincided with the acceleration of economic growth. The growth in exports between 2005 and 2008 was only interrupted by the worsening of the international financial crisis after September 2008, and the growth comprised diversification, that resulted from increasing shares in extra-European markets, and also the increase of exports of products of medium and high technology, which have grown sharply since 1995.

The energy balance, which accounted for half of the country's external deficit in 2008 (see Box III.3), worsened between 2005 and 2008 due to higher oil prices, offsetting the positive effects of competitive gains expressed in the balance of non-energy goods and services which, for the same period, improved significantly as a result of the accelerating in exports growth.

This scenario partly explains the worsening of the net borrowing requirements of the Portuguese economy *vis-à-vis* the rest of the world since the late nineteen nineties and start of the new century, and it is also partly to blame for the decline in the pace of economic growth.

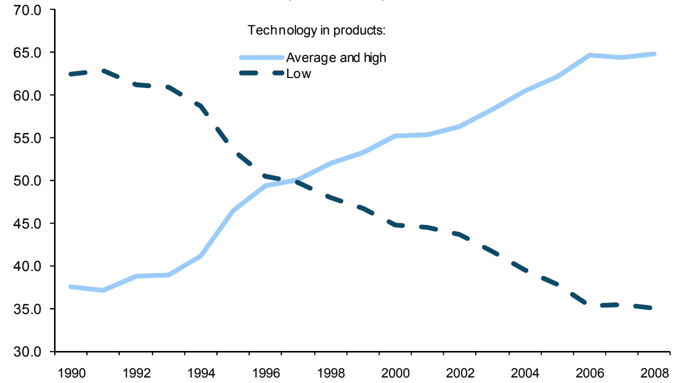
Reducing the external deficit and the indebtment of the country requires an increase of savings and the encouragement of structural changes that enhance the production of tradable goods. This demands an improvement in competitiveness sustained by investments in modernisation, by increases in internationalisation, technological development, and improvements in the functioning of markets and the reduction of red-tape costs. The reduction of the energy deficit, with better use of the country's natural resources, which the evolution of technology and fossil fuel prices make feasible, should also give an important contribute.

The recovery of economic growth should, therefore, focus on increasing exports and private investment, as well as reduced foreign dependence in key areas for growth such as technology and energy. This process will be supported by policies aimed at improving the competitiveness of domestic production, namely innovation, skills, scientific and technological capacity, and business environment, enhancing the increase of productivity in a context of wage moderation.

III.1 Diversification and Technological Improvement of Exports

Two major structural changes in Portuguese exports have occurred in the last decade. Firstly, there was an increase in the share of medium and high-tech sectors and a sharp decline in the share of low-technology sectors (Figure I.1). The increased incorporation of technology means that Portuguese exports moved towards sectors with a greater incorporation of knowledge, where the technological advantages and skills of the labour force are more important as factors of competitiveness than the availability of labour of low skill levels.

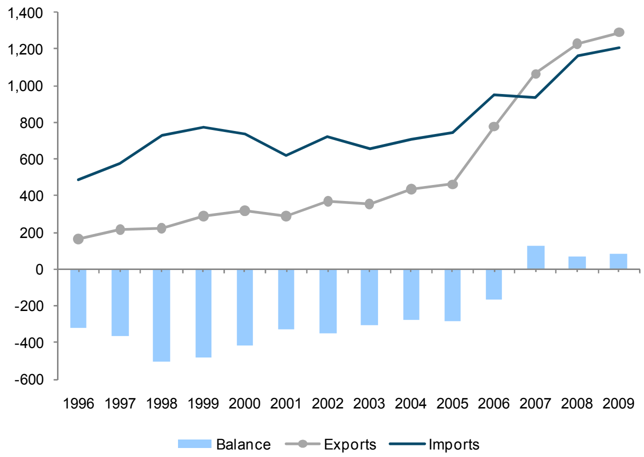
Figure III.1. Technological intensity of Portuguese exports
(% of total)



Source: INE and Ministry of Finance and Public Administration.

The growth of exports occurred not only in new product segments but also in relation to services, particularly in the export of technological services (Figure I.2). From 2005 the exports of services began to follow a strong growth dynamic. Exports of services included in the technology balance tripled between 2005 and 2008[12], making it turn to a positive sign since 2007. The highlights of that change included the evolution of exports related to information technology and to consultancy and construction projects services.

Figure III.2. Technological Balance of Payments
(Million €)

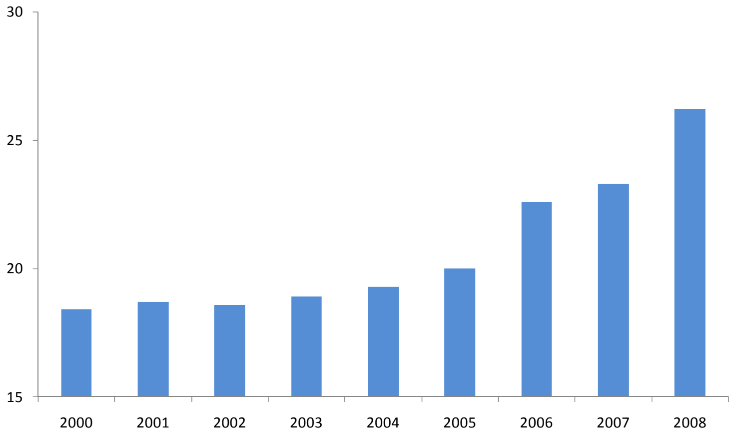


Source: Banco de Portugal.

12 The Technological Balance of Payments is composed of the following items: Rights to acquire and use patents, trademarks and similar rights; technical assistance services; research and development services and other technical services.

The second structural change concerns the increasing diversification of Portuguese export markets. The share of extra-EU markets increased from 15% to 27% of total Portuguese exports between 1999 and 2008, during which period these markets contributed to about half the growth of Portuguese exports (Figure I.3). This trend intensified after 2005, supported by the economic diplomacy which placed greater emphasis on extra-EU markets. The diversification of markets, targeted at countries registering higher economic growth is an important factor in the process of recovery of the country's exports.

Figure III.3. Share of non-EU markets in the Portuguese exports
(%)



Source: INE.

The growth of exports of goods and services between 2005 and 2008, the increase of exports of technology and goods of higher technology, and the gains in share in new markets suggests that Portuguese companies were able to meet the competitive challenges posed by the enlargement of the European Union eastwards and the opening of the European space to Asian products. This was reflected in the evolution of the balance of goods and services, excluding the effects of higher oil prices (between 2006 and 2008), which presented a positive evolution. The continuation of the external deficit at high levels was largely due to rising energy prices rather than a general loss of competitiveness. Exports grew even in traditional sectors between 2005 and 2008, demonstrating that the restructuring of industries such as clothing and footwear changed the competitive profile, generating smaller sectors but better equipped with technology and able to produce higher quality goods.

The data thus suggest that in the last decade there has been no overall decrease of competitiveness but rather a loss of competitiveness in low-tech goods due to increased competition from low-wage countries. The decline in exports in these sectors up to 2008 has paralleled the strong growth of exports in new sectors of medium and high technology. There was also a very positive development in exports of services and an increase in the generation of energy from renewable sources, helping to reduce the energy dependence of the country.

Up to 2005, and alongside the gains in share of Portuguese exports in extra-EU markets, a loss of market share in some European markets was recorded, particularly in Germany. That loss was associated with the increased share of the countries encompassed by the enlargement of the EU.

The conclusion in this scenario is that the increased competitiveness and the contribution of external demand to growth should occur according to five vectors: first, continuing to grow in areas of medium and high technology, which have been strongly affected by the economic and financial crisis and should now register higher growth with the recovery in investment and demand for durable goods; secondly, continuing to enhance the growth of extra-EU exports, reinforcing positions in markets with higher growth; thirdly, continuing to increase the exports of services; in fourth place, increasing the use of the country's resources and reducing energy dependence, and finally, promoting the attraction of modernizing investment.

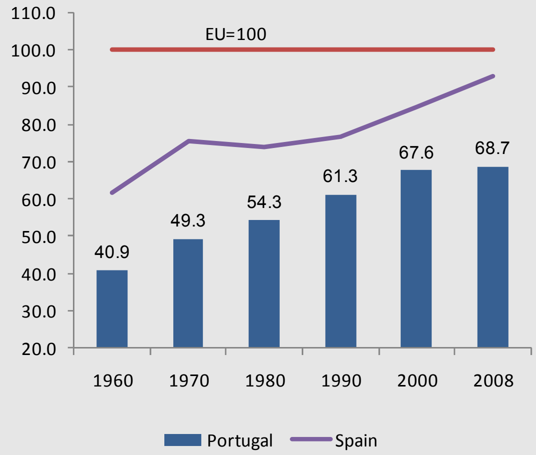
The positive external contribution of these five vectors has to be driven by policies that enhance competitiveness and economic growth, particularly in regards to:

- The labour market, where wage moderation and improving market functioning, by giving it greater flexibility, alongside with the progressive upgrade of skills and the promotion of entry of young workers and stronger stimulus to active employment search.;
- Improving the efficiency and effectiveness of the General Government in promoting a better business environment and reduce red-tape costs;
- Promoting internationalisation;
- Focusing on technology and innovation;
- The best harnessing of natural resources, including renewable energy sources.

Box III.1. Development of the Portuguese Economy in Recent Decades in the light of Structural Indicators

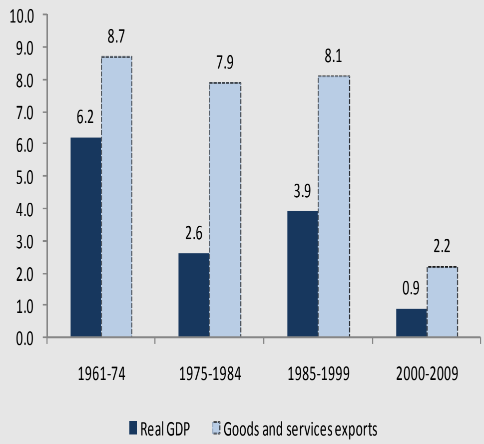
In a long-term outlook, the evidence suggests that the Portuguese economy has been converging to the development level of the European Union. Profound changes have occurred over the past few decades, including the opening up of the country to international trade and foreign investment, the change of the production structures, which has had an impact on the diversification of Portuguese exports, the consolidation of the banking sector and the development of the financial markets. The GDP per capita and the level of productivity of Portugal represented 41% and 36% of the average for the EU-15 in 1960, respectively, and that increased to 69% and 64% of the average for the EU-15 (76% and 71% of the average for the EU-27) in 2008.

Figure III.4. GDP *per capita* (in PPP)
(EU15=100)



Sources: AMECO and Eurostat.

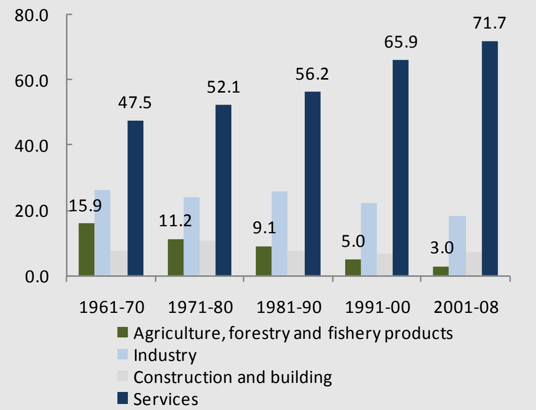
Figure III.5. Portugal – GDP and exports
(Real average growth rate, %)



Sources: AMECO and Eurostat.

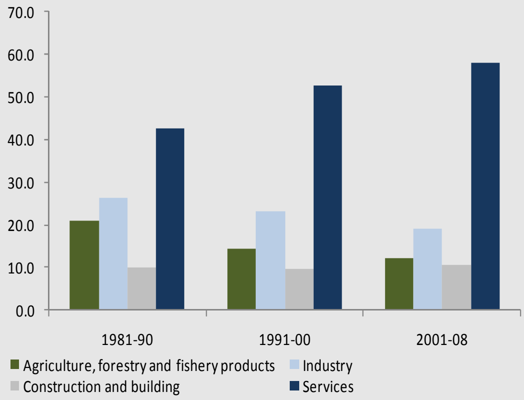
Following Portugal joining EFTA and then the EEC, GDP growth was primarily based on the growth of exports. In the decade starting with 2000, the intensification of globalization, China's accession to the WTO and the accession of some economies of Eastern Europe to the EU, partly curbed the further development of Portuguese exports, despite the recovery in 2005 and 2008.

Figure III.6. Sectoral breakdown of the Portuguese GVA
(In % of total)



Source: AMECO.

Figure III.7. Sectoral breakdown of the Portuguese employment
(In % of total)



Source: AMECO.

Another major transformation in the Portuguese economy over the last few decades has been that associated with the development of tertiary sector and the reduction of the weight of agriculture in the country, in terms of both Gross

Value Added (GVA) and also employment. In particular, the decline in the share held by industry of total GVA had repercussions that embraced the slowdown of productivity.

Thus, the share of services in total GVA represented 74% in 2008, while in 1960 this did not exceed 45%. Likewise, employment in this sector increased to 61% in 2008, when it did not go beyond 37% in 1977. On the other hand, the share of GVA of the agricultural industry fell to 2.3% in 2008 (it was 21% in 1960) and employment in the sector had declined to 12% in 2008 (28% in 1977).

Moreover, the Portuguese industrial structure has significantly changed in recent decades with visible results in the composition of exports. The highlights in this regard include the significant decrease in the share of traditional industries, which are labour-intensive and low technology (including textiles, clothing and footwear) and the emergence of new sectors with greater technological input, demanding higher skills, greater production scales, as well as the increased presence of multinational companies

The overall employment rate and employment rate of older people in Portugal registered levels above the European average in the last two decades, due in part to the increase of women in the labour market. Other indicators related to the level of education among the young population, the number of graduates in science and technology and the dropout rate in Portugal's schools are shown in the table below, and they show signs of positive developments.

Table III.1. Structural Indicators

Indicators	Portugal		European Union		Observation
	2008	Oldest year	2008	Oldest year	
GDP per capita in PPS	76.0	40,9 (1960)	100	100 (1960)	EU-27=100 to 2008 and EU-15=100 to 1960
Labour Productivity per person employed (in pps)	71.2	35,7 (1960)	100	100 (1960)	EU-27=100 to 2008 and EU-15=100 to 1960
Employment rate (Total)	68.2	61,5 (1986)	65.9	58,4 (1987)	The number of persons aged 15 to 64 in employment by total population of the same age group
Employment rate of older workers	50.8	44,5 (1986)	45.6	36,9 (1987)	The number of persons aged 55 to 64 in employment by total population of the same age group
Youth education attainment level	54.3	35,0 (1992)	75.8	69,2 (1995)	Percentage of the population aged 20 to 24 having completed at least upper secondary education
Science and technology graduates	12,6 (2006)	5,2 (1998)	13,0 (2006)	8,8 (1998)	Tertiary graduates in science and technology per 1000 of population aged 20-29 years
Early school leavers	35.4	50,0 (1992)	16.7	26,2 (1995)	Percentage of the population aged 18-24 with at most lower secondary education and not in further education or training
Long-term unemployment rate	3.7	1,2 (1992)	2.6	4,9 (1994)	Long-term unemployed (12 months and more) as a percentage of the total active population
Inequality of income distribution	6.1	7,4 (1995)	4.9	5,1 (1995)	The ratio of total income received by the 20 % of the population with the highest income to that received by the 20% of the population with the lowest income
At-risk-of-poverty rate after social transfers	18	23,0 (1995)	16	17,0 (1995)	The share of persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income
Life expectancy	79.38	63,97 (1960)	80,55 (2007)	77,38 (1995)	Life expectancy less than 1 year
Energy intensity of the economy	196,9 (2007)	230,6 (1990)	151,7 (2007)	215,9 (1991)	Gross inland consumption of energy divided by GDP (kilogram of oil equivalent per 1000 Euro)

Sources: AMECO, Eurostat and INE.

III.2 National Reforms Plan

Portugal has achieved an important set of structural reforms over the last five years that have already had a significant impact on reducing the red-tape costs, improving the business environment and increasing productivity and the incorporation of technology, both in the public and private sectors. Many of these reforms should continue to be effective in improving business activities, both in the relations between businesses and the State and within the public sector itself, leading to increases in productivity and economic growth.

The reforms should continue under the 2020 strategy, which is still being designed at the European level. This will follow on from the National Reforms Plan - 2008-2010 (PNR), which succeeds the National Action Programme for Growth and Jobs 2005-2008, covering a range of structural reforms in key sectors of the Portuguese economy.

This plan is annually monitored by the European Commission, which in its January 2009 report assessing the progress of the Member States on the implementation of the structural reforms envisaged in the Lisbon strategy, found that Portugal implemented measures leading to a sustainable reduction of deficit, Public Administration reform and the improvement of the sustainability of public finances. It also recognised that the country took steps to encourage more public and private R&D to fill the gaps in the national innovation system, and to make the education system more efficient. The revision of the Labour Code was also regarded as an important achievement.

The report cites a number of challenges that Portugal still has to face, especially to increase productivity and achieve a more balanced external position, suggesting a more quality-oriented public expenditure policy, improving the functioning of markets, improving efficiency in the education and training systems and making them more focused on increasing competitiveness, particularly by increasing the pegging of wage increases to actual gains in productivity.

The National Reforms Plan 2008-2010 absorbed the recommendations of the European Commission in the measures presented further on in this document.

In the field of public finances and public services, the National Reforms Plan focuses on areas that promote the growth potential of the country and employment. Some ongoing activities include the promotion of the effectiveness and efficiency of revenue, the revision of financial management processes in the public sector the introduction of accrual accounting and analytical software based on the RIGORE software, in the integrated services. In addition, increased attention will be paid to the composition of expenditure, creating net borrowing thresholds for public enterprises.

In the area of support to Small and Medium-size Enterprises (SME) and the fostering of a more favourable business environment, a number of measures that have been implemented are of note, such as the Pay on Time programme and the financing of SME through the INOFIN programmes, which includes the FINICIA, FINCRESCE and FINTRANS programmes. The support to the capitalisation processes of businesses has been embodied in the PME Consolida programme, which intends to improve access to financing instruments for strengthening the capital structure of SMEs; it consists of three instruments: i) Support Fund for Company Merger and Consolidation ii) Special Real Estate Fund to support Business and iii) venture capital.

Support for private investment through measures in the National Strategic Reference Framework (NSRF) has been intensified by the up-front payment of ERDF incentives to businesses, expanding the eligibility to incentive schemes for private investment, the increase of the maximum rates of European Community co-funding, flexibility in the payment of advances to investment projects and support to sectoral plans (cars, fashion, cork and wood and furniture), the frontloading of municipal investment in the upgrade of schools of the first cycle of basic education and nursery schools, streamlining municipal investment, decentralisation contracts for the management of NSRF with municipal associations, and the frontloading of the municipal investment in urban renewal or integrated into collective efficiency strategies.

Another instrument of structural support is the programme to support Projects of National Interest, which in September 2009 comprised 56 projects in the monitoring phase, two projects undergoing analysis and 4 in the investigation phase.

The facilitation of the business environment has also been promoted by the implementation of the Technological Plan for Justice, which under the sector modernisation programmes and the use of IT, has made significant changes in three areas: land register and civil register and the dematerialisation of legal proceedings.

In the field of promoting research and development (R&D) and the improvement of the innovation system, Portugal further developed its favourable Technology balance and has made significant progress on the European Innovation Scoreboard (EIS 2008), being the country where the R&D investment has most grown, to represent 1.5% of GDP. Another notable change occurs in the composition of the R&D, with the predominance of investment made by business over that of the public sector. Also of note is the work done to support collective innovation dynamics, the highlight of which is the support provided for the formation of clusters and competitiveness nuclei, with a global view, integrating companies but also other relevant organizations of the Scientific and Technological System.

In the area of climate change, Portugal is currently the 5th European country in terms of the highest share of renewables in their energy balance. A redesign of the energy profile of the country has been undertaken, involving the focus on renewable energy and the National Dams Plan in particular, which will take Portugal from its current 46% use of hydro potential to around 70% by 2020.

The highlight of the field of qualifications, employment and social cohesion is the substantial improvement to the indicators for qualifications, including the reduction of education system drop-outs and the increase to young people aged between 20 and 24 years who have completed at least secondary education. One million adults were involved in processes of improvement and/or recognition, validation and certification of skills. The NSRF measures in this area total EUR 280 million for financing the Employment Initiative 2009.

In the area of promoting an intelligent territory, the measures to be implemented reflect the commitment to promoting smart networks and the use and management of the territory as a factor of competitiveness, quality of life and social cohesion, which have a very positive impact on quality of the business environment in the country.

III.3 Reforms in the Labour Market, Qualifications and Productivity

The reform of labour legislation was an important advance to the functioning of the labour market, permitting greater flexibility and improving the management of human resources in enterprises.

Figure III.8 shows the development of an indicator of labour rigidity for different countries. This indicator shows that in Portugal the reform of Labour Law was reflected very positively in the reduction of the rigidity of the labour market. Hence, the most recent figures show that Portugal is moving closer to the reference countries for the European Social Model, such as Germany and France, while Spain remains with relatively higher rigidity.

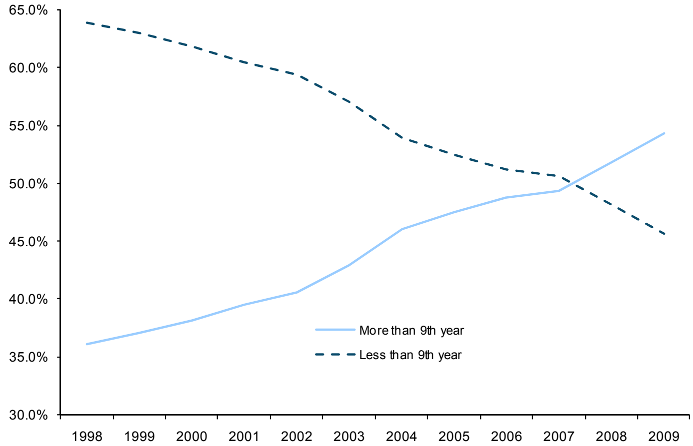
Figure III.8. Labour market rigidity

Source: OCDE.
* Values for 2008 for Germany and Spain
This indicator is calculated on a scale from 0 (less restrictive) to 6 (more restrictive), which corresponds to the weighted sum of indicators for regular contracts, temporary contracts and collective dismissals.

The effects of new legislation which came into force in 2009, should begin to become much more evident only when economic activity recovers. In fact, with the recovery the new law will help to facilitate job creation and promote greater flexibility and efficiency in the labour market, which can result in reduced costs and increased productivity for businesses. The change in labour law changed, too, the country's situation as regards the relative position in terms of flexible working, a fact that can contribute positively to the attraction of direct foreign investment.

Another aspect that should help increase productivity and enhance the process of change in Portuguese specialisation is the increase of qualifications of the labour force. The level of Portuguese qualifications is one of the main aspects that determine productivity differences still existing between Portugal and its European partners. Over the past four years, there has been a substantial increase in skills, which resulted from the enlargement of the number of students, particularly in higher education, and also the investment effort in skills by more than 900,000 workers who participated in the New Opportunities programme.

Figure III.9. Proportion of labour force (15-65) with more (or less) of 9 years of education

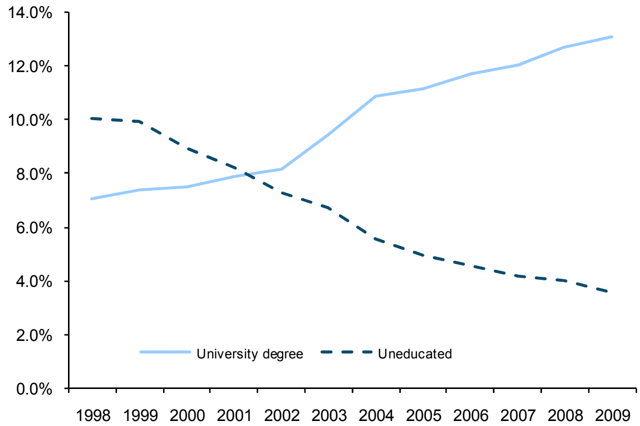


Source: INE and Ministry of Finance and Public Administration.

The change of qualifications in the last decade is visible in Figure I.9 and Figure III.10. In this period, the number of graduates in labour force has doubled and the proportion of workers with complete compulsory education exceeded the 50% barrier for the first time, in 2008.

The proportion of young people attending a higher education course exceeded 30% of the age group, registering, for the first time, amounts similar to the EU average.

Figure III.10. Qualification of the labour force: university degree and uneducated



Sources: INE and Ministry of Finance and Public Administration.

The increase in the qualifications of Portuguese workers should continue in forthcoming years, as well as the absorption and harnessing of new highly skilled workers, as companies and the country's international specialization adjusts to the new qualifications level. This reality should have an impact on productivity and competitiveness, even in the short and medium-term, resulting from the increase of education effort in the previous two decades.

Moreover, and in a perspective of encouraging long-term growth, the focus was set on increasing the number of students and improving the quality of education. In higher education, incentives were created for universities to increase the number of graduates. These already had a strong increase in the number of doctorates, a strengthening of internationalisation and a sharp increase in research. In the last four years there has also been a significant increase in the share of students in the science and technology areas.

A number of reforms were implemented in primary and secondary education, involving strengthening i) the use of Information and Communication Technology, ii) the teaching of English from early learning ages, iii) vocational education, iv) and improving the management of schools and the school infrastructure.

The effort to improve education and the qualifications of the Portuguese will proceed with the extension of compulsory schooling to 12 years, the upgrade of the school infrastructure as a result of the investment program in progress, improvements in the quality of education, particularly by strengthening teacher assessment and learning results, and, by means of the Trust Agreement, increasing the number of graduates. Many of these reforms will primarily have an effect on productivity and growth only in the long-term, but some, such as the enlargement and improvement to higher education and the further qualification of workers may produce results in the near future.

In order to accelerate the entry of qualified young persons in the labour market, the Government launched trainee placement programmes such as Inov-Young, Inov-contact or Inov-Export. The goal of speeding up the recovery in employment is also the focus of the proposed changes to unemployment benefit, which create incentives for the active search for a job and the adjustment of labour supply to the labour market situation resulting from the crisis.

Lastly, it is to be emphasized that the effort to curb public expenditure by the State should also contribute to competitiveness and to the curbing of the evolution of unit labour costs. In Portugal, the negotiation of wage increases in the private sector is strongly influenced by the agreements in the public sector, so it can be expected that the proposed constraint in civil service wages will also contribute to wage moderation in the private sector, and particularly in the tradable goods sectors, enhancing competitiveness.

III.4 Improvement to the Business Environment and Reduction of Red-tape Costs

The importance of administrative simplification targeted to businesses comes from the need to create a more favourable business environment that increases their competitiveness. This simplification operates through a reduction of red-tape costs, as a positive factor for the growth of the Portuguese economy in the recovery cycle now starting.

The Simplex Programme is an ambitious set of measures to modernise and simplify administration, with benefit to the citizens and the competitiveness of enterprises. Over the past four years over 730 measures have been implemented, 46% of which had business as their direct beneficiaries. The following box highlights some of the main measures.

Box III.2. Examples of some Simplification Measures between 2005 and 2009

On the Spot Firm

Just over 4 years ago, creating a company in Portugal took several weeks and involved filling in multiple forms and many visits to various departments. In 2005, we implemented a simplified procedure for start-ups - On the Spot Firm. From July of that year, it became possible to create companies - public limited, private limited or single-person limited company - in less than one hour (35 minutes was the average time in January 2010).

- 87386 firms were created on the spot, which represents 56.4% of all companies started up;
- EUR 15.8 million is the estimated saving of the on the spot companies established.

Online Firm

In 2006, the founding of companies at a one-stop shop also became available in a dematerialized form via the Business Portal. Founding a company online is available to all citizens with a Citizen's Card, as well as lawyers, solicitors or notaries holding digital certificates. It is thus possible to choose the name of the company, submit a memorandum and articles of association, digitally sign documents and pay the fees online, which were reduced to one-third for using this procedure.

- An average of 32.6 companies are founded online per day (data from February 2010);
- EUR 20.37 million is the saving from the online founding of companies.

Permanent extract and permanent extract in English

The company registry information is now available on line, continuously updated through the Permanent Extract. Companies can permit any public or private entity to view their registry entries by providing them an access code, saving time, money and travel. This certificate is also available in English

- More than 1250 000 permanent extracts of the company register have been issued over the internet – doing away with the need to obtain a hard copy of the extract, as of July 2009;
- EUR 38.8 million is the saving from extracts permanently available online (as of July 2009).

Simplified Business Information

The Simplified Business Information statement ensured that the submitting of accounts and tax and statistical data was made in one single transaction over the internet, where as previously it had involved various.

- 1112709 Simplified Business Information statements submitted online to 4 different entities between 2007 and July 2009;
- 6000000 pages saved with the dematerialisation of the registration of accounts;
- EUR 5.51 million is the saving on administrative costs with the submittal of the Simplified Business Information statement from 2007 to July 2009.

Dematerialisation of export procedures

Several measures to simplify the procedures for import and export, providing electronic forms for orders and instruction of various procedures, fully dematerialising some of the procedures and implementing mechanisms for communication between information systems, which enable the electronic authentication of documents. The computerisation and simplification of procedures replaced the export declaration on paper with an electronic declaration.

- 720000 export declarations were submitted in a dematerialised manner, from implementation in 2006 to August 2009;
- EUR 1.4 million is the saving with the dematerialisation of the export process.

Exemption from submission of statement of no tax and Social Security debt

The presentation of the document certifying no outstanding tax or Social Security contributions was eliminated. Companies can now opt to allow their tax and contribution situation to be consulted at the Tax Administration or Social Security sites, by indicating the relevant tax and social security numbers.

More than 1100000 certificates are no longer requested from the Social Security and Tax Administration on paper, since implementation in 2006 and May 2009.

Local Government Simplex

This Programme arose from the need to develop simplification measures at the various levels of General Government. Some of the simplification measures implemented in the Central Government have significant impact on local government and its association to the programme has contributed to greater and more effective results. Therefore, a programme of simplification for local government was initiated in 2008, providing some good results for businesses.

Permits' Catalogue

In order to identify and facilitate the process of obtaining permits the catalogue of business permits was created at the Company Portal. It currently provides information on permits, authorisations and similar administrative constraints.

The simplification policy pursued by the Government, together with the investment in infrastructure for broadband communication, are key tools to enhance the country's recovery, as evidenced by international assessments. Portugal has been rated as one of the most advanced countries in this area, and it has evolved from 16th place (in 2004) to 1st place in the European ranking on the availability and sophistication of online public services[13]. Positive evaluations and praise from the IMF and EIB have also been addressed to Portugal.

In the preparation of a new round of measures to reduce red-tape costs in the period 2010-2013, the contributions of organizations like the OECD and the IMF were considered, in addition to the main domestic institutional and economic agents[14]. This collation of information aims to find measures that help to simplify business activity and reduce the red-tape costs for foreign companies with economic interests in Portugal, thereby promoting foreign investment, as also for national companies wishing to extend their operations across borders, thus fulfilling one of the priorities of the Government - to strengthen the internationalisation of the economy.

The following measures stand out in the new round of administrative simplification policies:

- Further developing the cutting of red-tape in licensing procedures and remove the permits required for a number of acts, thus simplifying the start-up companies and gathering all information about licenses and permits and similar administrative constraints. This project has already been authorised by the Central Government and nine Local Authorities, but the intention is to gradually extend it to all other local councils;
- The development of the company electronic file, at a reserved area of the Company Portal, which will be accessed through the Citizen's Card. This file will allow businesses to access information provided by different bodies of the General Government, considering the profile and characteristics of the activity of each of these companies. The intention is that a specific request to a governmental body can be initiated or have its status checked in this file;
- The creation, within the electronic file of the company, of a central repository of information of each company for consultation by any entity of the Public Administration. Initially it is intended to provide access to the public documents needed for procurement processes, through interaction with the existing procurement platforms. The possibility of including documents issued by private entities is still being assessed;

[13] According to data of the EC study, *Smarter, Faster, Better eGovernment*.

[14] Such as the Secretary of State for Administrative Modernisation, AICEP, the representatives of the foreign chambers of commerce present in Portugal and the institutions representing Portuguese companies.

- The possibility of Portuguese citizens with a Citizen's Card soon being able to access online services of the Spanish Government, and Spanish citizens being able to access the online services of the Portuguese General Government, using their "*Documento Nacional de Identificación*". In an initial phase, Portuguese companies operating in the civil construction area in Spain are going to be able to register their employees online with the Ministry of Labour and Immigration. Spanish citizens will be allowed to found companies online in Portugal, through the Company Portal, using their "*Documento Nacional de Identificación*".

III.5 Promotion of Internationalisation

The Government is aware that for effective economic recovery and the gradual reduction of net borrowing requirements vis-à-vis the rest of the world the promotion of the competitiveness factors is required, which will, at a time of recovery, maximize national GDP growth and move the country towards equilibrium, where macroeconomic balances can be maintained and the economic growth of the country enhanced.

The Government takes on the objective of increasing the share of exports in output, undertaking to implement measures aimed at increasing exports, especially those of higher value added.

In order to achieve this, it has been pursuing a strategy of economic recovery steered to strengthening competitiveness and the export capacity along three main pillars: the expansion of the export base and encouraging and supporting new companies to enter foreign markets, secondly the diversification of exports, and thirdly continuing to reinforce the technology base and value added of Portuguese exports.

Council of Ministers Resolution No. 115/2009 of 15 December approved a set of measures intended to support the internationalisation of Portuguese companies, aiming to act in three areas: i) increase the value added of exports; ii) strengthen exports of companies already in international markets and iii) broaden the base of exporting companies, particularly SMEs.

Accordingly, the Government has set the target for the period 2010-2013 of increasing the internationalisation of the economy and it has already approved a range of measures in this regard, including:

- Support the operations to aid Portuguese SMEs in international markets, aiming to strengthen the capacity to enter foreign markets, namely through the Fund for Internationalisation;
- Creation of the INOV-Export programme, intended to support, in its initial phase, the insertion of 500 young professional staff specialised in international trade in domestic SMEs;
- Opening 14 export stores in Portugal, especially devoted to providing technical support to exporting companies or potential exporters;
- Council for the Promotion of Internationalisation, composed of representatives of business associations, with capacities to intervene, galvanise and promote significant exporters processes among domestic companies.

The diversification of markets, reducing dependence on the European market is a strategy that has been consolidated, taking advantage of the diplomatic framework and a group of missions sponsored by the Agency for Investment and Foreign Trade (AICEP) and the Government, which has opened the door to new markets. The next few years will entail a new focus on reformulating economic diplomacy, which will be complemented by the creation of a network of senior executives of Portuguese companies abroad, articulating with the economic diplomacy and AICEP, to detect, create and support the implementation of investment opportunities in Portugal or for the internationalisation of Portuguese companies.

This investment in building synergies between the AICEP network and diplomatic representations will increase the number of representations of the agency, expanding the support it provides to businesses in new markets, notably in emerging economies in Asia and South America.

The data presented above illustrates the vast sector changes and development of the value chain. Moreover, the necessary increase of competitiveness and production capacity encompasses the attraction of modernising foreign investment in high-value industries where the country has significant competitive advantages. Simultaneously, the creation of networks to strengthen the roots of direct foreign investment projects by increasing their linkage to domestic suppliers and the transfer of technology to domestic companies.

These measures established here embody the strategy for the internationalisation of the economy and to increase exports for economic recovery.

Further support for internationalisation is provided through the development of the monitoring strategy provided to domestic firms by the client manager of AICEP, creating conditions to leverage the client's internationalisation processes. More than 5,000 companies are being monitored, which clearly illustrates the concern and focus on creating conditions to develop the business of domestic companies. In addition, an international network of resources which already includes more than 2,000 trainees has been leveraged through the trainees on the INOV Contact Programme. The PME SEGURA programme, which aims to ensure access to export loan insurance, is another relevant measure supporting internationalisation.

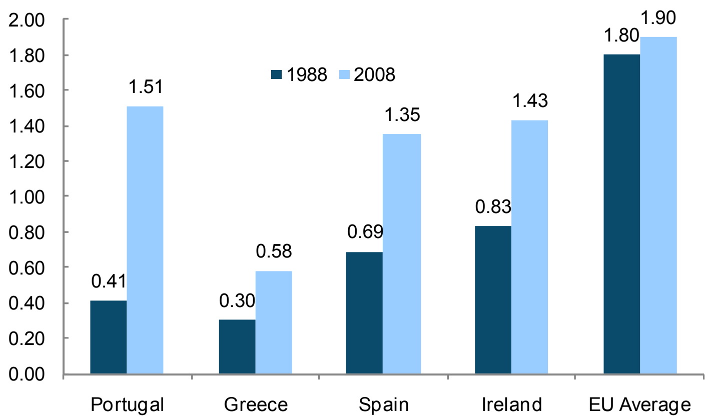
The support to Tourism during 2009 involved the reinforcement a set of promotional actions abroad, with the aim of ensuring tourist flows remained at the same level, increasing occupancy rates on air routes, encouraging the promotion of the country among tour operators as well as improving financing conditions of companies of the tourism sector. Besides launching a set of financing support measures, measures to facilitate tourism were developed (simplification of the system for setting up, operating and managing tourism developments and access to the tourist entertainment business segment).

III.6 Investment in Technology and Innovation

The focus on technology and innovation is reflected in a sharp increase in investment in research and development – see Figure I.11. Portugal approached the European average in terms of investment in research and development, as public sector investment grew and private sector investment increased more sharply to exceed 50% of total expenditure on research and development. This development should continue to contribute to the process of changing the profile of exports, as mentioned above, and to continue improving the technology balance.

The introduction in companies of graduates specialising in high potential areas - especially health and energy, the strengthening of national laboratories and the internationalisation of Portuguese universities have contributed to improve the productivity and competitiveness of many sectors that are now motors of national exports and to increase the potential for economic growth, particularly through the improved incorporation of technology and innovation, creation of brands and through measures to structure the business environment and reduce red-tape costs, and including the better harnessing of natural resources. This strategy will be reinforced with collective efficiency measures established in the through the creati on of clusters a nd com petitiveness nucl ei th at grou p tog ether ex porting co mpanies, thus encouraging c ooperation a nd s ynergies in terms of innovation and capac ity bui lding and in areas concerning internationalisation

Figure III.11. Research and development expenditure
(In % of GDP)



Notes: For Ireland and EU average, the value for the 1st year refers to 1990 and 1995, respectively. For Greece, the value for the last year is 2007.
Source: Eurostat.

III.7 Encouraging Private Investment

The stimulus of private investment is an essential element of economic policy in the period 2010-2013. A prerequisite fo r Portug al best take a dvantage of t he general r ecovery of eco nomic activit y o n th e international stage is to support the m odernisation of production structures - thr ough rationalisation and optimisation, strengthening technological capacity building or improving international sales capacity. Some measures in this area that are to be developed in 2010-2013 are:

- Support the pr ocesses of ca pitalisation of companies, i ncluding t hrough: i) Sup port Fund for Company Mergers and Consolidation; ii) the Special Real Estate Su pport Fund for Businesses; iii) venture capital instruments and iv) the development of a specific segment of capital markets direct at SME's;
- Speed up the pace of inve stment co-fun ded by the N SRF, develo ping an d ad apting th e measures already taken for this p urpose (u p-front pa yment of ERDF incentives to businesses, expanding th e elig ibility to i ncentive sche mes for privat e investme nt, the increas e of the maximum rates of Communit y co-fu nding, fl exibility in th e pa yment of ad vances to i nvestment projects and support for sectoral plans);
- Providing stim ulus to SMEs through the development of municipal investment initiatives under the NSRF , and follo wing o n from the recent agr eement with the n ational assoc iation of municipalities (implementation target of €600M in 2010);
- Promotion of Collective Effi ciency Strate gies (nuclei a nd clusters), i n order to sup port the rationalisation of investment, the development of modern c ompetitive capabilities and business cooperation ca pacities in the areas of Eng ineering & T ooling; Mobi lity Industries; R efining , Petrochemical and Industrial Chemical Industries; Energy; Manufacturing Technologies; Forestry

Industries; Tourism; Information Technology; Communication and Electronics; Fashion; Health; Agro-Industry; Furniture businesses; Sustainable Home Items; Natural Stone; Wines from the Douro Demarcated Region; Sea-related Knowledge and Economics; Creative Industries of the North Portugal Region.

III.8 Public Investment

Public investment is essential to modernizing the economy and increasing productivity. The investments promoted by the State may also make an important contribution to reducing business costs and to strengthen their competitiveness. Investment may also contribute to boosting internationalisation, reducing the distance to the market, cutting red-tape costs that companies operating in Portugal are faced with and boosting the capacity to attract foreign investment.

The improvement of infrastructure in the last 10 years has helped to improve communications and distribution networks in Portugal, thus making an important contribution to increasing the country's productivity and decreasing red-tape costs.

Following i) the peak of public investment in 2009, to combat the crisis; ii) the gradual signs of economic recovery, iii) the need to restore the balance of public accounts, the selection of public investments should continue to pay particular attention to the impact on the General Government deficit and the long-term indebtedness of the country. The quality of public investment is a key factor in determining its contribution to long-term economic growth, wherein growth and competitiveness are core criteria to be considered when deciding on projects to implement.

Investment deemed to be a priority also help to promote the consolidation process by fostering the growth and competitiveness of the economy in the long term, thus assisting towards relieving the problems of General Government deficit and external borrowing of the Portuguese economy.

The high-speed rail link to Madrid, the investment in Lisbon's new airport, the development of the logistics and port networks are examples of the type of investment that promotes the internationalisation and productivity of the Portuguese economy. Many of these investments, because of their capacity to raise private capital and generate revenue, have a relatively low impact on Government spending.

On the other hand, the acceleration of investments under the NSRF will be a priority to be pursued. In this area, the investments aimed at the critical factors of competitiveness - the qualification of human resources, business competitiveness, innovation and territorial enhancement - with high economic stimulation capacity and low budgetary impacts, will be favoured.

III.9 Harnessing Natural Resources: Energy Strategy

As regards the use of natural resources, we highlight the harnessing of energy resources, particularly wind energy and hydroelectric energy.

The energy strategy in Portugal has been strongly focused on renewables, energy efficiency, new concepts of mobility as well as the provision of infrastructure.

The Government's energy policy aims to promote competition, the environmental adequacy of the entire energy process and energy supply security. A major contributor to the achievement of these objectives has been energy generation based on indigenous renewable sources, which generate new private investment in high-technology energy equipment, fostering the creation of employment and reducing energy dependence on external supplies. The Government has also taken a proactive approach in the area of energy efficiency, as a means of reducing carbon emissions and increasing productivity and the competitiveness of the economy. Another significant area of focus, in which Portugal is a pioneer, is electrical mobility, whereby the Government extends its policies on renewable energy and environmental sustainability to the transport sector.

These energy policy guidelines are structural in promoting the competitiveness and sustainability of the country, since they contribute to the reduction of carbon emissions, energy dependency and the increase of the export capacity of goods and services in this economic sector.

Portugal has taken a leading role in the field of renewable energy, which is acknowledged in Europe and internationally. The strategy to diversify supply sources, based on the use of resources the country possesses - wind, water and sunshine - has contributed to the reduction of dependence on energy imports and also to achieving the objectives of reducing greenhouse gases. The sector is directly and indirectly responsible for 30,000 jobs, and it is estimated that it will create about 7,000 new jobs annually over the next decade, and that it will generate an annual GVA of about €1000 million, which is envisaged to triple by 2020. At the end of 2008, 43.3% of all electricity consumed came from renewable sources.

The motor for this advance has been wind energy, which has grown in installed capacity from 537 MW in 2004 to 3450 MW in 2009, and this is expected to grow by a further 1100 MW in 2010. In the field of hydroelectric power, the National Programme for Dams of High-Potential Hydroelectric Power was published, which is intended to boost the generation capacity of various existing dams and build 8 new dams, to provide a total of more than 1300 MW. There are also plans to simplify the process of identifying the potential for the construction of mini-hydroelectric plants. This investment in hydroelectric power combined with wind power has a positive effect on the efficiency of the national electricity generation system.

It should be noted that the use of wind and hydroelectric power will reduce a component of imports that accounts for one-half of the foreign trade deficit of the Portuguese economy – see Box III.3. Furthermore, this is also an area where the investment in this market has permitted the internationalisation of the national energy strategy, through the export of equipment for the generation of wind and solar power.

Box III.3. The Energy Balance and the Policy of Promoting Renewable Energy

Portugal, like other developed economies, has always been a country dependent on foreign energy. In 2008, imports of energy accounted for 13.5% of total imports of goods and services and the balance of energy account was 50.2% of the total trade deficit in goods and services account in the same period (Figure III.12). This reflects the continued deterioration of the trade in energy, which is illustrated by the worsening energy deficit which increased from 3838 million in 2000 to 7439 million in 2008, equivalent to an increase of 1.9 p.p. of GDP (Figure III.13). This trend was interrupted in 2009 by the effects of the financial and economic crisis on international trade flows and price of raw materials, particularly oil, which price dropped by 35% compared to 2008 (Figure III.14).

Figure III.12. Goods and services account deficit evolution

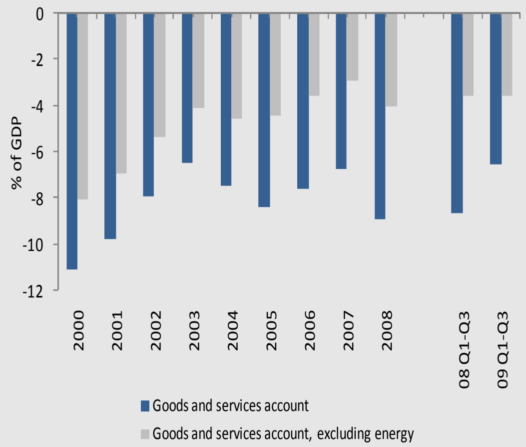
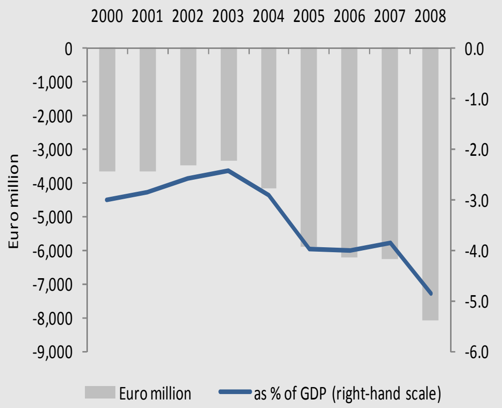


Figure III.13. Energy account deficit evolution



Sources: Banco de Portugal and INE.

Thus, the Portuguese economy is strongly influenced by the volatility of oil prices. The price effect has been, since 2005, the most significant factor in explaining the variation in the balance of energy account (Figure III.13) and it wields relatively more importance here than in the balance of goods and services account (Figure III.15).

Figure III.14. Evolution of the average spot price of Brent oil
(quarterly average)

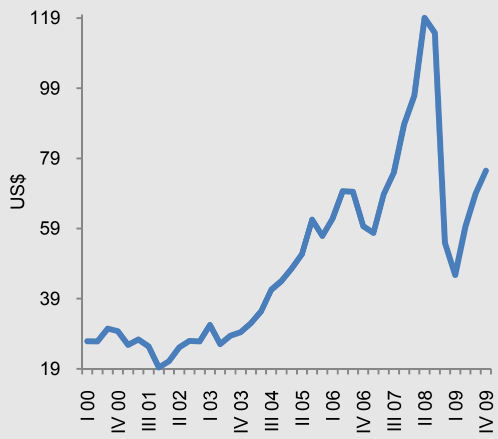
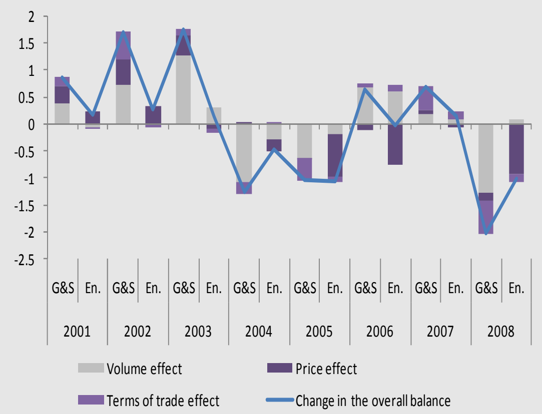


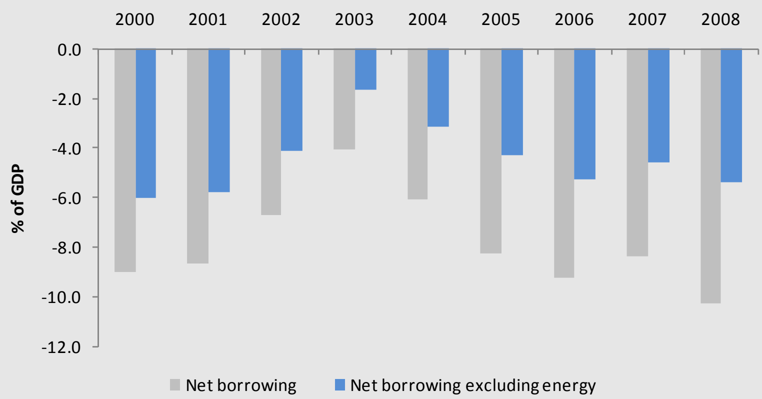
Figure III.15. Breakdown of the change in balance of goods and services account and energy account



Sources: Banco de Portugal, DGGE and INE.

The energy account deficit thus has quite a significant impact on the net borrowing requirements of the economy (Figure III.16), which stood at 9% of GDP in 2000. Excluding the energy component, this indicator was 6% of GDP, decreasing until 2003, the year when the net borrowing requirement reached the minimum value of 1.6% of GDP. Since then, it has been worsening, though it did not exceed 5.4% in 2008, which compares with 10.3% of GDP when the energy component is included. In that year, the contribution of the energy component to the net borrowing requirement of the economy, which has been increasing since 2003, reached a peak of 4.9 p.p. of GDP, being this result driven by the negative development of the oil price. Excluding the energy component the net borrowing requirement of the economy has remained quite constant in recent years.

Figure III.16. Net lending with and without energy

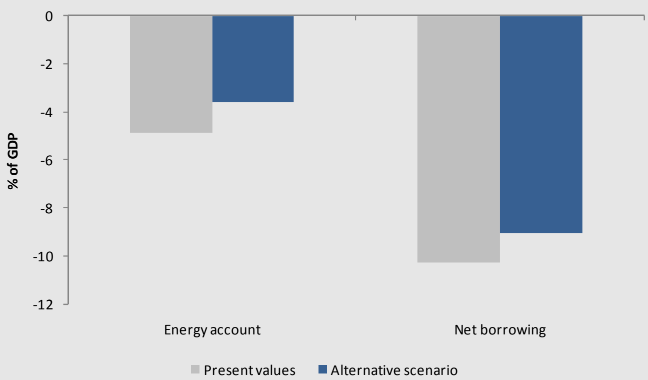


Source: INE.

In view of this situation, the development of a policy to promote renewable energy has been one of the strategic lines of development of the country, aimed, on the one hand, at reducing energy dependence and, on the other, at promoting economic development and environmentally sustainability, including by means of reducing CO_2 emissions.

The energy policy underway has, among other, the purpose of reduction of energy imports in order to significantly reduce the foreign trade deficit of the Portuguese economy. According to the estimated values for the goal of this policy on the trade balance in 2020, and considering an alternative scenario in which the impact is reflected in data for 2008, a reduction of 1.2 p.p. of GDP of the net borrowing requirement of the economy would be obtained, and the estimate of the energy deficit would stand at 3.6% of GDP (Figure III.17).

Figure III.17. Impact evaluation of the energy policy



Sources: INE, Ministry of Economics, Innovation and Development, Ministry of Finance and Public Administration.

The action in the field of energy efficiency is focused on the target set by the National Action Plan for Energy Efficiency, which intends to reduce current energy consumption by 10% by 2015. To this end, a broad range of initiatives has been implemented like the launch of the Energy Certification of Buildings; the System for Managing Intensive Energy Consumption, which aims to rationalise energy consumption and achieve energy savings in the 758 highest consuming industrial plants in the country; the distribution of about 2.5 million energy efficient light bulbs to around 600,000 low consumption/income households; support provided to individuals, private social solidarity institutions and clubs and associations of public utility for the installation of solar thermal panels; and the promotion of energy efficiency in public buildings, contributing to the reduction of their energy bill and increasing financial and environmental sustainability.

Green taxation measures were also implemented, for example strengthening the environmental performance weighting in the calculation of motor vehicle tax, the creation of the tax on light bulbs with low energy efficiency, income tax allowances for the use of renewable energy equipment. The Government will also extend the scope of tax incentives to construction works that promote energetically sustainable buildings. A pilot project will also be implemented in Évora for demonstrate an integrated intelligent energy management model for an entire city.

The third major area of intervention in energy is electrical mobility, which assumed the implementation of new environmentally sustainable mobility models. The introduction of the electric vehicle embodies the principle of low polluting, more efficient and technologically advanced mobility. The Programme for Electric Mobility in Portugal was created in 2009, based on the principles of focus on the user; free market competition for electric mobility, and the focus on energy from renewable energy sources.

The electrical mobility program is in its pilot phase, which will run until the end of 2011. A number of important milestones have already been achieved. Firstly, a partnership was signed with Renault/Nissan to set up a plant to manufacture lithium batteries, which attracts structural business investment and initiative in this area, which in turn can stimulate more investment as well as research and development among the entities of the national scientific and technological system. Secondly, various types of agreements were concluded with municipalities and national companies in various industries (distribution, hotels, transport, energy), to promote the homogeneous and interactive charging network for electric vehicles, a key infrastructure of the electric mobility model. Thirdly, incentive measures for the electric car were also launched such as the subsidy to private individuals for the purchase of electric vehicles, tax incentives to companies and private individuals who purchase electric vehicles, the establishment of an annual percentage of electric vehicles in the renewal of the Central Administration's fleet of vehicles and the implementation of an infrastructure spread throughout the country to charge electric vehicles.

The Government will approve in March of this year the National Energy Strategy 2020. This strategy develops objectives and quantified targets in 5 areas: i) the promotion of renewable energy; ii) the consolidation of electrical mobility; iii) the promotion of smart grids; iv) improving energy efficiency; and v) increased competition in markets.

Chapter

4

IV. BUDGETARY PERFORMANCE AND PROJECTIONS

IV.1 2009 Budget Outturn and 2010-2013 Outlook[15]

IV.1.1 2009 Budget Outturn

The 2009 budget outturn in Portugal, like most developed countries, was strongly affected by the economic and financial crisis. As a result, macroeconomic developments were reflected in the public accounts both through automatic stabilisers – particularly in terms of falling tax revenue – and through the anti-crisis measures, which above all involved increases in public spending. Thus, the budget consolidation process which had started in 2005 was interrupted in 2008, with the General Government deficit estimated to have increased by 6.7 p.p. of GDP between 2007 and 2009.This result is in line with international context since the EU Member States' estimated budget balance deterioration was around 6 p.p. of GDP, and in the OECD and in the G20 countries' nearly 7 p.p. of GDP.

Table IV.1. Budget balances
(% GDP)

	2005	2006	2007	2008	2009
Net Lending of Gen. Government	-6.1	-3.9	-2.6	-2.7	-9.3
Primary balance	-3.5	-1.2	0.2	0.2	-6.4
Structural balance[(a)]	-5.8	-3.9	-3.1	-2.8	-8.1
Structural primary balance[(a)]	-3.2	-1.1	-0.3	0.1	-5.2

Notes: (a) Including, in 2010, anti-crisis measures.
The values for 2009 correspond to the estimate presented in the Report of the State Budget for 2010.

Sources: INE and Ministry of Finance and Public Administration.

Furthermore, the public debt ratio over GDP increased, estimated at 77.2% of GDP at the end of 2009, which was nevertheless lower than the average for the Euro area (Table IV.2). This increase was also less than that observed in a significant number of countries, given the greater resilience shown by the Portuguese financial sector, leaving the Portuguese State no need of intervention operations to stabilise the financial system. Thus, the increase in the ratio of public debt over GDP is almost fully explained by the value of the primary deficit and the growth differential between nominal GDP and the debt's implicit interest rate (dynamic effect), with financial operations having less significance.

[15] Analysis in this section is based on comparable values. i.e. the General Government Account for 2008 and the estimate for 2009 were adjusted from the methodological changes, as outlined in Box IV.1.

Box IV.1. Compatibility of General Government Account - 2008 - 2010

The State Budget for 2010 has embodied some methodological changes that affects the comparability of the General Government (GG) Account for the 2008-2010 period, in what concerns current revenues and expenditures although having no effect on the value of the budget balance.

The first modification relates to the State subsidy to *Caixa Geral de Aposentações* (CGA) which, until 2008, was classified as State's social contribution to that entity, and was recorded entirely under compensation of employees, on the expenditure side, and as social contributions, on the revenue side. With CGA's closure to new subscribers since the start of 2006, the State's transfer required for ensuring the financing of CGA will becoming larger, while the amount corresponding to public employees costs enrolled in CGA will be decreasing over time. Thus, in 2009, with the decision to extend contribution to CGA to the State's direct administration, only 7.5% of gross remuneration, subject to quota discount, is to be recorded as actual social contribution, with matching record under compensation of employees. The remaining value, corresponding to the State subsidy for financing CGA, is to be classified as current transfer. For 2010, in accordance with the State Budget, the contribution of the State's direct administration recorded under actual social contributions item becomes 15%, meaning its recording in the National Accounts must be adjusted accordingly. Also, according to Law no. 39/2005, of 24 June, the revenue collected following the 2 p.p. increase of the standard VAT rate in 2005, was earmarked equally to CGA and Social Security. According to article 3 of Law no. 26-A/2008, of 26 June, this allocation ceased on 31 December 2009. Thus, these sums, which had an identical methodological treatment to the one mentioned for the State's CGA subsidy, are now reclassified in the same way as current transfers, to ensure compatibility with the methodology structure used for 2010.

It should be noted that the counterpart of these two changes observed under the compensation of employees and social contributions items is recorded as current transfers between GG entities. As the forecast for the account presented refers to consolidated data, i.e. excluding operations between GG subsectors, this compensation is also excluded. Thus, total current revenue and current spending is now lower, in equal measure, not affecting the GG balance.

Another methodological change relates to the recording of the State's transfer to finance the National Health Service (NHS) to cover the costs from providing healthcare to beneficiaries of public health subsystems. Until 2009, this value was recorded as compensation of employees, on the expenditure side, and as social contributions, on the revenue side, and therefore without implications for the balance. From 2010 onwards, this amount will be recorded as current transfer. With this methodological change, the recording of the State's transfers to the NHS to cover the costs of this Service with the beneficiaries of the public health subsystems is brought into line with that of the State's transfers for healthcare costs borne by the NHS regarding other citizens. The compatibility of the data between years also involves a correction of the compensation of employees and the social contributions expenditure for the years before 2010. As in the prior case, the transfers between subsectors are cancelled out in the consolidated account, the current revenue and current expenditure totals also falling by the same amount.

Table IV.2. General government debt dynamics

	2006	2007	2008	2009
Consolidated public debt (% GDP)	64.7	63.6	66.3	77.2
Change (p.p. of GDP)	1.1	-1.1	2.7	10.8
Primary balance effect	1.2	-0.2	-0.2	6.4
Snow-ball effect	0.2	-0.2	1.6	4.1
Other	-0.2	-0.6	1.3	0.4

Note: The primary balance effect for 2009 corresponds to the estimate presented in the Report of the State Budget for 2010.

Sources: INE and Ministry of Finance and Public Administration.

The budget balance performance reflects the behaviour of the primary balance, with the cost of public debt maintaining its relative proportion of GDP, as the effect of the stock increase was compensated by the reduction recorded in interest rates. (Table IV.3).

Table IV.3. General government account

	% GDP	
	2008	2009
1. Tax Revenue	24.5	22.2
Taxes on Production and Imports	14.6	13.1
Taxes on Income and Wealth	9.9	9.1
2. Social Contributions	10.9	11.2
of which: Actual Social Contributions	10.2	10.4
3. Other Current Revenue	4.8	4.9
4. Total Current Revenue (1+2+3)	**40.3**	**38.2**
5. Intermediate Consumption	4.4	4.4
6. Compensation of Employees	10.9	11.2
7. Social Transfers	19.9	21.8
Social Transfers other than in kind	15.6	17.1
8. Interest Expenditure	2.9	2.9
9. Subsidies	1.2	1.5
10. Other Current Expenditure	**2.0**	**2.7**
11. Total Current Expenditure (5+6+7+8+9+10)	**41.2**	**44.6**
Current primary expenditure	***38.3***	***41.7***
12. Gross Saving(4-11)	**-0.9**	**-6.4**
13. Capital Revenue	**0.9**	**1.2**
14. Gross Fixed Capital Formation	2.2	2.6
15. Other Capital Expenditure	0.5	1.6
16. Total Capital Expenditure (14+15)	**2.7**	**4.2**
17. Total Revenue (4+13)	**41.2**	**39.5**
18. Total Expenditure (11+16)	**43.9**	**48.8**
Primary expenditure	**41.0**	**45.9**
19. Net Lending/ Borrowing of General Government (17-18)	**-2.7**	**-9.3**

Note: The values for 2009 correspond to the estimate presented in the Report of the State Budget for 2010, whereas the 2008 and 2009 figures are adjusted from the methodological changes described in Box IV.1.

Sources: INE and Ministry of Finance and Public Administration.

In 2009, tax revenues fell significantly, more than in previous recessive episodes. The latest economic crisis, aside from the real fall in GDP, involved particular factors that cause revenue to fall more than is explained by generally assumed tax elasticity. Among these factors are to me mentioned: the significant fall in prices, the abrupt decrease in sales of durable goods, the increase in households saving and the effect from budget stimulus measures implemented since 2008, in order to strengthen confidence among economic agents.

The following table presents the breakdown of the change in revenue and expenditure, as a share of GDP, for the following components: nominal GDP reduction effect, stimulus measures effect, cyclical component effect, recession component effect and residual. The ‘measures’ component comprises contributions that arose from measures implemented affecting revenue or expenditure since 2008. The ‘cyclical’ component results from the direct application of revenue and expenditure elasticities in relation to the economic activity. The ‘recession’ component quantifies the contribution from the considered abnormal behaviour of macroeconomic variables which is not captured by standard elasticities. The contributions that are not explained by any of the previous items are aggregated into the ‘residual’ component.

Table IV.4. Breakdown of the General Government deficit change between 2008 and 2009
(in p.p. of GDP)

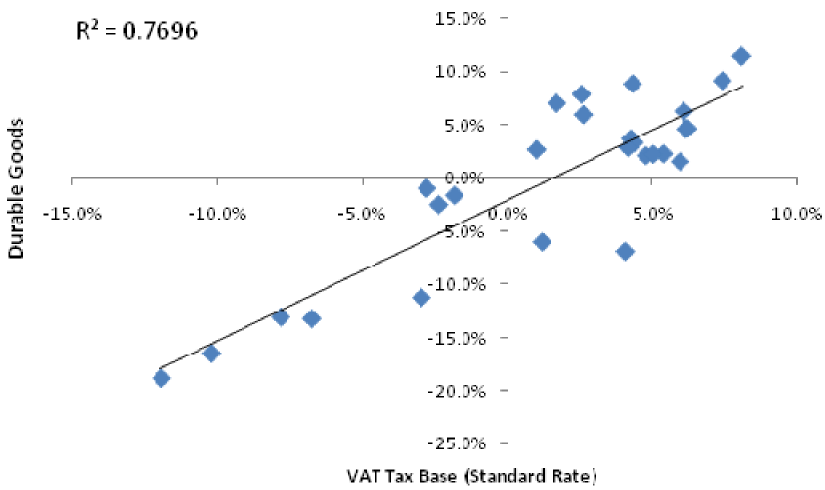
	Total change	Nominal GDP effect	Measures effect	Cyclical effect	Recession effect	Residual
1. Tax Revenue	-2.3	0.4	-0.7	-0.7	-1.0	-0.3
Taxes on Production and Imports	-1.5	0.2	-0.4	-0.4	-0.7	-0.2
Taxes on Income and Wealth	-0.9	0.2	-0.3	-0.3	-0.3	-0.1
2. Social Contributions	0.2	0.2	0.0	-0.3	0.0	0.3
of which: Actual Social Contributions	0.2	0.2	0.0	-0.3	0.0	0.3
3. Other Current Revenue	0.0	0.0	0.0	0.0	0.0	0.0
4. Total Current Revenue (1+2+3)	**-2.1**	**0.7**	**-0.7**	**-1.1**	**-1.0**	**0.1**
5. Intermediate Consumption	0.1	0.1	0.0	0.0	0.0	0.0
6. Compensation of Employees	0.3	0.2	0.3	0.0	0.0	-0.2
7. Social Transfers	1.9	0.4	0.4	0.1	0.3	0.8
Social Transfers other than in kind	1.5	0.3	0.2	0.1	0.3	0.6
of which: Pensions	0.8	0.2	0.0	0.0	0.0	0.6
Unemployment benefits	0.3	0.0	0.2	0.1	0.0	0.0
Social tranfers in kind	0.4	0.1	0.2	0.0	0.0	0.2
8. Interest Expenditure	0.0	0.0	0.0	0.0	0.0	-0.1
9. Subsidies and Other Current Expenditure	1.0	0.1	0.2	0.0	0.3	0.5
11. Total Current Expenditure (5+6+7+8+9+10)	**3.4**	**0.8**	**0.8**	**0.1**	**0.6**	**1.1**
12. Gross Saving(4-11)	**-5.4**	**-0.1**	**-1.5**	**-1.3**	**-1.6**	**-0.9**
13. Capital Revenue	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.3**
14. Gross Fixed Capital Formation	0.5	0.0	0.2	0.0	0.0	0.2
15. Other Capital Expenditure	1.0	0.0	0.0	0.0	0.0	1.0
16. Total Capital Expenditure (14+15)	**1.5**	**0.1**	**0.2**	**0.0**	**0.0**	**1.2**
17. Total Revenue (4+13)	**-1.8**	**0.7**	**-0.7**	**-1.1**	**-1.0**	**0.3**
18. Total Expenditure (11+16)	**4.9**	**0.8**	**1.0**	**0.1**	**0.6**	**2.3**
19. Net Lending/ Borrowing of General Government (17-18)	**-6.6**	**-0.2**	**-1.7**	**-1.2**	**-1.6**	**-2.0**

Note: The values for 2009 correspond to the estimate presented in the Report of the State Budget for 2010, whereas the 2008 and 2009 figures are adjusted from the methodological changes described in Box IV.1.
Source: Ministry of Finance and Public Administration.

The reduction in tax revenue in 2009, estimated at 2.3 p.p. of GDP, reflects a particularly large fall in production and imports tax revenue and, to a lesser extent, in income and wealth tax revenue, which partly depend on previous year income.

Production and imports tax recorded a fall of 1.5 p.p. of GDP, of which around 0.7 p.p. are explained by the additional effects that certain variables had on revenue, and are captured by the recession component mentioned above. An example of this is the fall in VAT revenue, driven by the reduced consumption of durable goods, in particular vehicles, which fell around 26% in 2009, leading also to a reduction in Vehicles Tax revenue. Figure IV.1 shows the strong relationship between the performance of durable goods consumption and the behaviour of VAT's tax base, and it was in 2009 quarters that VAT's tax base fell the most in the period analysed.

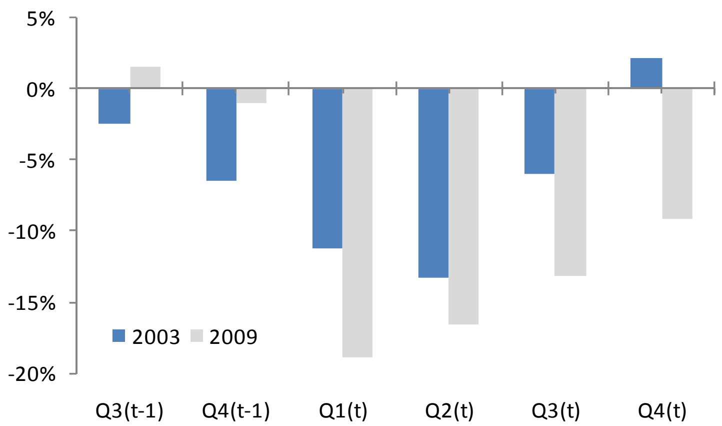
Figure IV.1. Relation between VAT tax base and durable goods consumption
(Y-o-y quarterly change rate – 2002 to 2009)



Sources: INE and Ministry of Finance and Public Administration.

A further particular factor relates to the strong fall in durable goods consumption during the four quarters of 2009, when compared, for example, to the crisis of 2003. Then, the fall it was more spread out and therefore had a relatively less intense effect, smoothing the respective annual variation.

Figure IV.2. Consumption of durable goods
(y-o-y quarterly change rate – 2003 to 2009)



Note: Qi(t) stands for quarter i of year t.
Source: INE.

In addition, other effects contributed to the fall in tax revenue, in particular the decrease in prices, especially fuel prices; the strong fall in imports from outside the EU (which fell around 37% in 2009) and the contraction in the housing market with a significant impact on Stamp Duty and Municipal Property Transfer Tax revenue. Regarding income and wealth taxes, corporate income tax's behaviour is to be highlighted, falling around 24% in 2009. The strong fall in 2009 will lead to a faster recovery pattern in subsequent years. These effects must be seen as temporary, given their nature and the outlook for future performance.

In 2009, social contributions revenue increased 1.3%, on a comparable basis, despite the context of falling employment and the implementation of temporary measures to reduce the rate of contribution in specific instances, according to that defined in the Initiative for Investment and Employment (IIE). However, this same Initiative, with the aim of stimulating employment, allowed the reduction in the tax base to be contained. The measures for fighting tax evasion and fraud have contributed to this result, as has the increase in wages above inflation recorded in 2009.

While other current revenues kept their proportion to GDP virtually constant, it should be noticed that transfers from the European Social Fund increased due to the co-financed job training actions, and capital revenue rose by 0.3 p.p. of GDP, also in line with the increase in transfers from the EU Funds for financing capital spending.

General Government expenditure in 2009 was particularly affected by the stimulus package implemented as part of the IIE. It should be noted its effect on social transfers, namely unemployment benefit and employment support, subsidies and investment spending. In what related unemployment benefit, aside from the effect of automatic stabilisers due to the increase in unemployment, the impact was felt of the measures to extend unemployment benefit to all those whose granted period for this support was to be ended in 2009 and of the reduction in the guarantee period for access to unemployment benefit.

The remaining social transfers other than in kind increased, mainly due to the performance of old age and survivors pensions and other social support payments (with a 1.1 p.p. of GDP increase). Social transfers in kind were directly affected by the social support measures for households.

The expenditure with job training supported by the European Social Fund, as well as measures to support the acquisition of thermal solar panels are the most relevant components of the subsidies' variation. Regarding investment spending, the school modernisation programme and the acceleration of the National Strategic Reference Framework (QREN) implementation were reflected in the significant growth of gross fixed capital formation (0.5 p.p. of GDP).

Compensation of employees in 2009 was affected by the 2.9% increase in the wage scale, significantly above inflation recorded for the year (-0.8 per cent)[16]. Healthcare costs included in compensation of employees also contributed to this result, despite the containment of admission of new public employees.

The remaining primary current spending components – intermediate consumption and other current expenditure – rose by 0.1 and 0.8 p.p. of GDP respectively, with the latter driven by the increased financial contribution to the European Union, as well as the increase of social transfers to private non profit institutions.

The baseline effect resulting from the deduction of the revenue of the public water domain rights concession from other capital expenditure item in 2008 (around 1 p.p. of GDP) and the special support for

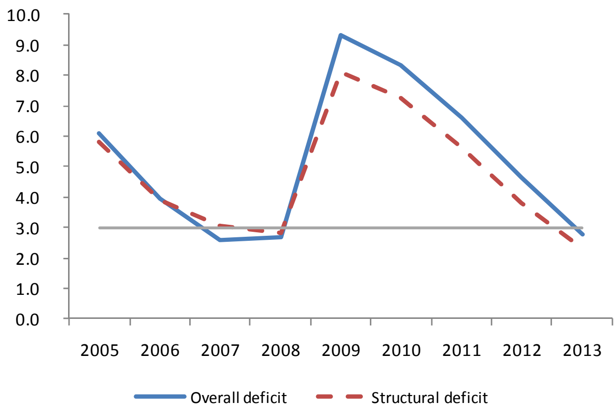
[16] Note that at the time of the public employees' wage scale negotiations, the inflation forecast for 2009 was still 2.5%.

economic activity, exports and small and medium enterprises, via capital transfers, are the main items that contributed to the performance of other capital expenditure.

IV.1.2 Medium-Term Outlook

The budget consolidation path for the 2010-2013 period begins moderately in 2010, intensifying in subsequent years (Figure IV.3).The recovery of economic activity contributes to the public accounts correction, not only through automatic stabilisers, which act essentially through tax revenue and to a lesser extent social transfers expenditure, but also through the reversal of the "recession effect" on the public accounts outlined in the previous section. More dynamic activity will allow stimulus measures to be withdrawn, which affected mainly the 2009 budget outturn, but also impacting on 2010 (specifically in the case of the 2010 Employment Initiative).

Figure IV.3. General Government deficit
(% of GDP)



Sources: INE and Ministry of Finance and Public Administration.

Table IV.5. General Government account

	% GDP					
	2008	2009	2010	2011	2012	2013
1. Tax Revenue	24.5	22.2	22.4	23.4	24.3	24.7
Taxes on Production and Imports	14.6	13.1	13.5	14.2	14.8	14.9
Taxes on Income and Wealth	9.9	9.1	8.9	9.2	9.4	9.8
2. Social Contributions	10.9	11.2	11.1	11.2	11.2	11.4
of w hich: Actual Social Contributions	10.2	10.4	10.5	10.6	10.6	10.8
3. Other Current Revenue	4.8	4.9	5.6	5.3	5.2	5.2
4. Total Current Revenue (1+2+3)	**40.3**	**38.2**	**39.0**	**40.0**	**40.7**	**41.4**
5. Intermediate Consumption	4.4	4.4	4.7	4.5	4.0	4.0
6. Compensation of Employees	10.9	11.2	11.2	10.9	10.5	10.0
7. Social Transfers	19.9	21.8	22.1	21.9	21.8	21.5
Social Transfers other than in kind	15.6	17.1	17.1	17.0	17.0	16.8
8. Interest Expenditure	2.9	2.9	3.2	3.8	4.1	4.1
9. Subsidies	1.2	1.5	1.7	1.5	1.3	1.2
10. Other Current Expenditure	**2.0**	**2.7**	**2.5**	**2.1**	**2.0**	**1.9**
11. Total Current Expenditure (5+6+7+8+9+10)	**41.2**	**44.6**	**45.5**	**44.7**	**43.6**	**42.6**
Current primary expenditure	***38.3***	***41.7***	***42.3***	***40.9***	***39.5***	***38.5***
12. Gross Saving(4-11)	**-0.9**	**-6.4**	**-6.5**	**-4.8**	**-2.9**	**-1.2**
13. Capital Revenue	**0.9**	**1.2**	**1.5**	**1.2**	**1.2**	**1.2**
14. Gross Fixed Capital Formation	2.2	2.6	2.7	2.3	2.1	2.0
15. Other Capital Expenditure	0.5	1.6	0.7	0.7	0.8	0.9
16. Total Capital Expenditure (14+15)	**2.7**	**4.2**	**3.3**	**3.0**	**2.9**	**2.8**
17. Total Revenue (4+13)	**41.2**	**39.5**	**40.5**	**41.1**	**41.8**	**42.6**
18. Total Expenditure (11+16)	**43.9**	**48.8**	**48.8**	**47.7**	**46.5**	**45.4**
Primary expenditure	**41.0**	**45.9**	**45.6**	**43.9**	**42.4**	**41.3**
19. Net Lending/ Borrowing of General Government (17-18)	**-2.7**	**-9.3**	**-8.3**	**-6.6**	**-4.6**	**-2.8**

Note: The values for 2009 correspond to the estimate presented in the Report of the State Budget for 2010, whereas the 2008 and 2009 figures are adjusted from the methodological changes described in Box IV.1..
Sources: INE and Ministry of Finance and Public Administration.

In 2013, the excessive deficit situation will be corrected, with the General Government deficit reaching 2.8% of GDP (Table IV.6).

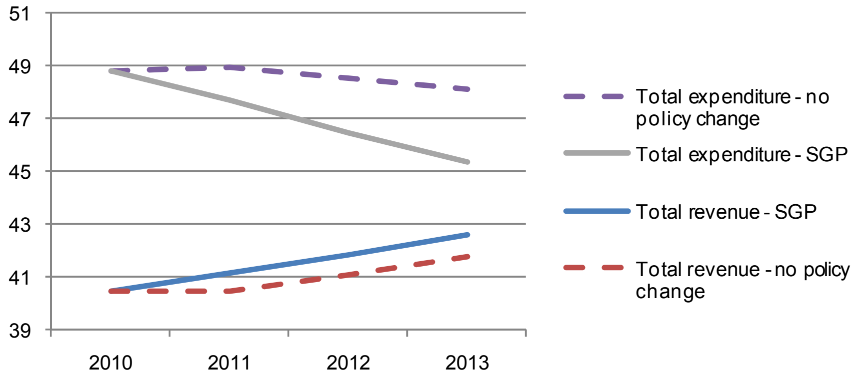
Table IV.6. Budget balances
(% of GDP)

	2009	2010	2011	2012	2013
Net Lending of Gen. Government	-9.3	-8.3	-6.6	-4.6	-2.8
Primary balance	-6.4	-5.1	-2.8	-0.6	1.3
Structural balance[(a)]	-8.1	-7.3	-5.6	-3.8	-2.3
Structural primary balance[(a)]	-5.2	-4.1	-1.8	0.3	1.8

Notes: (a) including anti-crisis measures.
The values for 2009 correspond to the estimate presented in the Report of the State Budget for 2010.
Sources: INE and Ministry of Finance and Public Administration.

The consolidation strategy is thus based on containment of public expenditure by means of the package of measures presented, and to a lesser extent, on the increase in revenues. Comparing the estimates for public revenue and expenditure performance with those of a scenario in which additional measures to those defined up to 2010 are absent, is visible the medium-term effect of the new measures, which should contribute to the budget deficit reduction, in 2013, of about 3.5 p.p. of GDP (Figure IV.4 and Box IV.2).

Figure IV.4. General Government revenue and expenditure
(% of GDP)



Sources: INE and Ministry of Finance and Public Administration.

On the revenue side, the gradual recovery of tax revenue stands out, reflecting the recovery of economic activity and the effects of the measures defined to reduce tax spending with effect from 2011 onwards.

For 2010, it is expected a tax revenue growth of about 2%, driven mainly by indirect taxes, in particular VAT, since this tax was affected the most by the main anti-crisis measures taken in 2009 (namely the acceleration of reimbursements), which, not having an effect in 2010, ultimately have a considerable impact on the growth rate of this tax revenue. During the remaining of the forecast period, the economic recovery will allow the effects on indirect tax revenues associated with the crisis component mentioned previously to be gradually reversed, to the levels existing prior to 2008.

Regarding direct taxes, the developments expected for the labour market, both in terms of wage performance and employment, will contribute moderately to the evolution of personal income tax revenue during 2010, reacting in the following years to the employment's recovery, added to which is the expected outcome of the consolidation measures outlined here.

Regarding corporate income tax, the effect of the economic recession on company's results for 2009 will be felt in revenue collectable in 2010, although a part of this effect has already taken place through the fall in tax pre-payments. However revenues from this tax are not expected to post a positive performance in 2010. The economic developments for the period considered are expected to contribute towards an increase in corporate income tax revenue to relative levels from before the crisis.

Furthermore, the measures to fight against contributory fraud and evasion and the broadening of the contributory base should allow a growth in social contributions revenue larger than the one expected only from the recovery in the labour market, projected to be stronger from 2012 onwards.

With regard to primary current expenditure, the budget consolidation measures outlined have significant effects on restraint of compensation of employees and social benefits expenditures, in particular on non-contributory scheme benefits and healthcare expenditure. In the same way, the ratio of intermediate consumption over GDP is projected to fall, due to rationalisation of General Government operating costs and military equipment expenditure.

Interest expenditure will increase its share on GDP until 2012, not only due to the increase of public debt stock, but also as a result of the increase in the benchmark interest rates for debt issued by the General

Government[17]. For 2013, it is foreseen a stabilisation of public debt costs on GDP in line with the behaviour of the public debt ratio and the assumption of relative stabilisation of interest rates.

Capital operations will have a decreasing relative importance on GDP from 2010, given the withdrawal of stimulus measures taken for public investment and the promotion of private investment. The ratio of Gross Fixed Capital Formation over GDP should turn more compatible with those observed in the years before the recession. In the same way, capital revenues will reduce in proportion to GDP, in line with the fall in participation of EU funds in financing capital expenditure.

Box IV.2. Specification of the no Policy Change Scenario

If the reform measures included in this Programme's base line scenario were to be disregarded, projections for the General Government accounts would follow the following assumptions:

Main revenue items

For projecting revenues from direct taxes and social contributions, in each year, would be considered the nominal growth of economic activity, the labour market dynamics and the elasticity of each of these items (in the case of corporate income tax revenue depends mainly on the activity of the previous year). Regarding indirect taxes, the revenue projection would take into account the nominal growth of the economic activity of each year, the respective elasticity, and the recovery of various economical variables whose effect on revenue from these taxes is substantial, as is the case, mentioned above, of durable goods consumption.

Main expenditure items

In projecting compensation of employees, the wage updates would be made in line with expected inflation for each year.

For pension expenditure, the rules in force would be applied, apart from the changes outlined in the State Budget for 2010; in the case of the non-contributory social benefits and social transfers in kind, their percentage of GDP would be maintained.

Regarding intermediate consumption, the forecast evolution of military equipment deliveries and payments of rent for shadow toll motor ways would be used; for the remaining intermediate consumption expenses, the evolution according to expected inflation would be used.

For interest expenditure, the public debt stock at the end of the prior year would be used and the assumptions followed in the macroeconomic scenario for the evolution of the relevant interest rates.

Regarding investment expenditure, its relative proportion to GDP recorded during the economic and financial crisis would be maintained.

The budget consolidation outlined up to 2013, in particular the improvement in the primary balance, will allow the growth trend in public debt in evidence since 2008 in the context of the economic and financial crisis to be contained (Table IV.7). A reduction in the ratio on public debt on GDP is forecasted for 2013, when the primary balance should once again be positive. The privatisation operations outlined up to 2013 should also contribute significantly to the reduction of the public debt ratio, given that revenues from privatisation operations will largely be allocated to debt redemption. The dynamic effect caused by the growth differential between the nominal GDP and the interest rate implicit in the debt will also contribute to decreasing debt ratio, as the pace of the economic recovery in nominal terms should be higher than that of the increase forecasted for the interest rates.

[17] According to the external assumptions presented by international institutions, that were used in this forecast exercise.

Table IV.7. General government debt dynamics

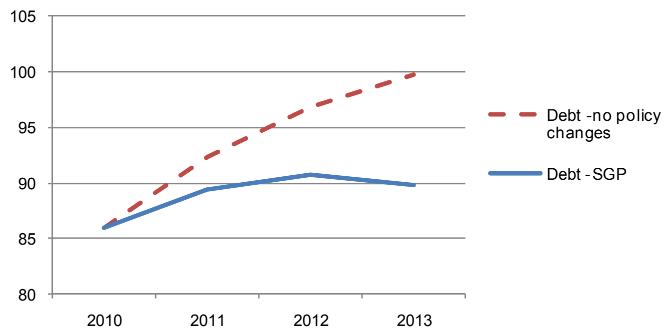
	2009	2010	2011	2012	2013
Consolidated public debt (% GDP)	77.2	86.0	89.4	90.7	89.8
Change (p.p. of GDP)	10.8	8.9	3.4	1.3	-0.9
Primary balance effect	6.4	5.1	2.8	0.6	-1.3
Snow-ball effect	4.1	2.0	1.4	1.2	0.8
Other	0.4	1.7	-0.7	-0.5	-0.4

Note: The primary balance effect for 2009 corresponds to the estimate presented in the Report of the State Budget for 2010.

Sources: INE and Ministry of Finance and Public Administration.

The budget consolidation measures affecting the primary balance, as well as the privatisation programme with direct repercussions for public debt, allow to contain the public debt to GDP ratio's growth trend that would be observed in a scenario without additional measures from 2010 (Figure IV.5).Thus, it is clear that the implementation of the measures outlined in this Programme is crucial to the rebalancing of the public accounts within this medium-term horizon and to the sustainability of the public finances in the long term.

Figure IV.5. General Government debt dynamics
(% of GDP)



Source: Ministry of Finance and Public Administration

Chapter
5

V. Sensitivity Analysis and Comparison with the January 2009 Update

V.1 Sensitivity Analysis

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

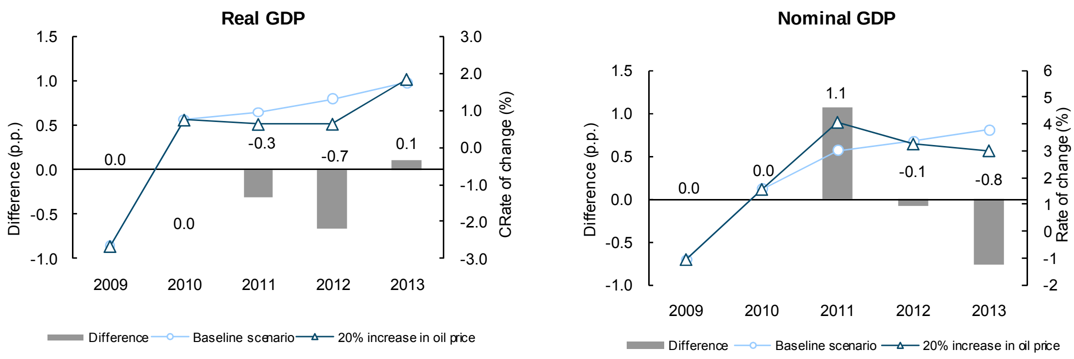
In this context, Figure V.1 illustrates the evolution of the main variables of the domestic economy in a scenario where the oil price is 20% higher than the price existing in the baseline scenario. It is assumed that the shock occurs in 2011 and that the impact is permanent.

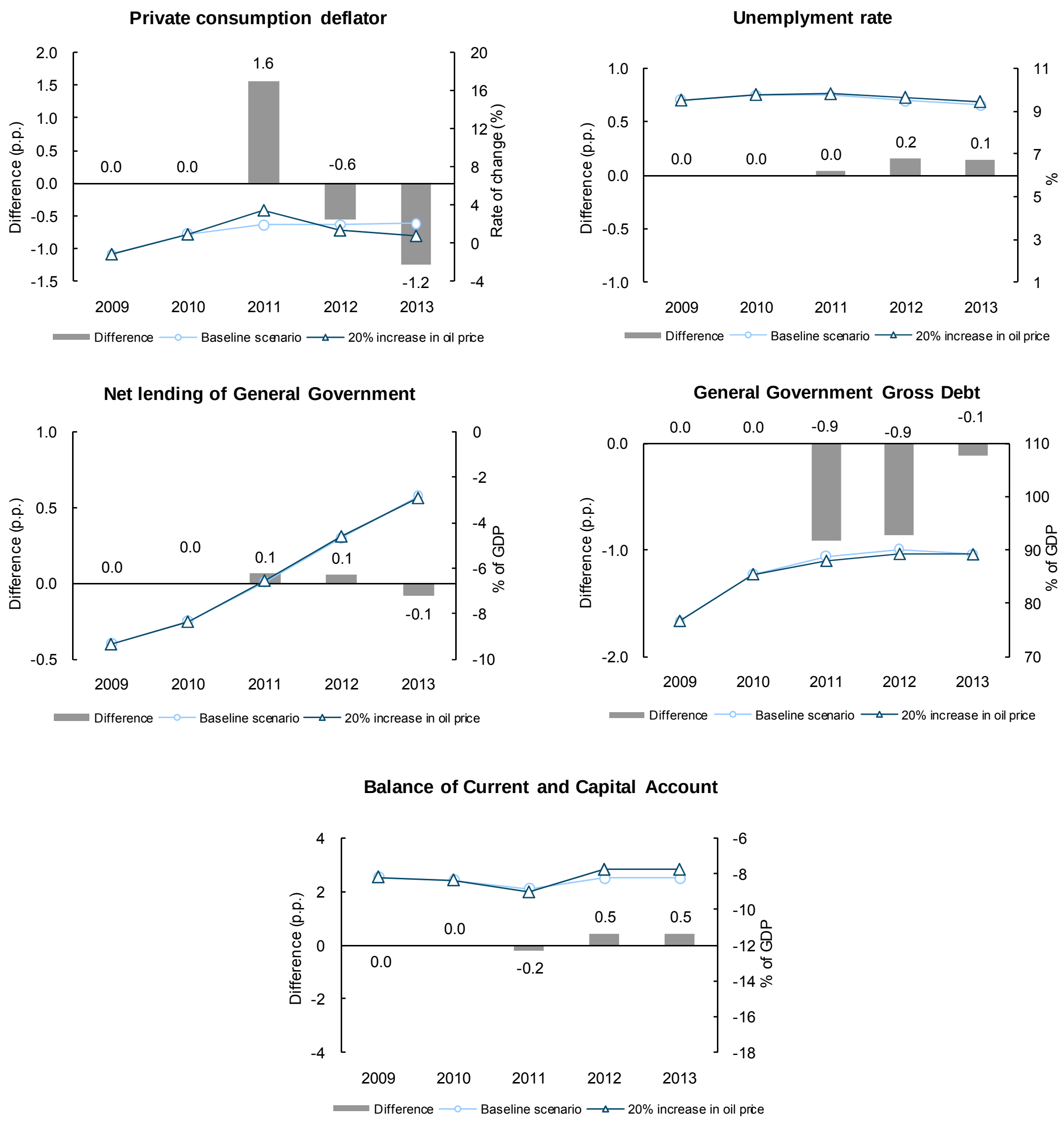
The simulation shows a negative effect on real GDP growth in 2011 and 2012, then reversing in 2013 (it shows a zero differential over the baseline scenario), mainly due to the adverse effects on domestic demand. This reduction in real economic activity in the period 2011-12, induce negative effects on the labour market, being visible a slight increase in unemployment throughout the projection horizon

Nominal GDP, just like consumer prices, rises in 2011 compared to the baseline scenario, reflecting the impact on inflation. In subsequent year, this trend is reversed, as a result of the downward pressure on prices driven by the slowdown to the real economy. The external deficit also performs less favourably compared to the baseline scenario, but gradually will show a better performance over the forecast horizon.

As regards the impact on public finances, a slight improvement to the budget balance is observed in the year of the shock, influenced by the increase to nominal GDP. This situation is reversed in subsequent years due to the negative impact on tax revenue as a result of the shrinkage of economic activity. In line with this momentum, the debt ratio shows an improvement against the baseline scenario over the forecast horizon.

Figure V.1. Sensitivity analysis to a 20% increase in the oil price





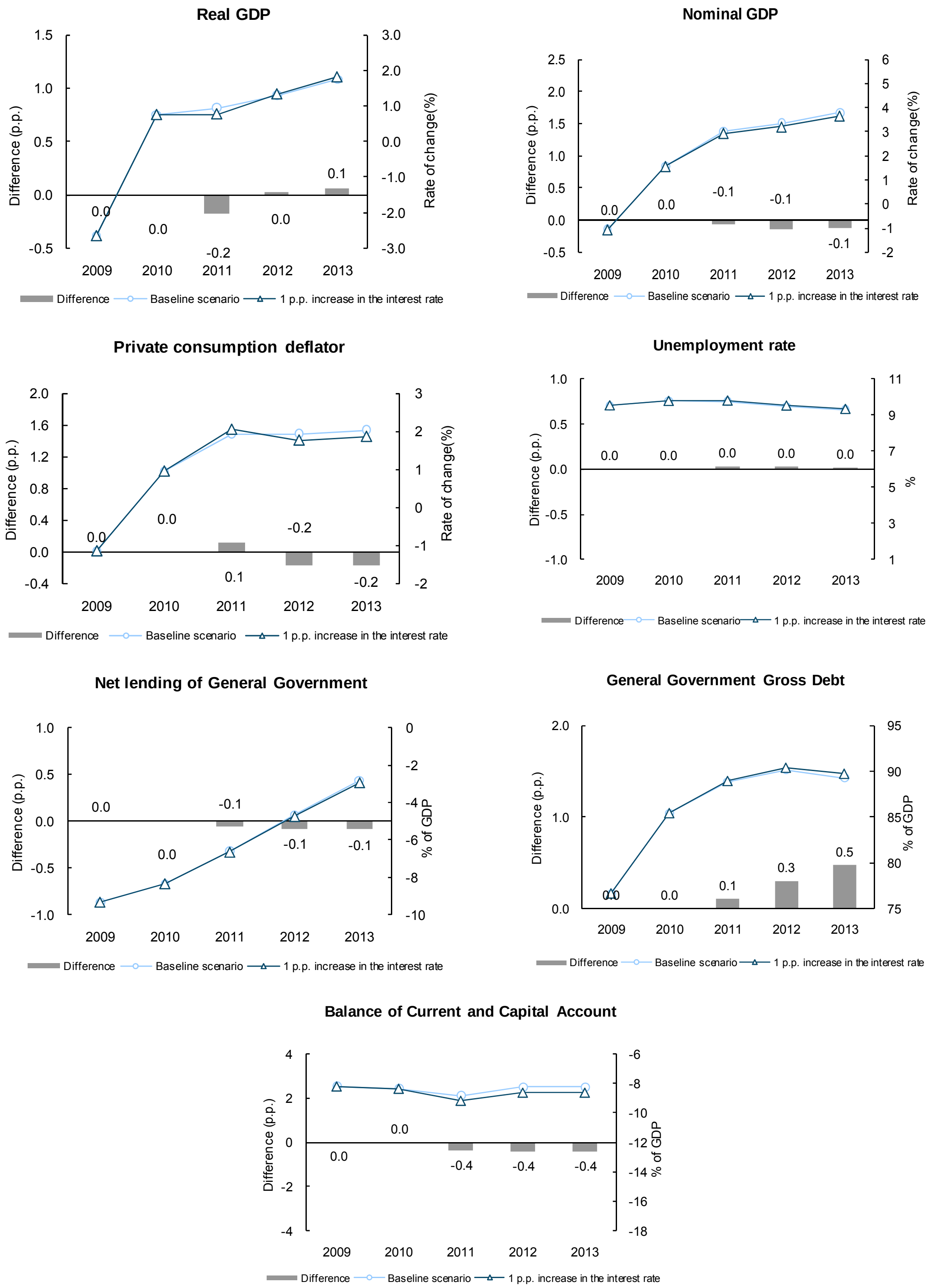
Source: Ministry of Finance and Public Administration.

It is assumed in the simulation of the domestic economy's response to a scenario of higher interest rates that the short-term rates remain 1 p.p. above the value projected in the baseline scenario throughout the projection horizon. Figure V.2 illustrates the main results of the projection in this new scenario.

The adverse effects on the real growth of the domestic economy are limited to 2011 owing to a considerable contraction of domestic demand. The acceleration of consumer prices is also observed in this period. The adverse effects on the labour market are less than in the oil price shock scenario since the negative impact on real economic activity is exclusively confined to 2011.

The negative impact of the higher interest rates on the external net lending is most notable through the higher value of interest paid abroad. This impact is most marked at the end of the projection horizon. The financial burden associated to public debt are also higher than those of the baseline scenario, a situation that causes a worsening of the budget deficit between 2011 and 2013, and a consequent progressive deterioration of public debt.

Figure V.2. Sensitivity analysis to a 1p.p increase in the short-term Interest rate



Source: Ministry of Finance and Public Administration.

V.2 Comparison with the January 2009 Update

In January 2009 update of the Stability and Growth Pact, the economic prospects were beginning to be negative, but they have worsened over the year, namely in the first half of the year, resulting in a fall in

GDP of 2.7 %, 1.9 p p below the forecast of January 2009. This period of exceptional circumstances in which not only affected the Portuguese economy but also the most advanced economies has been reflected in a significant deterioration in the General Government deficit, and also the Public Debt (as a % of GDP).

Table V.1. Stability programme – Comparison with the January 2009 update

	2008	2009	2010	2011	2012	2013
GDP (real grrowth rate, in %)						
January 2009 update	0.3	-0.8	0.5	1.3	:	:
March 2010 update	0.0	-2.7	0.7	0.9	1.3	1.7
difference	-0.3	-1.9	0.2	-0.4	:	:
Net Lending/ Borrowing of General Government (% of GDP)						
January 2009 update	-2.2	-3.9	-2.9	-2.3	:	:
March 2010 update	-2.7	-9.3	-8.3	-6.6	-4.6	-2.8
difference	-0.4	-5.4	-5.4	-4.3	:	:
General Government Debt (% of GDP)						
January 2009 update	64.1	62.5	59.7	56.7	:	:
March 2010 update	66.3	77.2	86.0	89.4	90.7	89.8
difference	2.2	14.6	26.3	32.7	:	:

Source: Ministry of Finance and Public Administration.

Thus, the revised figures for the overall balance and public debt in the years 2011 to 2013 reflect, above all, the impact of current economic and fiscal measures adopted to stimulate economy. The current Programme foresees a period of consolidation in order to achieve a General Government deficit below 3% in 2013.

In structural terms, it is estimated that the General Government deficit has reached 8.1% of GDP in 2009, returning, in 2010, to the fiscal consolidation path, and it is foreseen to be 2.3% of GDP in 2013.

Table V.2. Budgetary prospects
(% of GDP)

	2008	2009	2010	2011	2012	2013
Net Lending/ Borrowing of General Government						
SGP – January 2009	-2.2	-3.9	-2.9	-2.3	:	:
SGP – March 2010	-2.7	-9.3	-8.3	-6.6	-4.6	-2.8
Strutural Balance						
SGP – January 2009	-2.2	-3.1	-2.1	-1.7		
SGP – March 2010	-2.8	-8.1	-7.3	-5.6	-3.8	-2.3

Source: Ministry of Finance and Public Administration

The General Government debt to GDP ratio is higher than that established in the January 2009 update for the 2010 to 20113 period. This rise not only reflects the larger deficit compared to the previous update but also the arithmetic impact of the lower GDP growth.

Chapter 6

VI. LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES[18]

Public finances sustainability, defined in theoretical terms, implies that the present value of the future budget primary balances is equal to the current public debt value. This means that public finances can be considered sustainable if, in the case fiscal policies are maintained unchangeable, tax revenues and other budgetary revenues are sufficient to finance future expenditures that depend, particularly, on demographic evolution. It is to be noted that demographic structure has implications on public expenditure, directly on social expenditure, especially with pensions and health care, and indirectly by means of labour supply on the potential growth of the economy.

In fact, public finances sustainability depends not only on the demographic trend but also on the initial budgetary position and potential growth (in particular on the differential between the growth rates of product and public debt implicit interest rate, that affects its dynamic).

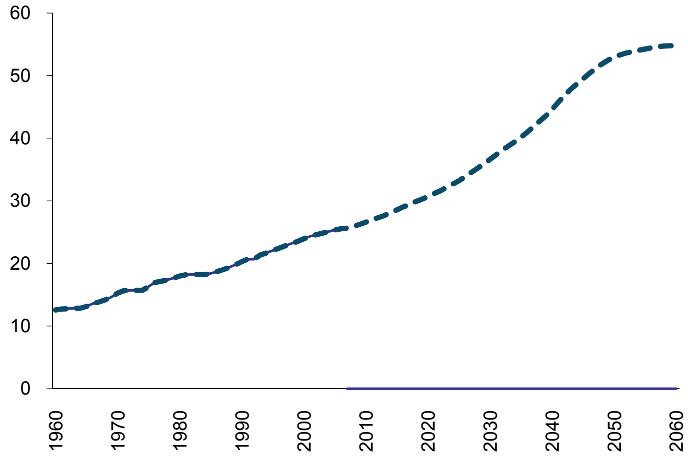
The recent economic and financial crisis had an immediate impact on the sharp deterioration of most developed countries budget positions and may also affect the potential growth of the economies in the future. The stimulus measures recently taken intend to counter this last effect, along with the structural reforms that foster employment and growth as defined under the Lisbon Strategy. This means that current economic situation in general, and public finances is particular, raise increased challenges to the sustainability of public finances in a population ageing scenario. This situation is common to European countries in general and Portugal is not an exception. Structural reform measures already in course will be further intensified (referred in Chapter II) contributing to assure sustainable public finances. In this context, the reform of the public pension regime, reinforced since 2005, has permitted Portugal to became a medium risk country in terms of the sustainability of public finances when previously was a high risk country.

Demographic Evolution

Low fertility rates trend together with higher average life expectancy has being leading to a major change in the Portuguese demographic structure, following other European countries pattern. In particular, the old-age dependency ratio, measured as the ratio between the population aged over 65 and the working age population (15-64 years), has doubled in the last 50 years, and a new raise to the double is foreseen in the next 50 years (Figure VI.1).

[18] The analysis presented in this Chapter is based in the methodology defined in the Code of Conduct of the Stability and Growth Pact. In particular, the projections presented in this Chapter and in Table A.9 of the Annex make use of the assumptions defined in 2008 by the Working Group on Ageing Populations and Sustainability (AWG) that assists the Economic Policy Committee (EPC) of the European Union's Economic and Financial Affairs Council. These assumptions and projections are published in "Ageing Report 2009" and were the base for the public finances sustainability analysis disclosed in "Sustainability Report 2009".

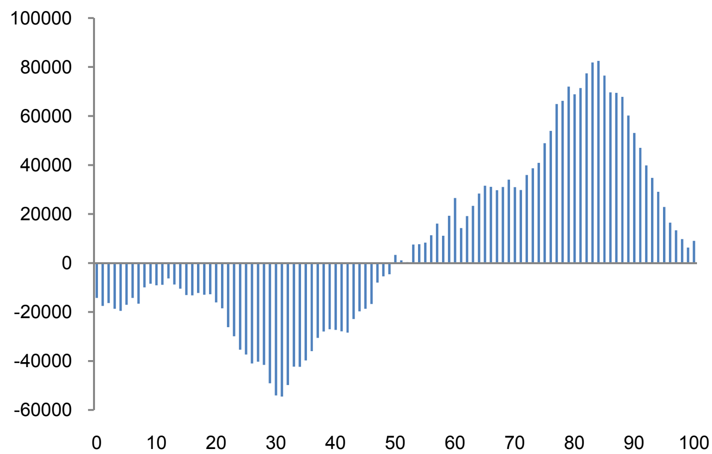
Figure VI.1. Old-age dependency ratio
(pop 65+/pop 15-64, in %)



Sources: INE and Eurostat (EUROPOP2008).

By analysing the population trend until 2060, it is projected a slight increase of the overall population but, by age, we shall assist to a decrease of the population up to 50 years old, more accentuate within the working age population, and to a significant increase in higher ages (Figure VI.2).

Figure VI.2. Population by age – projected change
(2060-2007)



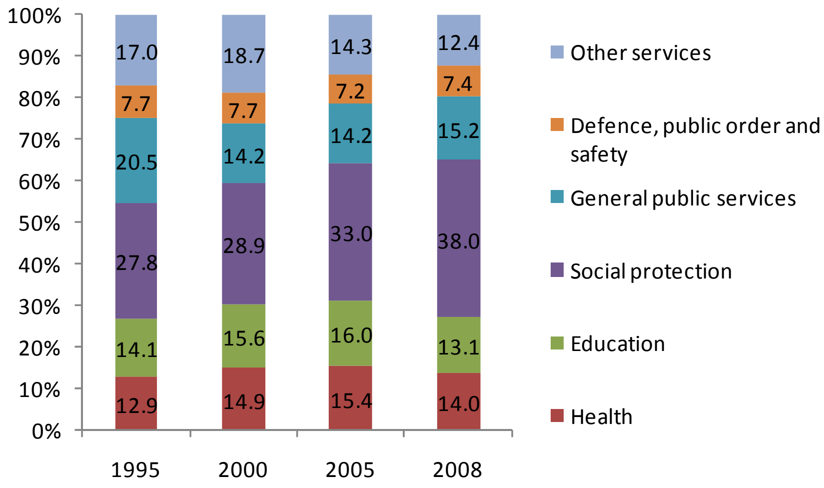
Sources: INE and Eurostat (EUROPOP2008).

This change in the demographic structure is particularly relevant when analysing public expenditure structure and one concludes that around two thirds of General Government expenditure is age related.

Public Expenditure

The most recent available data on public expenditure by function reveal that social security (namely pensions, family allowances, unemployment benefits and social income supplement for the elderly), health and education expenditures represent about 65% of total expenditure. Social security and health care expenditures have increased their relative weight while education expenditures are decreasing in the last few years (Figure VI.3).

Figure VI.3. Public expenditure by function



Source: INE.

In this context, and having in mind that the Portuguese public pension scheme consists in a Pay-as-you-go (PAYG) system, the decrease in working-age population and in the social contributions as well as the increase in the number of pensioners and in the value of pensions with the maturity achievement of the system, bring more pressure over the social security system. Therefore, public finances sustainability analysis made in 2006 revealed a high risk of non-sustainability. The reform measures that have being taken in the social security pension system since 2007 reduced significantly that risk.

Reform Measures

In the sequence of the agreement established between the Government and social partners in Autumn 2006, the public pension system was submitted to main reform measures enacted since 2007 for the Social Security subsystem and since 2008 for the *Caixa Geral de Aposentações* sub-ystem (which covers public employees admitted until end 2005).

Currently convergence mechanisms between both subsystems are being deepened as a way to increase social security system sustainability and to increase the accuracy in the evaluation of General Government labour cost. Therefore, the State Budget for 2010 presents three new measures: i) increase of the contribution rate for State services as employers; ii) change in the way reference remuneration is determined for calculating old-age pension for *Caixa Geral de Aposentações* pensioners enrolled until August 1993 (covered by the retirement legal framework *Estatuto da Aposentação*); and iii) immediate submission to the new rules on early retirement, namely the new financial penalty rate applicable. Additionally, estimated expenditure for 2010 reflects the suspension of the pension update rule for this year having into account the exceptional inflation occurred in 2009 (-0.8%). But, as mentioned in the State Budget 2010 Report, that same rule will be resumed in 2011.

These changes, besides making the contributory social security system more sustainable[19], concur to the decrease in the pensioners income inequality: on one side, *Caixa Geral de Aposentações* regime is in convergence with the Social Security General regime and, on the other side, the new pensions update rule allows higher updates to lower value pensions establishing a maximum value for the pensions eligible to be updated[20]. With the same aim and taking into account the estimated decrease of the replacement rate for future pensioners, it was created the public capitalization system, on a volunteer basis, but that will allow, in the future, to supplement the income of PAYG system pensioners.

Also regarding the universal public health care system, through the National Health Care Service (SNS), measures have been taken in light to turn the system more efficient and finance sustainable. This effort will be intensified in the next years namely through the new measures already introduced in State Budget for 2010 that will allow for efficiency gains in this system such as: i) expenditure control in SNS; ii) best practices promotion and use of common share services; iii) promotion and implementation of measures related to collection and to the issue of invoices, to third persons that are legal or contractually liable, for SNS services[21].

This sector will continue to be constantly monitored as expenditure is determined not only by demographic factors but also by other demand driven factors (income, technological progress…). Even demand for public services on long-term care will tend to increase with the changes in households composition and the decrease of informal care provided by relatives.

Analysis of the sustainability indicators

General evaluation of long-term sustainability risks that Member States have to face is based on specific indicators and in additional information (both qualitative and quantitative). Sustainability indicators used by European Commission (EC) measure the permanent adjustment of the primary budget balance required to assure that public debt value is not higher than 60% of GDP (in the end of the projection horizon, in the case of indicator S1) or that General Government intertemporal budget restriction is fulfilled (in the case of indicator S2), i.e., the present value of future primary balance surpluses must be equal to current public debt value[22].

In the computation of these indicators, a “no policy change” scenario is assumed, i.e. both the revenue and the primary non-ageing related expenditure maintain their GDP weight. The trajectory considered for public age-related expenditure is determined by the Monetary Policy Committee’s and the European Commission’s joint exercise, the last one released in 2009.

It should be noted that, due to the high uncertainty inherent to this type of exercises, based on long term projections, the results obtained must be analysed as indicative of future trends. Nevertheless, this analysis is crucial since, in order to ensure the sustainability of public finances it is important to assess the need for additional measures on a timely manner, allowing the economic agents to incorporate them as

[19] The financial impact of the joint implementation of these two changes in determining the pensions’ value is expected to be a reduction in pension expenditure of approximately €28 million in 2010 and €60, €90 and €120 million, each year, between 2011 and 2013. These measures shall also have important medium and long-term consequences.

[20] The effect of the pensions update rule over income distribution is discussed at: Cunha, V., A. Paulo, N.S. Pereira e H. Reis (2009), *The Reform of the Portuguese Public Employees’ Pension System*, WP no. 2, GPEARI, Ministry of Finance and Public Administration.

[21] Health-care expenditure management and control measures are developed in section II.1.2.

[22] Any of these indicators can be brokendown into the contribution of the Initial Budgetary Position (IBP) and in the long-term change, as a result of the age-related expenditure (LTC). S1 indicator presents also the component related to the necessary additional reduction in debt to achieve the goal of 60% of GDP in 2060 (DR). For a more detailed explanation of these indicators *vide* the December 2007 update of the SGP.

soon as possible in their decisions, thus minimizing the adjustment costs. Postponing necessary measures may signify the accumulation of budgetary imbalances and, consequently, the increase of the public debt stock, which implies future increases of the tax burden or reductions of social expenditure.

For Portugal, the projected increase for this type of expenditure is of 3.4 p.p. of the GDP until 2006, which is mainly explained by the evolution of the expenditures with pensions and with health and long-term care, in identical parts, being these the expenses more sensitive to the ageing of the population. On the contrary, the expenditures with education and with unemployment benefits tend to reduce its relative importance given the reduction of the younger and working-age population (Table VI.1).

Table VI.1. Age related revenue and expenditure projections
(% of GDP)

	2007	2010	2020	2030	2040	2050	2060	Change 2060-2007
Age related expenditure	24.5	24.9	25.2	25.7	26.0	27.4	27.8	3.4
Pensions	11.4	11.9	12.4	12.6	12.5	13.3	13.4	2.1
Health and long-term care	7.3	7.4	7.7	8.1	8.6	9.1	9.3	2.0
Others[1]	5.8	5.6	5.2	4.9 4.8	5.0		5.1	-0.7
Social contributions revenue [2]	9.9	10.3	9.7	9.0 8.7	8.6		8.5	-1.5

Notes: (1) Education and unemployment benefits; (2) Includes actual social contributions
Source: EPC and EC (2009), *The 2009 Ageing Report*.

The demographic evolution is reflected in the employment developments and, as a consequence, also in the revenue derived from social contributions which are expected to decrease by 1.5 p.p. of the GDP in the same horizon.

Comparing to the average of the remaining European countries, one can observe that the expected increase on the expenditure side is inferior in Portugal, mostly in the case of pension expenditure, as a result of the structural measures implemented over the last years (Table VI.2). In the case of health care expenses, an increase higher to the one of the average of the countries in the Euro area and in the EU27 is projected, which indicates the need for additional measures in this system. In addition, this exercise only takes into account the demographic factors and, as mentioned before, there are other factors that may put additional pressure on the expenditures with health care services rendered.

Table VI.2. Age related expenditure – international comparison
(% and p.p. of GDP)

	Pensions		Health care		Long term care		Unemployment		Education		Total	
	2007	Change 2007-60	2007	Change 2007-60	2007	Change 2007-60	2007	Change 2007-60	2007	Change 2007-60	2007	Change 2007-60
Portugal	11.4	2.1	7.2	1.9	0.1	0.1	1.2	-0.4	4.6	-0.3	24.5	3.4
European Union	10.2	2.4	6.7	1.5	1.2	1.1	0.8	-0.2	4.3	-0.3	23.1	4.7
Euro Area	11.1	2.8	6.7	1.4	1.3	1.4	1.0	-0.2	4.2	-0.3	24.3	5.2

Sources: EPC and EC (2009), *The 2009 Ageing Report*.

The projections on the pensions' expenditure for Portugal has suffered significant revisions between the former Sustainability Report divulged in 2006 and the last one divulged in 2009. In 2006, the increase projected for this expenditure was close to 10 p.p. of the GDP (Table VI.3). However, the adoption of the reform measures of public pensions' schemes, in force since 2007, has contributed to the short come of such increase in around 50 per cent. In the 2009 exercise, new demographic and macro economic assumptions were considered for the European countries. In what the demographic projections are concerned, the new scenario (EUROPOP 2008) is, similarly to what happens regarding other countries, more favourable to Portugal than the former one (EUROPOP2004), mostly because it assumes a larger stabilisation of the net migratory flows, unlike what happened in the former one, which projected a steep fall on the medium term. The macroeconomic scenario also assumes a steep convergence with the remaining European countries in terms of the factors productivity and, consequently, in terms of economic growth until 2030. Under these assumptions, the increase of the public expenditure with pensions is more moderate (2.4 p.p. between 2005 and 2050).

Table VI.3. Breakdown of the change in pension expenditure projections between 2006 and 2009
(% and p.p. of GDP)

	2005	2007	2020	2030	2040	2050
Ageing Report 2006	**11.5**	**11.7**	**14.1**	**16.0**	**18.8**	**20.8**
- New model (CGA) (1)	-0.6	-0.1	-0.6	-0.5	-0.8	-1.3
- Reform of the public pensions system	0.0	-0.1	-0.9	-2.1	-3.0	-3.6
Peer Review 2007	**11.0**	**11.5**	**12.6**	**13.4**	**15.0**	**16.0**
- Change in assumptions	-0.1	-0.1	-0.2	-0.8	-2.5	-2.6
Ageing Report 2009	**10.9**	**11.4**	**12.4**	**12.6**	**12.5**	**13.3**

(1) Includes other effects as the revision of the base year data.
Sources: EPC and EC (2009), Country Fiche Portugal.

The new projections in pensions are crucial for the improvement registered in the sustainability indicators, in particular in the LTC component which suffered a significant reduction between the 2006 and 2009 exercises (Table VI.4.).

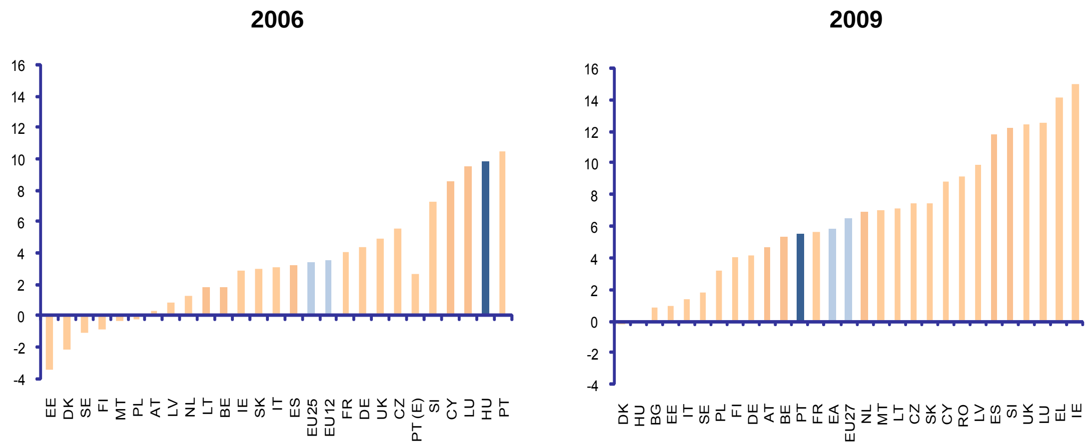
Table VI.4. Sustainability indicators
(% of GDP)

	S1	IBP	DR	LTC	S2	IBP	LTC
Baseline scenario 2006	**7.9**	3.6	0.3	4.1	**10.5**	3.8	6.7
Baseline scenario 2007	**1.9**	0.2	0.0	1.7	**3.6**	0.4	3.2
Baseline scenario 2009	**4.7**	3.4	0.3	1.0	**5.5**	3.7	1.9

Source: European Commission.

The IBP and DR components, which translate the initial budgetary position, reveal deterioration when one compares the 2007 baseline scenario with the 2009 baseline scenario, explaining the most significant share of the sustainability gaps. Indeed, the worsening of the structural balance in 2009 and the increase in the debt ratio following the economic and financial crises have put additional pressure to resume the budgetary consolidation policies as the economy recovers. Nevertheless, the sustainability analysis for Portugal reveals a sustainability gap (S2) of 5.5% of the GDP, inferior to the average of the EU (6.5% of the GDP) and, as recognised by the European Commission, Portugal maintained its medium risk classification in terms of sustainability of the public finance. Indeed, the relative situation of Portugal in the context of the European Union has improved significantly since the analysis on the sustainability of the public finances undertaken in 2006 (Figure VI.4).

Figure VI.4. Sustainability indicator S2
(baseline scenario, % GDP)



Source: European Commission.

The current update of the Stability and Growth Programme already presents the budget consolidation path until 2013, year in which the excessive deficit situation will be corrected. The implementation of this Programme is crucial for the correction of this imbalance and to assure the sustainability of public finances. The consolidation's policy effect can be measured by recalculating the sustainability indicators using the 2013 forecasted budget position as a starting point, and taking into account the additional reform measures introduced by the State Budget for 2010 in the *Caixa Geral de Aposentações* (CGA) system[23]. In this case, the sustainability gaps are already reduced notoriously (Table VI.5.). On the contrary, in a scenario without the measures provided for in this Programme, the sustainability indicators would deteriorate significantly vis-à-vis the 2013 baseline scenario.

Table VI.5. Sustainability indicators – change in the baseline scenario
(% of GDP)

	S1	IBP	DR	LTC	S2	IBP	LTC
Baseline scenario 2009	**4.7**	3.4 0.3 1.0			**5.5**	3.7 1.9	
Baseline scenario SGP 2013	**0.6**	-0.7 0.4		0.9	**1.4**	-0.4 1.8	
No policy change scenario 2013	**4.5**	2.9 0.6 1.0			**5.1**	3.2 1.9	

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

[23] Given that, since 2006, CGA is a system closed to new subscribers the impact of these measures in the long-run is limited and, therefore, the reduction in LTC component is only 0.1 p.p. of GDP.

Chapter 7

VII. QUALITY OF PUBLIC FINANCES

The key strategic vector of budget policy is investment in the quality of public finances, through promotion of long-term sustainability of the public accounts and the creation of an enabling macroeconomic environment for economic growth.

VII.1 Reform of the Budgetary Framework

In the previous legislature several initiatives started towards evaluating and reforming the Portuguese budgetary process. Recommendations resulted from these initiatives, covering modernisation of the budgetary framework, key among which were those from the report drafted especially by the OECD, in particular the need for a multiannual spending framework to be defined, which should be comprehensive, giving the budget objectives stability and credibility.

The 18th Constitutional Government Programme contains the aim of implementing a new ‘multi-year cycle of planning, programming, budgeting, control and evaluation of the performance, in fulfilment of the annual spending thresholds defined’. The new budgetary framework to be introduced is based on four pillars: i) a multi-year spending framework; ii) balance sheet and analytical accounting following the Official Public Accounting Plan (POCP); iii) performance based budgeting; and iv) management based on performance.

Given that the majority of public policies are developed over several years and produce results that often go beyond one legislature, it is important to programme the projects and activities through a multi-year budgetary framework, defining annual spending limits. This framework, aside from making strategic planning more effective, allows budgetary risks for subsequent years to be evaluated better, bringing stability and credibility to the medium-term budget objectives, and transparency and added answerability among the bodies implementing the budget. For the purpose, fixed public spending ceilings for several years sets effective budget restrictions for each body, which has a disciplinary effect, since it forces reallocations whenever necessary.

This reform is a complex and continuous process, taking place over several years. Within the current Programme’ horizon the following key steps are foreseen:

1. By 30 June 2010, the Ministry of Finance and Public Administration will submit a proposal for revision of the Budgetary Framework Law for consideration by the Government.
2. By the time the Budgetary Policy Steering Report (ROPO) is presented in May 2011, a new Budgetary Framework Law must be approved in Parliament. Revision of this Law has three aims: i) to make the financial and material programming multi-year, defining thereby a medium-term public spending framework; ii) in coordination with other reforms such as SIADAP, to finalise the budgetary and management model performance oriented; and iii) to adjust the budget cycle calendar to make the budgetary process logical, consistent and regular.
3. By the time of the presentation of the ROPO in May 2012, the POCP should be applied across all Central Administration.

In the State Budget for 2010 and the current Programme the following are noteworthy: the introduction of spending ceilings, with the limitation on State Budget transfers to other subsectors, in particular to Social Security for the financing of non-contributory social benefits, and the implementation of the zero net indebtedness rule for Regional and Local Administration bodies, with certain exceptions, such as those arising from the Budget Stability Law (Law no. 48/2004 of 24 August, articles 87 and 88). These measures will contribute to the increase in quality of public finances, while also bringing considerable savings in public spending.

VII.2 State-Owned Enterprises' Sector and Public Services Contracts

Since 2007, the State-Owned Corporate Sector (SEE) has been promoting a new governance model for itself, which has involved, among other things, a new legislative framework (for the SEE and the public manager statute), the State's release of strategic guidance aimed at a broader corporate sector, the implementation of a new economic and financial IT system (the Economic and Financial Information Gathering System) and the new legal regime covering the granting of public subsidies.

As a result, following reform of the SEE regime, based on modernising the companies' management model through demanding greater transparency to that practiced in the private sector, the State Budget for 2010 introduces measures to consolidate the results achieved and to deepen the economic and financial restructuring of public companies, which will be continued within the scope of the Stability Growth Programme horizon. These include:

- To make compulsory the guidance arising from the Good Governance Principles, specifically in terms of transparency requirements, remuneration regime and prevention of conflicts of interest;
- To conclude the process of signing management contracts, defining quantified and scheduled economic and financial objectives as instruments of answerability and performance evaluation;
- To conclude the process of contracting public service provision, strengthening the State's transparency and responsibility in paying compensation;
- To carry out restructuring of the financial liabilities of public companies, cognisant of the need to define investment objectives in sustainable terms that are compatible with the debt capacity of public companies and the State's financial capacity;
- To define general guidance taking into account the alignment of benefits relating to pensions and healthcare, giving rise to the constitution of complementary pension funds for acquired rights;
- To strengthen the transparency and efficiency of the public companies' provisioning procedures, through the creation of purchasing centres, individual or shared, possibly in liaison with the National Public Purchasing Agency within the scope of the National Public Purchasing System in operation.

VII.3 Public-Private Partnerships

Public-Private Partnerships (PPP) have taken on an increasing importance, becoming a key instrument in the development of structural projects. Experience has shown that contracting through PPPs involves considerable complexity levels, specifically regarding suitable sharing of the risks involved and quantification of costs, the public sector comparator's analysis and, generally, the evaluation of efficiency that is necessarily associated to this choice of contracting method.

Thus, over three years after the last review of the PPP legal regime, an entity exclusively dedicated to the monitoring of partnerships and concessions has been created, replacing the current State-owned corporations, Public-Private Partnerships and concessions Monitoring Office, whose intervention area encompasses the State-owned corporations exclusively.

To this end, a centralised PPP and concessions monitoring unit is to be established in 2010, under the direct dependence of the minister responsible for the finance area, with effective coordination powers over the strategic, economic and financial components of those initiatives, as well as control of implementation of the respective contracts.

This unit's mission is to undertake research and strategic coordination in the PPP area, encouraging the appropriate sharing of risk between the partners involved, and the monitoring and control of public partners' intervention in its definition, design, preparation, tender, award, modification and inspection. This unit will also have powers in the areas of research, collecting and disclosure of information on PPPs.

VII.4 Green Taxation

Green taxation is nowadays an important component of the Portuguese tax system. Over the last few years, vehicle taxation has been reformed, becoming based on CO2 emissions, tax benefits have been created for biofuels and electric vehicles, energy taxation has been improved and fiscal stimuli have been introduced for more environmentally friendly behaviours, through income tax, asset tax and consumption tax. At the same time and in compliance with EU laws, rates on the use of water resources or on management and disposal of waste have been introduced.

The strengthening of quality in our public finances involves necessarily deepening these mechanisms, as it is certain that the purpose of green taxation is not only to generate revenues, but also to serve as behavioural guidance. At the EU level, the effectiveness of this behavioural guidance through taxation has been such that the relative weight of environmental taxation has diminished over the last ten years, which paradoxically often stands as a sign of its own success.

Over the next few years, as part of the Stability and Growth Programme, the Portuguese Government will deepen our tax system's environmental component, not only to ensure it can collect revenue in the long term, but also to encourage households and companies to make more rational choices, above all in the areas of energy efficiency and transport, which are so important to our national accounts.

Among other measures to be introduced, the SGP currently includes the following:

- The creation of tax stimuli for companies acquiring electric vehicles, while discouraging the acquisition of conventional vehicles and encouraging the offer of vehicles as a staff remuneration component;
- The full transposition of Directive No. 2003/96, broadening the energy taxation to electricity, as is constituted by the EU Law;
- The introduction of a rule of minimum annual increase of 5g/km in the tax scales on vehicles due at the moment of purchase, to ensure the tax is adapted to market performance and revenue is procured;

- The rationalisation of the tax spend from Oil and Energy Products Tax and Vehicle Tax, placing existing usage under more rigorous environmental criteria, such as incentivising vehicle scrappage, to moving progressively towards the purchase of electric vehicles.

Through these measures, green taxation aims to sustain its capacity for guiding behaviours and sourcing revenue during the period 2009-2013, contributing at the same time to the sustainability of the Portuguese economy and the public finances.

ANNEX

Statistical Tables

Table A.1. Macroeconomic prospects

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level (10^6 euros)	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP[1]	B1*g 1	63051.6	0.0	-2.7	0.7	0.9	1.3	1.7
2. Nominal GDP	B1*g 1	66436.9	2.1	-1.7	1.5	3.0	3.3	3.8
Components of real GDP								
3. Private Consumption expenditure	P.3 1	07846.2	1.7	-0.8	1.0	0.8	0.9	1.0
4. Government Consumption expenditure	P.3 33413.	9	1.1	3.5	-0.9	-1.3	-1.4	0.2
5. Gross fixed capital formation	P.51 35323	2	-0.7	-11.1	-0.8	1.0	1.6	1.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P53	741.9	0.6	0.1	0.1	0.0	0.0	0.0
7. Exports of goods and services	P.6 53186.	7	-0.5	-11.4	3.5	4.1	4.5	4.6
8. Imports of goods and services	P.7 67460.	1	2.7	-9.2	1.7	1.9	1.9	2.0
Contributions to real GDP growth								
9. Final domestic demand		-	1.2	-2.4	0.3	0.4	0.6	1.0
10. Changes in inventories and net acquisition of valuables	P.52 + P53	-	0.1	-0.2	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11 -		-1.2	0.2	0.4	0.5	0.7	0.7

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

Table A.2. Price developments

	ESA Code	2008	2009	2010	2011	2012	2013
		rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		2.1	1.0	0.8	2.0	2.0	2.0
2. Private consumption deflator		2.6	-1.8	1.0	1.9	1.9	2.0
3. HICP		2.7	-0.9	0.8	1.9	1.9	2.0
4. Export price deflator (goods and services)		3.2	-4.9	3.1	1.8	2.9	2.9
5. Import price deflator (goods and services)		4.9	-8.7	4.5	1.9	2.9	2.8

Table A.3. Labour market developments

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		5147.0	0.4	-2.5	-0.5	0.1	0.4	0.6
2. Employment, hours worked[2]		4924.5	0.4	-2.5	-0.5	0.1	0.4	0.6
3. Unemployment rate (%)[3]			7.6	9.5	9.8	9.8	9.5	9.3
4. Labour productivity, persons [4]		25.6	-0.4	-0.1	1.3	0.8	0.9	1.2
5. Labour productivity, hours worked [5]		26.8	-0.4	-0.1	1.3	0.8	0.9	1.2
6. Compensation of employees	D.1 83466.	6	4.1	0.6	0.1	0.5	1.5	2.4
7. Compensation per employee		19.9	3.2	2.4	0.5	0.3	1.1	1.9

[1] Occupied population, domestic concept national accounts definition. [2] National accounts definition. [3] Harmonised definition, Eurostat; levels. [4] Real GDP per person employed. [5] Real GDP per hour worked.

Table A.4. Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Net lending/borrowing vis-à-vis the rest of the world	B.9 -	10.3	-9.4	-9.3	-9.1	-8.7	-8.3
of which: - Balance on goods and services		-9.6	-7.6	-7.8	-7.3	-6.6	-5.8
- Balance of primary incomes and transfers		-2.5	-3.0	-3.0	-3.5	-4.0	-4.3
- Capital account		1.8	1.2	1.6	1.7	2.0	1.8
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-7.6	-0.1	-0.9	-2.5	-4.0	-5.5
3. Net lending/borrowing of general government	B.9 -2	.7	-9.3	-8.3	-6.6	-4.6	-2.8

Table A.5. General Government budgetary prospects

	ESA Code	2008 Level	2008 % of GDP	2009 % of GDP	2010 % of GDP	2011 % of GDP	2012 % of GDP	2013 % of GDP
Net lending (EDP B.9) by sub-sector								
1. General government	S.13 -	4456	-2.7	-9.3	-8.3	-6.6	-4.6	-2.8
2. Central government	S.1311 -	5575	-3.3	-9.1	-8.6	-6.8	-4.8	-3.0
3. Local government	S.1313 -	137	-0.1	-0.4	-0.1	0.0	0.0	0.0
4. Social security funds	S.1314 125	6	0.8	0.2	0.3	0.2	0.2	0.2
General government (S13)								
5. Total revenue	TR 7197	8	43.2	39.7	40.5	41.1	41.8	42.6
6. Total expenditure	TE	76434	45.9	49.1	48.8	47.7	46.5	45.4
7. Net lending/borrowing	EDP B.9	-4456	-2.7	-9.3	-8.3	-6.6	-4.6	-2.8
8. Interest expenditure	EDP D.41	4835	2.9	2.9	3.2	3.8	4.1	4.1
9. Primary balance		378	0.2	-6.4	-5.1	-2.8	-0.6	1.3
10. One-off and other temporary measures		0	0.0	0.0	0.0	0.0	0.0	0.0
Selected components of revenue								
11. Total taxes (11=11a+11b+11c) 4081		9	24.5	22.2	22.4	23.4	24.3	24.7
11a. Taxes on production and imports	D.2 2429	1	14.6	13.1	13.5	14.2	14.8	14.9
11b. Current taxes on income, wealth, etc	D.5 1651	7	9.9	9.1	8.9	9.2	9.4	9.8
11c. Capital taxes	D.91	11	0.0	0.0	0.0	0.0	0.0	0.0
12. Social contributions	D.61	21552	12.9	11.4	11.1	11.2	11.2	11.4
13. Property income	D.4 142	1	0.9	0.7	0.6	0.6	0.6	0.7
14. Other (14=15-(11+12+13))		8187	4.9	5.4	6.4	5.9	5.8	5.8
15=5. Total revenue	TR 7197	8	43.2	39.7	40.5	41.1	41.8	42.6
p.m.: Tax burden (a) (D.2+D.5+D.61+D. 91-D.995)		60677	36.5	32.6	32.8	34.0	34.8	35.5
Selected components of expenditure								
16. Compensation of employees + intermediate consumption	D.1+P.2	28677	17.2	15.9	16.0	15.4	14.5	14.0
16a. Compensation of employees	D.1	21436	12.9	11.5	11.2	10.9	10.5	10.0
16b. Intermediate consumption	P.2	7241	4.4	4.4	4.7	4.5	4.0	4.0
17. Social payments (17=17a+17b)		33163	19.9	21.8	22.1	21.9	21.8	21.5
17a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	7181	4.3	4.8	5.0	4.9	4.8	4.7
17b. Social transfers other than in kind	D.62	25982	15.6	17.1	17.1	17.0	17.0	16.8
18.=8. Interest expenditure	EDP D.41	4835	2.9	2.9	3.2	3.8	4.1	4.1
19. Subsidies	D.3 197	0	1.2	1.5	1.7	1.5	1.3	1.2
20. Gross fixed capital formation	P.51 362	2	2.2	2.6	2.7	2.3	2.1	2.0
21. Other (21=22-(16+17+18+19+20)) 416		8	2.5	4.3	3.2	2.8	2.8	2.8
22=6. Total expenditure	TE 7643	4	45.9	49.1	48.8	47.7	46.5	45.4
p.m.: Government consumption (nominal)	P.3	34516	20.7	22.2	22.1	21.5	20.5	20.0

Table A.6. General Government debt developments

% of GDP		2008	2009	2010	2011	2012	2013
1. Gross debt		66.3	77.2	86.0	89.4	90.7	89.8
2. Change in gross debt ratio		2.7	10.8	8.9	3.4	1.3	-0.9
Contributions to changes in gross debt							
3. Primary balance		-0.2	6.4	5.1	2.8	0.6	-1.3
4. Interest expenditure		2.9	2.9	3.2	3.8	4.1	4.1
5. Stock-flow adjustment		1.3	0.4	1.6	-0.7	-0.5	-0.4
- Differences between cash and accruals							
- Net accumulation of financial assets		0.6	0.3	-0.3	-0.7	-0.5	-0.4
of which: *- privatisation proceeds*		0.0	0.0	0.6	1.0	0.8	0.7
- Valuation effects and other							
p.m. implicit interest rate on debt		4.7	4.3	4.2	4.6	4.7	4.7

Table A.7. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Real GDP growth (%)		0.0	-2.7	0.7	0.9	1.3	1.7
2. Net lending of general government	EDP B.9	-2.7	-9.3	-8.3	-6.6	-4.6	-2.8
3. Interest expenditure	EDP D.41	2.9	2.9	3.2	3.8	4.1	4.1
4. One-off and other temporary measures		0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		0.8	0.1	0.6	0.7	1.0	0.9
contributions:							
6. Output gap		0.3	-2.5	-2.4	-2.2	-1.9	-1.1
7. Cyclical budgetary component		0.1	-1.2	-1.1	-1.0	-0.8	-0.5
8. Cyclically-adjusted balance (2-7)		-2.8	-8.1	-7.3	-5.6	-3.8	-2.3
9. Cyclically-adjusted primary balance (8+3)		0.1	-5.2	-4.1	-1.8	0.3	1.8
10. Structural balance (8-4)		-2.8	-8.1	-7.3	-5.6	-3.8	-2.3

Table A.8. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012	2013
Real GDP growth (%)							
Previous update		0.3	-0.8	0.5	1.3		
Current update		0.0	-2.7	0.7	0.9	1.3	1.7
Difference		-0.3	-1.9	0.2	-0.4		
General government net lending (% of GDP)	EDP B.9						
Previous update		-2.2	-3.9	-2.9	-2.3		
Current update		-2.7	-9.3	-8.3	-6.6	-4.6	-2.8
Difference		-0.4	-5.4	-5.4	-4.3		
General government gross debt (% of GDP)							
Previous update		64.1	62.5	59.7	56.7		
Current update		66.3	77.2	86.0	89.4	90.7	89.8
Difference		2.2	14.6	26.3	32.7		

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

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure							
Of which: age-related expenditures	24.5	24.9	25.2	25.7	26.0	27.4	27.8
Pension expenditure	11.4	11.9	12.4	12.6	12.5	13.3	13.4
Social Security pension	7.3	7.8	8.3	8.7	9.6	11.5	12.6
Old-age and early pensions	5.4	5.9	6.5	7.0	7.7	9.3	10.2
Other pensions (disability, survivors)	1.9	1.9	1.8	1.7	1.9	2.2	2.3
Civil servants subsystem (CGA)	4.1	4.2	4.0	3.9	2.9	1.8	0.9
Health care	7.2	7.3	7.6	8.0	8.5	8.9	9.1
Long-term care	0.1	0.1	0.1	0.1	0.1	0.2	0.2
Education expenditure	4.6	4.5	4.3	4.1	4.0	4.2	4.3
Other age-related expenditures [(a)]	1.2	1.1	0.9	0.8	0.8	0.8	0.8
Interest expenditure							
Total revenue							
Of which: property income							
of which: from pensions contributions (or social contributions if appropriate)	9.9	10.3	9.7	9.0	8.7	8.6	8.5
Pension reserve fund assets	4.5	6.6	12.3	12.9	9.1	0.0	0.0
Of which: consolidated public pension fund assets (assets other than government liabilities)							
Assumptions (1)							
Labour productivity growth	1.1	1.1	1.8	2.7	2.2	1.7	1.7
Real GDP growth	1.8	2.0	2.1	2.5	1.8	1.2	1.4
Participation rate males (aged 20-64)	84.8	85.2	84.9	84.5	84.1	84.5	84.3
Participation rates females (aged 20-64)	73.6	75.2	77.8	78.4	78.4	79.0	78.8
Total participation rates (aged 20-64)	79.2	80.1	81.4	81.5	81.3	81.8	81.6
Unemployment rate (15_64)	8.5	7.7	6.2	6.2	6.2	6.2	6.2
Population aged 65+ over total population	25.6	26.6	30.7	36.6	44.6	53.0	54.8

(1) Assumptions underlying the Ageing Report 2009 (based on the EC Spring 2008 Economic Forecasts). (a) Expenditure on unemployment benefits.

Table A.10. Basic assumptions

	2008	2009	2010	2011	2012	2013
Short-term interest rate (annual average)	4.6	1.2	1.2	2.4	2.9	3.2
Long-term interest rate (annual average)	4.6	4.3	4.5	5.1	5.3	5.2
USD/€ exchange rate (annual average)	1.47	1.39	1.43	1.47	1.46	1.45
Nominal effective exchange rate (annual change)	1.3	-0.9	0.0	0.0	0.0	0.0
World excluding EU, GDP growth	3.9	-0.7	2.5	4.8	5.1	5.2
EU GDP growth	0.9	-4.0	0.9	1.9	1.9	1.8
Growth of relevant foreign markets	2.5	-14.7	1.7	4.5	4.5	4.6
World import volumes, excluding EU	1.8	-10.2	2.1	6.2	6.7	6.6
Oil prices, (Brent, USD/barrel)	96.4	62.5	76.6	82.0	84.8	86.5