

PORTUGAL

**STABILITY AND GROWTH
PROGRAM**

Update for 2004-2007

December • 2003



Portugal em Acção

INDEX

I. INTRODUCTION	1
II. ECONOMIC POLICY OBJECTIVES.....	2
III. MACROECONOMIC FRAMEWORK	3
RECENT DEVELOPMENTS	3
MEDIUM-TERM MACRO-ECONOMIC SCENARIO (2004 TO 2007).....	6
IV. PUBLIC FINANCES	9
DEVELOPMENTS UNTIL 2003	9
STATE BUDGET FOR 2004	13
MEDIUM TERM PROGRAMMING	14
CYCLICALLY ADJUSTED BUDGET BALANCES	18
DEBT DEVELOPMENT.....	20
SENSITIVITY ANALYSIS	20
COMPARISON WITH THE PREVIOUS UPDATE.....	22
V. STRUCTURAL REFORMS.....	23
PUBLIC ADMINISTRATION REFORM.....	23
HEALTH	25
EDUCATION	26
LABOUR LEGISLATION	28
MEASURES TO LIMIT THE GROWTH OF SOCIAL EXPENDITURE	29
ECONOMIC REFORM MEASURES	30
VI. LONG TERM SCENARIOS FOR SOCIAL SECURITY	32

ÍNDICE DE QUADROS E GRÁFICOS

Table III-1 Basic assumptions	6
Table III-2 Central macroeconomic scenario	7
Table IV-1 Current Revenues.....	10
Table IV-2 Current Expenditure.....	11
Table IV-3 General Government Overall and Primary Balance	12
Table IV-4 General Government Accounts (2003-2007).....	15
Table IV-5 Cyclical Developments	18
Table IV-6 General Government Debt	20
Table IV-7 Sensitiveness to different real rates of growth of GDP	21
Table IV-8 Sensitiveness to different rates of interest	22
Table IV-9 Comparison between actual and previous SGP forecasts.....	23
Table VI-1. Projection of the increase [in percentage points of GDP]	32
Table VI-2. Projection of expenditures in social security pensions	33
Chart III-1 Indebtedness of households.....	3
Chart III-2 Employment and unemployment(%)	4
Chart III-3 Unemployment rate (%)	4
Chart III-4 Wages and productivity.....	4
Chart III-5 Wages and productivity.....	4
Chart III-6 External deficit *.....	5
Chart III-7 OECD leading indicator	5
Chart III-8 Real GDP and Output Gap*	7
Chart III-9 Export performance.....	8
Chart III-10 Real compensation of employees per head and labour productivity.....	9
Chart IV-1 Output gap*	18
Chart IV-2 Actual and cyclically adjusted overall balance	19
Chart IV-3 Actual and cyclically adjusted primary balance	19
Chart IV-4 Alternative real rates of growth of GDP	21
Chart IV-5 Alternative rates of interest	22

I. INTRODUCTION

- 1 The Portuguese economy has been receding since the second half of 2002, under the cumulative effect of two major factors - a faltering external demand and a domestic demand affected by the gradual correction of strong macroeconomic imbalances. The year-on-year GDP growth rate that stood at 2,5% at the end of the second quarter of 2001 has decreased to -2,1 at the end of the second quarter of 2003. The economy appears to be recovering, in the last part of the year, while the macroeconomic imbalances are fading. The external deficit (current account plus capital account balance), which stood at about 9% of GDP, in 2000, is expected to decrease to below 4% of GDP in 2003. The cyclically-adjusted public deficit showed a clear decline in the last two years. In 2003 the economy is expected to recede by about 0,8%. Some signs of economic recovery have been emerging and rebound is expected to strengthen in 2004, leading to a projected 1% output growth.
- 2 The baseline macroeconomic scenario underlying the previous update of the Stability Programme, foresaw an economic growth rate about 2 percentage points above the currently expected growth for 2003. Such a negative deviation would lead, by itself, to a deficit exceeding the 3% reference value established by the Treaty. Hence, the Portuguese government took a set of additional measures in order to keep the public deficit below that ceiling. Still, the implementation of such measures does not avoid a revision to the adjustment path planned in the previous update.
- 3 The revised adjustment path for public accounts follows the recommendations made to Portugal in the BEPGs - cyclically adjusted deficits decreasing by at least 0,5% of GDP a year, mainly through expenditure side adjustments in the areas of public administration, education, health and social security. While being affected by the downward revision of economic growth, in the period 2003-2007, the revised adjustment path fully retains the medium term goal of a balanced budgetary position. The new path merely adapts the previous one to non-foreseeable circumstances that have since emerged.
- 4 The Stability Programme for 2004-2007 builds upon the State Budget for 2004. It follows the guidelines in article 3 of Council Regulation n. 1466/97, of 7 July 1997 and provides the information required by the 2001 Code of Conduct. It was approved by the Portuguese Government in December 2003.
- 5 The current update of the Stability Programme is geared to clearly defined economic policy objectives, described in chapter II and is based upon a macroeconomic scenario presented in chapter III. The description of the fiscal policy developments this year and the strategy for the period 2004-2007 is made in chapter IV, which includes a sensitivity analysis. In chapter V the main structural reforms underway or to be implemented during the period covered by the Programme are presented. Finally the long term projections related with the impact of population ageing on public accounts are presented in this chapter VI.

II. ECONOMIC POLICY OBJECTIVES

- 6 As stated in the previous update, the main objectives of economic policy in Portugal are twofold:
 - To accelerate the pace of real convergence towards the European Union;
 - To prepare the economy and the public finances for long term demographic changes.
- 7 In order to achieve these long-term objectives it is essential that efforts for sound public finances through the reduction of current expenditure be continued, that competitiveness enhancing structural reforms be pursued, and that efforts aiming at improving education and skills be stepped up.
- 8 The gradual elimination of the fiscal deficit is an essential condition for the growth and the sustained development of the Portuguese economy. The current revision of the adjustment path is due to an economic juncture clearly more depressed than initially expected. Achieving a balanced fiscal position remains a key policy goal, which once achieved must be kept in a sustained way.
- 9 The Budget Stability Law is an important instrument in this context. This Law establishes that all bodies of Public Administration are subject to three major principles:
 - Budgetary stability - the budgets, on a national accounting basis (ESA-95) should be balanced or in surplus;
 - Solidarity - the different sectors of Public Administration should contribute, proportionally, to the overall budgetary stability, even if transfers from the State to the other Public Administration entities are set below the legally foreseen. The Budget Stability Law is an organic law, which means it ranks above the remaining legislation;
 - Transparency- Public Administration entities that do not present their accounts when they are due will stop receiving transfers from the State.
- 10 Achieving budgetary stability on a sustained basis requires budget surpluses to be generated in years with strong economic growth and further efforts to contain current expenditure and to improve Public Administration efficiency. This is a necessary condition to accommodate the budgetary impact of population ageing while also releasing resources to the private sector. This will contribute to accelerate the real convergence of the Portuguese economy to levels close to those of the European Union.
- 11 A faster pace of real convergence will require clear productivity gains. Labour productivity in Portugal is well below the average European levels and has developed in an unfavourable way, in recent years, as compared to the real

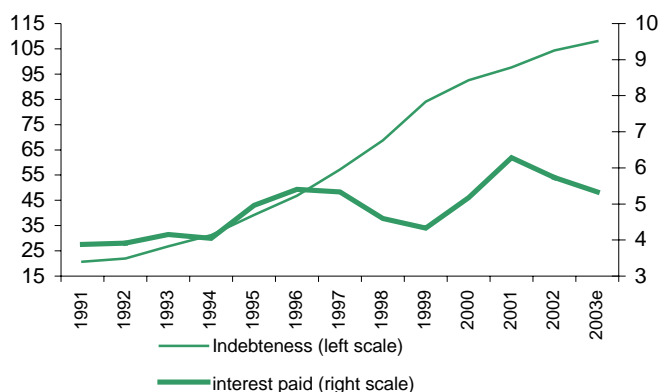
wage growth. The ongoing structural reforms - reorganization of Public Administration, reforms in the education and health sectors, incentives to technological innovation and the creation of an environment favourable to investment – are set to improve the competitiveness while contributing, even if not immediately, to consolidate public finances.

III. MACROECONOMIC FRAMEWORK

RECENT DEVELOPMENTS

- 12 Since the end of 2000, domestic demand slow down significantly as a result of the adjustment of private agents to the high indebtedness levels accumulated in the second half of the 90's.

Chart III-1 Indebtedness of households

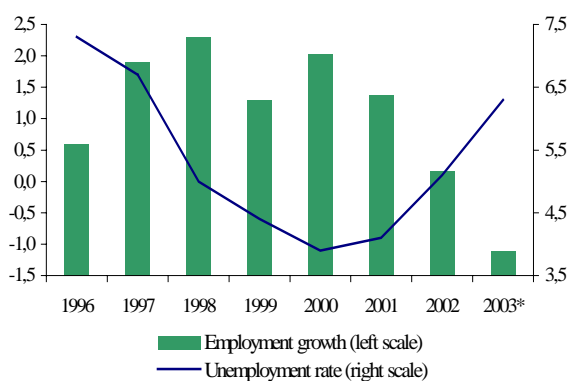


Sources: Banco de Portugal and Ministério das Finanças.

- 13 In 2003, economic activity continued to follow the negative trend started in the previous year. Real GDP is expected to decrease between -1% and -0.5% , which compares to an increase of 0.4% in 2002. This deterioration reflects the deepening of the domestic adjustment process, in a context of faltering international growth. Following a gradual slowdown, private consumption should drop in 2003, equally reflecting a slowdown in the households disposable income, associated to wage moderation and the increase of unemployment. An increase in the savings rate is expected, due to precautionary reasons. Private investment should register a sharper fall than in 2002, due to the persistence of financial constraints and to the weak foreign and domestic demand perspectives. The feeble dynamism of foreign markets hampered the evolution of Portuguese exports, which should keep a moderate growth. Likewise, in 2003, imports should register a more intense fall than in the previous year, in line with the evolution of domestic demand. The positive contribution of net foreign demand to GDP growth should increase in 2003, albeit not enough to offset the contribution of domestic demand. The labour

market situation deteriorated in 2003 mirroring the economic cycle with the usual time lag, and in line with the trend observed since 2001. In the first three quarters, the activity rate remained at the level of 2002 (51.8%), employment declined by 1.1% and the unemployment rate reached 6.3% (5.1% in 2002). Despite this increase in the average annual average unemployment rate, the intra-annual behaviour shows a relative stabilization since the last quarter of 2002.

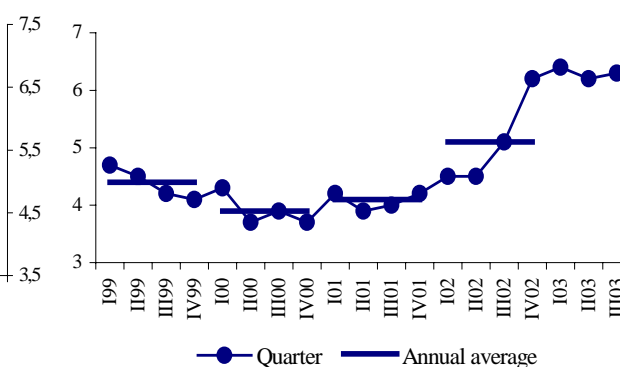
Chart III-2 Employment and unemployment(%)



Source: INE, "Employment Survey".

* First three quarters.

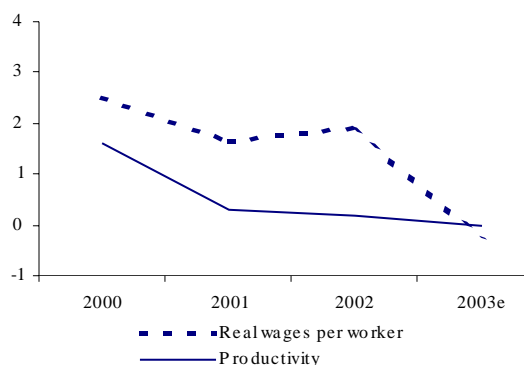
Chart III-3 Unemployment rate (%)



Source: INE, "Employment Survey"

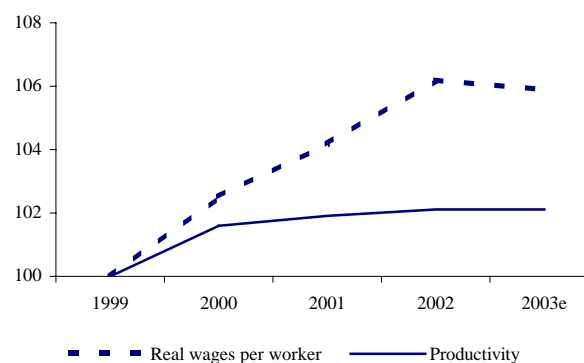
The inflation rate should decrease from 3.7% in 2002 to around to 3.3% in 2003. The main factors behind price slowdown were the contraction of domestic demand and wage moderation. In fact, the wage growth showed a significant slowdown in 2003, reflecting the near freeze of civil servants wages and overall wage moderation. In 2003, productivity growth is expected to exceed the increase in real wages.

Chart III-4 Wages and productivity (% change)



Sources: INE; Ministério das Finanças.
e – estimate.

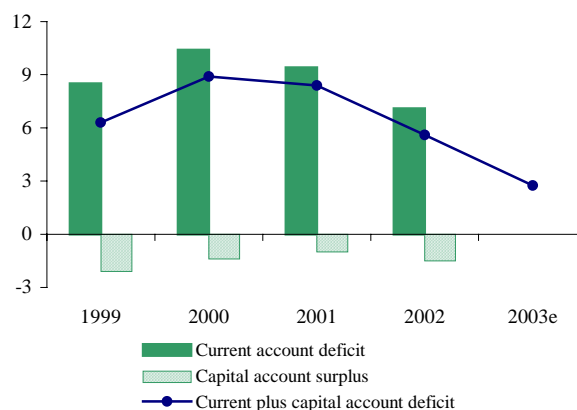
Chart III-5 Wages and productivity (Index 1999=100)



Sources: INE; Ministério das Finanças.
e – estimate.

- 14 The improvement of the trading balance, and the reduction of financing needs of private agents continued to contribute to the reduction of the external accounts imbalance. The overall deficit of the Current and Capital Account Balances should be below 4% of GDP in 2003 (8.9% in 2000).

Chart III-6 External deficit *
(% of GDP)



Source: Banco de Portugal.

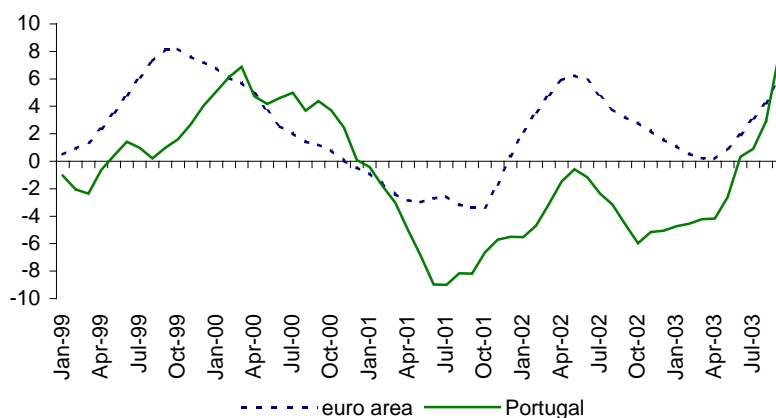
e – estimate.

* As measured by the sum of current and capital balances.

- 15 In intra-annual terms, economic activity should present a less unfavourable behaviour in the second half of 2003. Some positive signs have been emerging: the confidence indexes for consumers and entrepreneurs have shown a positive trend; the industrial production index has presented a favourable turn in the third quarter; interest rates and inflation have remained in low levels; the external demand after a period of stagnation is rising; and the OECD leading indicator for Portugal suggests a clear improvement.

Chart III-7 OECD leading indicator

(% change) *



MEDIUM-TERM MACRO-ECONOMIC SCENARIO (2004 TO 2007)

- 16 The macroeconomic scenario for the Portuguese economy for the period 2004-2007 mirrors the Autumn 2003 projections of the international institutions. Underlying these projections is, in particular, a recovery of the world economy starting on the second half of 2003, which was confirmed by GDP data for both the US and the euro area.

Table III-1 Basic assumptions

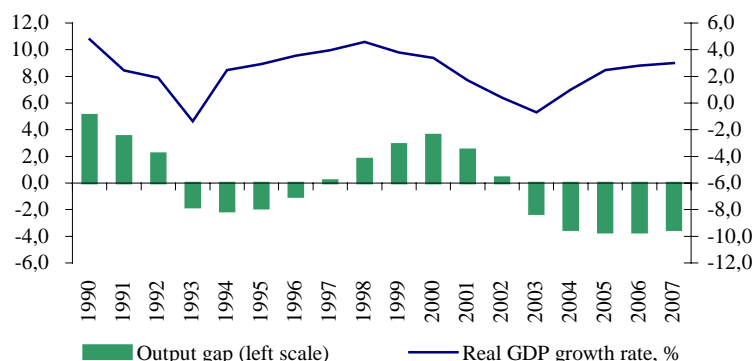
	2002	2003	2004	2005	2006	2007
Short-term interest rate (annual average)	3,3	2,3	2,3	3,2	3,3	3,4
Long-term interest rate (annual average)	5,0	4,2	4,5	4,9	5,1	5,2
Exchange rate 1 Euro = ... USD (annual average)	0,94	1,15	1,16	1,16	1,16	1,16
World GDP growth (real growth rate)	2,8	3,3	4,1	4,1	3,7	3,8
EU-15 GDP growth (real growth rate)	1,1	0,8	2,0	2,4	2,5	2,6
Growth of relevant foreign markets	1,5	3,1	5,7	7,1	7,2	7,5
World import prices (goods, in USD, percentage change)		8,2	1,8	0,7	0,0	0,0
Oil prices (Brent, USD/barrel)	25,0	28,3	25,6	24,1	24,1	24,1

Sources: European Commission, *Ministério das Finanças*.

The key assumption is a real growth of GDP in the European Union of 2% in 2004 and averaging 2.5% per year in the period 2005-2007. In the light of the expected developments in the economies of the main trading partners, the relevant foreign demand should accelerate from 3.1% in 2003, to around 7%, on average, in the period 2004-2007.

- 17 Projections are also influenced by the outlook for the ongoing adjustment process in the Portuguese economy. In the central scenario, it is assumed that the influence of the adjustment process of private domestic demand has reached its peak in 2003 to gradually fading out in the following years. Domestic demand growth will, gradually recover to levels below the average growth registered by the end of the 90's. The deepening of the budgetary consolidation process will contribute to moderate government consumption and investment. This way, the baseline scenario in the current update considers a moderate economic activity growth in 2004, followed by a progressive acceleration in subsequent years, to 2.5% in 2005, 2.8% in 2006 and 3% in 2007.

Chart III-8 Real GDP and Output Gap*



Sources: *INE* and *Ministério das Finanças*; *Estimation through the Production Function methodology.

- 18 Prospects for output growth are slightly higher than the E.U.'s, as the Portuguese economy is expected to resume convergence from 2005 onwards. The reduction of the major macroeconomic imbalances should foster economic reform and subsequent productivity increases, allowing for a more solid and sustained recovery.

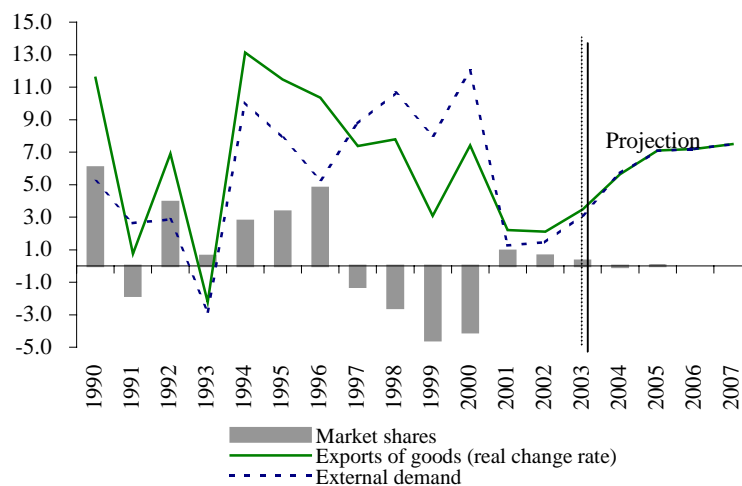
Table III-2 Central macroeconomic scenario

	2002	2003	2004	2005	2006	2007
GDP growth at constant market prices (7+8+9)	0.4	-0.7	1.0	2.5	2.8	3.0
GDP level at current market prices (10 ⁹ euros)	129.3	132.0	136.3	142.5	149.6	157.4
GDP deflator (change rate, %)	4.6	2.8	2.2	2.0	2.1	2.1
HICP change	3.7	3.3	2.0	2.0	2.0	2.0
Employment growth	0.2	-0.8	0.4	1.2	1.3	1.4
Labour productivity growth	0.2	0.0	0.7	1.3	1.4	1.6
Sources of growth: percentage changes at constant prices						
1. Private consumption expenditure	0.6	-0.7	0.5	2.0	2.5	2.7
2. Government consumption expenditure	2.8	-1.3	-0.5	0.0	0.2	0.2
3. Gross fixed capital formation	-5.3	-7.0	2.5	5.0	6.2	6.5
4. Changes in inventories and net acquisition of valuables as % of GDP	0.0	-0.2	0.0	0.0	0.0	0.0
5. Exports of goods and services	2.1	2.9	5.6	6.4	6.6	6.6
6. Imports of goods and services	-0.4	-2.6	4.0	5.2	6.3	6.4
Contribution to GDP growth						
7. Final domestic demand (1+2+3)	-0.5	-2.4	0.8	2.4	3.0	3.2
8. Change in inventories and net acquisition of valuables (=4)	0.0	-0.2	0.0	0.0	0.0	0.0
9. External balance of goods and services	0.8	1.9	0.2	0.1	-0.2	-0.2

Source: Ministério das Finanças.

- 19 Private consumption should gradually recover in line with improved expectations on growth and employment. Private investment should accelerate along the period, in line with the redressing of private companies balance sheets. Measures to improve tax competitiveness should promote domestic and foreign investment, as well as exports. However, as conservative assumption, no market share gains are projected in the current update time frame.

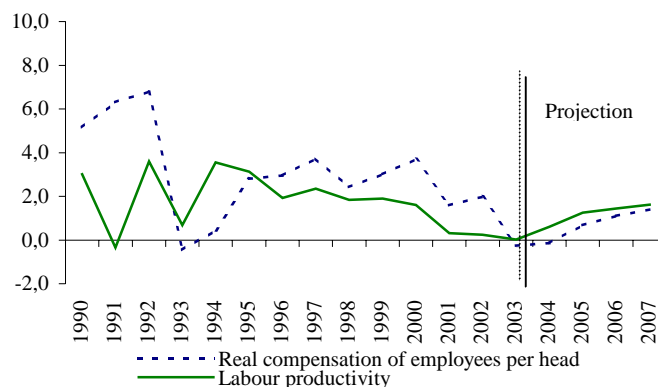
Chart III-9 Export performance
(%)



Sources: INE and Ministério das Finanças.

- 20 By the end of the projection period GDP growth is expected to return to levels close to potential. The output gap is projected to remain negative throughout the whole period only starting to narrow in 2007. Together with moderate growth in wages and import prices (given the assumptions for exchange rates and international prices of raw materials) the negative output gap should lead to a slowdown in inflation. The inflation rate is projected to decrease from close to 3.3% in 2003, to around 2% in 2004-2007.
- 21 The expansion of economic activity will determine an increase of employment. Given the lagged reaction of employment relatively to the economic cycle, estimated to be 5/6 quarters, employment growth will only become more significant after 2005. The unemployment rate should return to its natural level (the estimated value is slightly above 5%) after 2006, partly since a moderation of real wages is expected, with wage growth standing below productivity growth. In line with the European Commission, a significant slowdown of unit labour costs is, therefore, expected.
- 22 Productivity gains should stem from the structural reforms described in chapter V, in particular from the modernization of the labour market legal framework (done in 2003).

Chart III-10 Real compensation of employees per head and labour productivity
(change rate, %)



Sources: *INE* and *Ministério das Finanças*.

23 The projections presented are subject to several risks. The growth path can be negatively affected, in particular, by:

- A recovery of the international conjuncture weaker than considered in the baseline scenario;
- Unfavourable developments in interest rates or in exchange rates;
- An increase of instability related to an abrupt adjustment of the US foreign accounts.

IV. PUBLIC FINANCES

DEVELOPMENTS UNTIL 2003

24 Fiscal consolidation is a high priority intermediate goal, both because it is a necessary condition for sustained economic development, and because it contributes positively to the reduction of the macroeconomic imbalances that still persist in the Portuguese economy.

25 In 2001 the tax revenues and social contributions to GDP ratio decreased by about 0.6 percentage points of GDP, while primary current expenditures continued to grow, reaching 37.2% of GDP. The Public Administrations' global deficit increased from 2.8% in 2000 to 4.2% in 2001, above the reference value of the Treaty. In July 2002, the European Commission initiated the Excessive Deficit Procedure for Portugal. The Ecofin Council adopted, on November 5,

2002, a Decision on the existence of an excessive deficit situation and issued a Recommendation with a view to bringing the situation to an end.

- 26 The Government adopted, in 2002, several measures to contain public expenditures, and in particular, civil servants wage bill. The State Budget for 2002 Amendment Law was approved and the target for the Public Administration deficit was set at 2.8% of GDP. The positive impact of the measures adopted together with stricter control of budgetary execution allowed for the Public Administration deficit to be reduced to 2.7% of GDP in 2002, in spite of weaker than initial forecasted output growth. The primary balance improved from -1.1% of GDP in 2001 to a surplus of 0.4% in 2002.
- 27 The updated Stability and Growth Programme for 2003-2006 planned for 2003, a General Government overall deficit of 2.4% of GDP, a reduction of about 0.4 percentage points relatively to the previous year. To achieve this target, total revenue was projected to increased by 0.7 percentage points of GDP, while expenditure increase should be limited to 0.3 percentage points. These objectives were based on a real GDP growth rate that was 2 percentage points above the one currently expected.
- 28 The most recent forecasts point out to a decrease of GDP of about 0.8% in 2003. This lower than expected growth has a strong impact on tax revenues and social contributions, which are estimated to decrease by 0.7 percentage points of GDP relatively to the previous year. Direct taxes should record a significant reduction of about 1 percentage point of GDP, due to the slowdown in wages and profits. Current revenue is estimated to decrease to 40.3% of GDP, 1 percentage point less than in 2002.

Table IV-1 Current Revenues

	1995	2000	2001	2002e	2003p
Growth rate (%)					
Taxes on production and imports		4.3	5.8	9.6	2.6
Taxes on income and wealth		13.2	0.6	4.1	-8.5
Social contributions		10.9	7.7	7.6	3.5
Other current revenue		-2.4	2.6	13.0	-3.1
Total current Revenue		7.5	4.7	8.0	-0.3
As percentage of GDP					
Taxes on production and imports	13,6	14,4	14,3	15,0	15,1
Taxes on income and wealth	8,9	10,4	9,8	9,7	8,7
Social contributions	11,0	11,8	11,9	12,2	12,4
Other current revenue	4,3	4,2	4,1	4,4	4,2
Total current Revenue	37,7	40,8	40,1	41,3	40,3

e – estimate; p - forecast

- 29 The consolidation effort is patent in the slowdown of current expenditures, which will decelerate from 7.5% in 2002 to 3.8% in 2003, and of public consumption (from 6.9% in 2002, to 1% in 2003).
- 30 However, the intensity of consolidation is dampened by the strong growth (12,2%) in social benefits and transfers, reflecting an increase in pensions, the impact of the cyclical downturn and changes in accounting. The increase of the unemployment rate from 5.1% in 2002, to about 6.4% in 2003 boosted subsidies related expenditure. Also, changes in accounting resulting from 31 public hospitals becoming joint-stock companies, contributed to an increase in social transfers in kind.
- 31 Reflecting budget restraint and the above-mentioned accounting change, compensation of employees is expected to decrease to 14.8% of GDP, after reaching a peak of 15.4% in 2002. However the increase in social transfers (1.5 percentage points of GDP) more than offsets this result.
- 32 This significant slowdown in expenditure is undermined by the decrease in GDP that induces an increase in the current expenditure-to-GDP ratio to 42%, while current savings will deteriorate from 0% of GDP in 2002 to -1.7% in 2003.
- 33 In order to partially compensate for the negative developments in gross savings, the Government had to adopt extraordinary measures that should increase capital revenues from 2% in 2002 to 3.8% of GDP, in 2003.

Table IV-2 Current Expenditure

	1995	2000	2001	2002e	2003p
Growth rate (%)					
Intermediate consumption		13.0	3.3	5.9	-5.7
Compensation of employees		11.0	8.0	6.7	-2.0
Social benefits and transfers		10.4	7.3	9.6	12.2
Interest payments		7.8	3.7	-0.4	-2.3
Subsidies		-32.0	33.0	14.8	20.7
Other current expenditure		16.9	-0.9	8.8	4.3
Total current expenditure		9.2	7.0	7.5	3.8
As percentage of GDP					
Intermediate consumption	3,7	4,4	4,3	4,3	4,0
Compensation of employees	13,6	15,0	15,2	15,4	14,8
Social benefits and transfers	13,2	14,0	14,1	14,8	16,2
Interest payments	6,3	3,3	3,2	3,0	2,9
Subsidies	1,3	1,1	1,3	1,5	1,7
Other current expenditure	1,6	2,4	2,2	2,3	2,4
Total current expenditure	39,8	40,2	40,3	41,3	42,0

e – estimate; p - forecast

- 34 Following a decrease of capital expenditure by 16.4% in 2002, this expenditure should grow by 8.4% in 2003, with the respective ratio to GDP increasing from 4.7% to 5%.
- 35 The estimate for the General Government overall deficit, in 2003, is 2.9% of GDP, which compares to 2.7% in the previous year. However, to reach this goal the Government will rely on one-off measures to compensate for the shortfall in fiscal revenues, mainly due to the sharp cyclical deterioration, which the country faced in 2003. Among these measures, some already concluded and others in preparation, are the transfer of the pension fund and the corresponding obligations from the CTT (Post Office) to Caixa Geral de Aposentações (Civil Servants Pension Fund) and the sale of non-performing tax and social security claims to a private financial institution. Both operations were reported to the Eurostat and cleared by this institution.

Table IV-3 General Government Overall and Primary Balance

	1995	2000	2001	2002e	2003p
As percentage of GDP					
Total revenue	39,6	42,3	42,0	43,3	44,1
Total expenditure	45,0	45,2	46,3	46,0	47,0
Net borrowing	-5,5	-2,8	-4,2	-2,7	-2,9
Primary balance	0,8	0,4	-1,0	0,3	-0,1

e – estimate; p - forecast

- 36 In order to curb down expenditure growth, several measures were adopted in 2003:
- Hiring of new staff continued suspended - this policy, together with the strong decrease of civil servants due to retirement, will lead to a drop in public employment of about 1%. Thus the growth dynamic of public employment, which continuously increased in the last years, has been to an halt;
 - Monthly wages above €1000 were frozen, while those below that value were raised by just 1.5%;
 - Suspension of wage and career reclassifications;
 - The public employment pool was created, with online information on supply and demand within public administration, which will allow for the increase of mobility and the reduction of external recruitment.
- 37 Structural reforms continued to be implemented in 2003, having as final common goals: to increase the efficiency resource allocation, thereby

supporting budget consolidation; to increase productivity and competitiveness; and to improve the quality of public services. The most important reforms were undertaken in Health, Education and Social Security, including the civil servants scheme (see details in chapter V).

- 38 A reform of public administration aiming at “less State, yet better State” is underway, ensuring the necessary conditions to limit long-term public expenditure while improving the quality of public services. The main goals of this reform and an implementation plan were approved by the Council of Ministers (see details in chapter V).

STATE BUDGET FOR 2004

- 39 The State Budget for 2004, approved by Parliament, lies on a set of policies, mainly:
- a) Proceed with the structural reforms in Health, Education and Social Security, in order to rein in public expenditures and to ensure long term sustainability;
 - b) To undertake Public Administration reform in order to increase efficiency and productivity and to better serve citizens;
 - c) Reduce the Corporate Income Tax rate from 30% to 25%, in order to promote investment and help companies increasing competitiveness;
 - d) Implement the reform of Taxation on Assets that will introduce a fair and simple system to evaluate real estate, which will improve fight against tax fraud and widen the tax basis. The tax rates will decrease substantially;
 - e) Ensure the solidarity between public administration sectors in the public finances consolidation effort- budgets should be in equilibrium or surplus. It was established that the net borrowing of local and regional governments should be kept at zero;
 - f) Improve the quality of public investment;
 - g) Reduce, as a rule, the operating expenditures by 10% relatively to the previous year;
 - h) Deepen the restructuring process of public institutions, avoiding overlapping of functions and concentrating resources on the State’s key missions.

- 40 The macroeconomic scenario for 2004 points to a real growth rate of GDP between 0.5% and 1.5%; an inflation rate of about 2% and a small increase of the unemployment rate to about 6.5%.
- 41 Against this background tax revenues are unlikely to recover significantly, also to the extent that the Corporate Income Tax rate will be reduced leading to an estimated cost of €100 million in 2004 and €400 million in 2005. Hence, the tax revenue (excluding social contributions) as percentage of GDP is expected to remain unchanged, relatively to the previous year. The increase of revenues from taxes on production and imports will be offset by the reduction in taxes on income and wealth.
- 42 The increase in revenues is expected to be about 0.7% of GDP, and will be supported by an increase in social contributions (mainly due to the recovery of debts to social security), and other current revenues (resulting, mainly, from the raise in the price of marketed public services). Total revenues will decrease by 0.3 percentage points of GDP due to the decline in capital revenues, relatively to the previous year, where the impact of the extraordinary measures was included.
- 43 Expenditure consolidation will be supported by the decrease of total expenditure by 0.4 percentage points of GDP. This results from a stable current expenditure to GDP ratio that will remain at 43%, and from a decrease in capital expenditures ratio to 4.6%.
- 44 General Government overall deficit will decrease slightly, from 2.9% of GDP in 2003 to 2.8% in 2004. However, the cyclically adjusted deficit will decrease by 0.6 percentage points to 1.1% of GDP.

MEDIUM TERM PROGRAMMING

- 45 Consolidation of public finances should be reached through a progressive correction in the quantity and quality of expenditure in all sectors of public administration. The reinforcement of budgetary discipline and intra-sectoral solidarity are basic principles established by the budgetary stability law which are instrumental to reach that goal. The consolidation process is supported by structural reforms that will allow for gradual and sustained restraint of expenditure, simultaneously improving the quality of public services.
- 46 Financial programming for 2005 to 2007 covers a period in which the output gap will remain negative, only narrowing in the last year of programming. Therefore, an increased effort will be required, since consolidation will have to rely exclusively on the expenditure side. However, structural reforms are expected to contribute to a progressive decrease in the overall deficit, so that a close to balance cyclically adjusted position will be reached in 2006 (see next section).

- 47 Tax revenues should decline throughout the period, due to the cuts in the corporate income tax rate, to 25% in 2004 and to 20% in 2006 (with an estimated total cost of one thousand million euros). These tax cuts are seen as essential to boost investment and competitiveness.

Table IV-4 General Government Accounts (2003-2007)

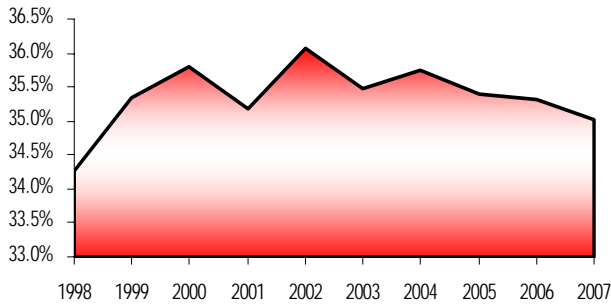
Percentage of GDP	2003	2004	2005	2006	2007
Overall Balance of Public Administration by subsectors					
General Government	-2.9284	-2.8	-2.2	-1.6	-1.1
Central Administration	-3.5844	-3.0	-2.4	-1.8	-1.5
Local and Regional Administration	-0.115	0.0	0.0	0.0	0.0
Social Security Funds	0.7711	0.2	0.1	0.3	0.4
General Government					
Total revenue	44.1	43.7	43.2	42.9	42.5
Total expenditure	47.0	46.6	45.5	44.5	43.5
Overall Balance	-2.9	-2.8	-2.2	-1.6	-1.1
Interests	2.9	2.9	3.1	3.0	3.0
Primary balance	-0.1	0.1	0.9	1.5	2.0
Revenue Components					
Taxes	23.8	23.7	23.5	23.4	23.0
Social contributions	12.4	12.7	12.6	12.6	12.6
Other	7.9	7.3	7.2	6.9	6.8
Total revenue	44.1	43.7	43.2	42.9	42.5
Expenditure Components					
Public consumption	20.9	20.1	19.6	19.2	18.7
Social transfers, ex. social benefits in kind	16.2	16.5	16.4	16.3	16.2
Interests	2.9	2.9	3.1	3.0	3.0
Subsidies	1.7	1.8	1.8	1.7	1.6
Gross fixed capital formation	3.5	3.0	2.9	2.8	2.6
Other	1.7	2.3	1.7	1.5	1.5
Total expenditure	47.0	46.6	45.5	44.5	43.5

- 48 Following a slight downward adjustment relatively to 2004, social contributions should remain unchanged at 12.6% of GDP, during the whole period. The remaining revenues will decrease, reflecting the progressive reduction of extraordinary revenues that, during the low stage of the economic cycle, support consolidation.
- 49 Between 2004 and 2007 public consumption should decrease by 1.4 percentage points of GDP, as a result of wage restraint, reduction in public employment and a tight control of spending in those sectors with the highest share in expenditure.

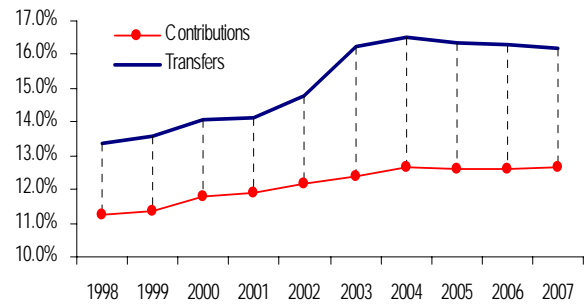
- 50 The Programme resumes the consolidation strategy laid down in the 2003 SGP update. In particular, ceilings for annual nominal growth rates of expenditure are established for those sectors with the highest contribution to budget consolidation:
- Health with 4%;
 - Education, excluding universities, with 1,6%;
 - Universities, with 0%.
- 51 Additionally, during this period measures will be undertaken so that transfers from the State to the social security system will not exceed 3.1% of GDP and transfers to the civil servants social security will be limited to 2.1% of GDP. Regional and local administrations will keep net borrowing at zero, while autonomous funds and services will have their budgets balanced or in surplus.
- 52 Expenditure with social benefits and transfers will gradually be reduced from 16.5% of GDP in 2004, when the unemployment rate will be at its highest, to 16.2% in 2007.
- 53 Both total and primary expenditures will decrease between 2004 and 2006, by respectively 3 and 3.2 percentage points of GDP.
- 54 The General Government overall deficit will decrease from 2.8% in 2004 to 1.1% in 2007, and the primary balance will improve from a marginally positive value in 2004, to a surplus of 2% in 2007. The cyclically adjusted overall deficit will reach a surplus of 0.4% of GDP in 2007.

FINANCIAL PROGRAMMING FOR THE CONSOLIDATION OF PUBLIC FINANCES (Percentage of GDP)

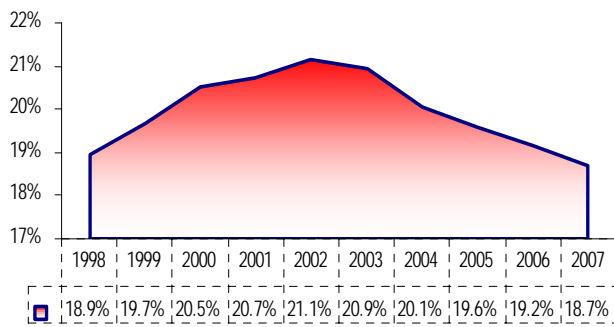
Fiscal Burden



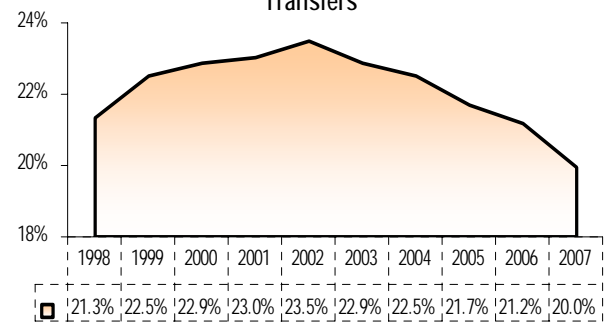
Social Contributions and Social Transfers



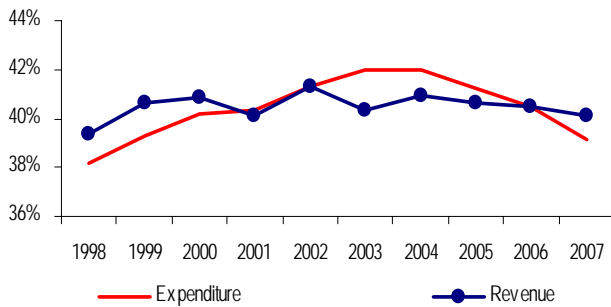
Public Consumption



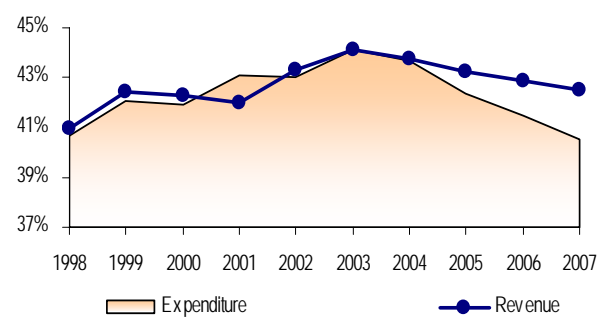
Primary Current Expenditure excluding Social Transfers



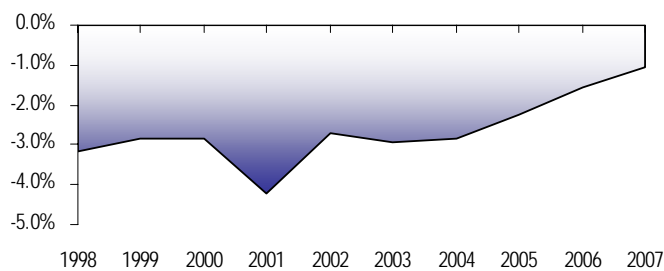
Current Revenue and Expenditure



Total Revenue and Primary Expenditure



General Government Net Borrowing

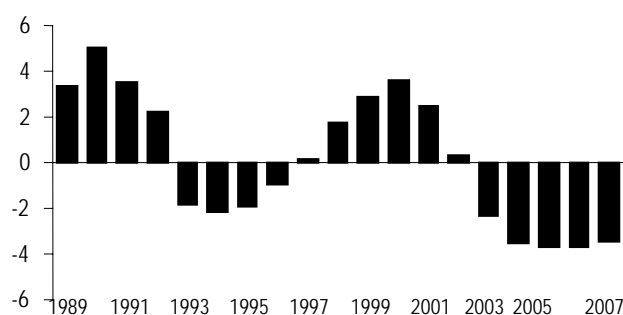


CYCLICALLY ADJUSTED BUDGET BALANCES

- 55 Following a five-year period during which economic growth remained above its potential, in 2002 the output gap closed and in the following years it became negative and gradually widened. The inversion of this movement will occur only in 2007.

Chart IV-1 Output gap*

(Deviation of actual output from potential output as a percentage of potential GDP)

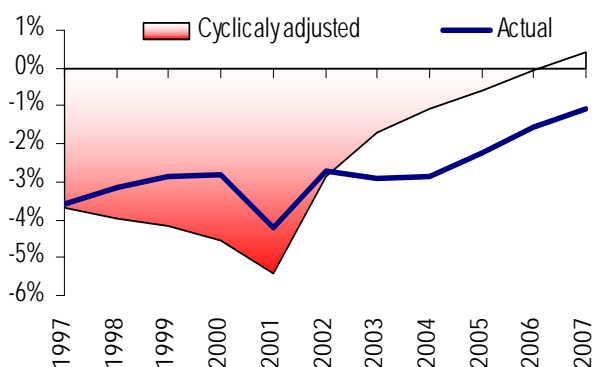
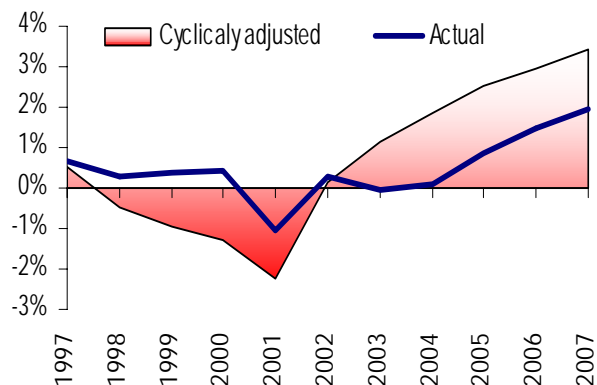


* Potential output is calculated on the basis of the production function

- 56 The cyclical component of the budgetary balance became negative in 2003 and is projected to remain so along all the projection period. The cyclically adjusted overall balance improves, from a deficit of 1.7% of GDP in 2003 to a close to balance position in 2006 and to a surplus in 2007.

Table IV-5 Cyclical Developments

Percentage of GDP	2003	2004	2005	2006	2007
GDP real growth rate	-0.8	1.0	2.5	2.8	3.0
Overall balance	-2.9	-2.8	-2.2	-1.6	-1.1
Interests	2.9	2.9	3.1	3.0	3.0
Potential output real growth rate	1.9	2.4	2.6	2.8	2.8
Output gap	-2.3	-3.5	-3.7	-3.7	-3.5
Cyclical budgetary component	-1.2	-1.8	-1.7	-1.5	-1.5
Cyclically-adjusted overall balance	-1.7	-1.1	-0.6	-0.1	0.4
Cyclically-adjusted primary balance	1.2	1.9	2.5	3.0	3.4

Chart IV-2 Actual and cyclically adjusted overall balance**Chart IV-3 Actual and cyclically adjusted primary balance****BOX I. OTHER MEASURES AFFECTING THE PUBLIC FINANCES CONSOLIDATION**

- Reinforcement of *taxpayers control*: simplification of payment documents concerning the main taxes; creation of a register of taxpayers by economic activities; organization of a register with individuals with tax debts and suppression of tax benefits to individuals with tax debts;
- *Reform of the taxation on assets*, aims at changing the present system that is outdated, unfair and allows for tax fraud and evasion. The reform considers the establishment of a simpler and more objective evaluation system, which will allow for effective fight against tax fraud, enlargement of the tax base through evaluation values more close to market values and the standardization of new facts liable to evaluation; general and substantial reduction of rates, decreasing the gains from evasion. The codes that support the real estate tax reform will be presented to Parliament until the end of 2003;
- Approval of legislation on access conditions to relevant information concerning the investigation of tax crimes by the Policia Judiciária (investigation police) and Tax Administration;
- Request for legal authorization, according to the State Budget for 2004, to cross data from the Tax Administration and Social Security;
- Rationalization of communication costs in Public Administration: to fight the negative effects of disperse management, all contract conditions will be renegotiated with the telecommunication operators (a potential 25% cost reduction, for the same service level);
- E-purchases: this project took off in the first semester of 2003 with the strategic definition of electronic public purchases and will proceed with pilot projects in 7 Ministries.

DEBT DEVELOPMENT

- 57 In 2000 General Government debt was 53.3% of GDP. In 2001, due to the excessive deficit, and in 2002, due to the significant amount of expenditure arrears that were cleared, the debt ratio increased by 4.8 percentage points.
- 58 While the contribution of the primary balance is only marginally negative, the debt ratio will increase by 1.5 percentage points of GDP in 2003, mainly due to the weak nominal growth of GDP, which is not sufficient to compensate for the interests contribution to change.

Table IV-6 General Government Debt

Percentage of GDP	2003	2004	2005	2006	2007
General Government gross debt	59.5	60.0	59.7	58.6	57.0
Change in gross debt	1.5	0.5	-0.4	-1.1	-1.5
Contributions to gross debt change					
Primary balance	0.1	-0.1	-0.9	-1.5	-2.0
Interest and GDP	1.7	1.0	0.4	0.1	0.1
Other	-0.3	-0.4	0.1	0.2	0.3

- 59 Despite the positive contribution of the primary balance to the reduction in debt ratio in 2004, the sluggish economic growth will again contribute to an increase of this ratio to 60%. After 2004, as the budgetary consolidation process gains momentum, the ratio should gradually decrease to 57% of GDP by the end of the projection period.

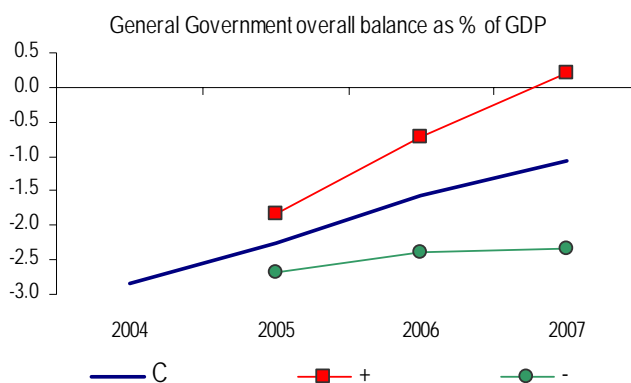
SENSITIVITY ANALISYS

- 60 The budgetary balance presents an average sensitivity of 0.42 for each percentage point change in GDP growth. A scenario with more intense economic growth, sustained through the projection period, will allow for a close to balance situation in 2007. The expenditure consolidation path, presented in this program is seen as an unbending objective, so that additional revenue generated by a more positive scenario will accelerate the budgetary consolidation process.

Table IV-7 Sensitiveness to different real rates of growth of GDP

	2003	2004	2005	2006	2007
GDP (C)	-0.8	1.0	2.5	2.8	3.0
GDP (+)			3.5	3.8	4.0
GDP (-)			1.5	1.8	2.0
General Government balance (C)	-2.4	-2.8	-2.2	-1.6	-1.1
General Government balance (+)	-2.4		-1.8	-0.7	0.2
General Government balance (-)	-2.4		-2.7	-2.4	-2.3

Chart IV-4 Alternative real rates of growth of GDP
Basic Scenario (C); Plus (+); Minus (-) 1 percentage point



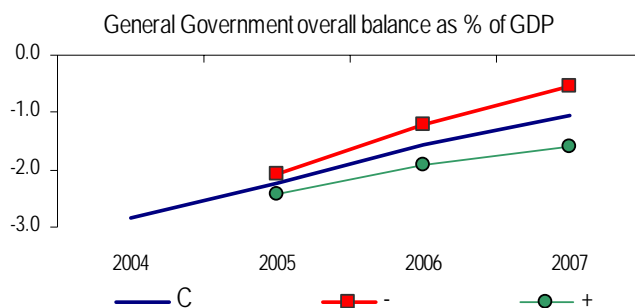
- 61 The same reasoning is valid in a more negative scenario, in which case the consolidation process will be slower. The Government cannot commit to a tighter policy than the one included in the central scenario for the public expenditure consolidation.
- 62 Changes in interest rates have a lower impact on the budgetary balance, but even under these conditions the Government considers unrealistic to absorb the shock through a more forceful reduction of expenditure than the one set in the current program.
- 63 In both situations, in which conditions are more adverse than those foreseen in the central scenario, the Government is committed to keep the deficit below the 3% ceiling.

Table IV-8 Sensitiveness to different rates of interest

	2003	2004	2005	2006	2007
GDP (C)	-0.8	1.0	2.5	2.8	3.0
GDP (+)			2.4	2.6	2.8
GDP (-)			2.6	3.0	3.3
General Government balance (C)	-2.4	-2.8	-2.2	-1.6	-1.1
General Government balance (+)			-2.4	-1.9	-1.6
General Government balance (-)			-2.1	-1.2	-0.5

Chart IV-5 Alternative rates of interest

Basic Scenario (C); Plus (+); Minus (-) 1 percentage point

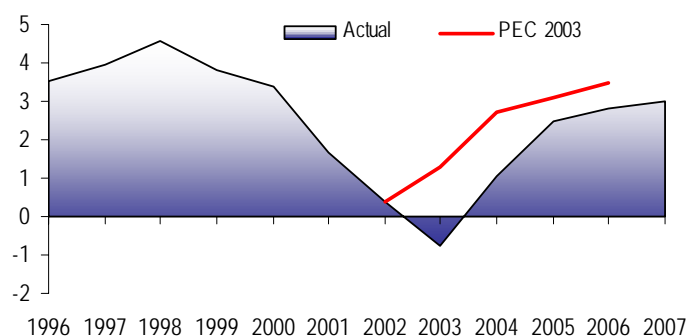


COMPARISON WITH THE PREVIOUS UPDATE

- 64 In December 2002, economic activity was expected to gain some momentum in 2003, and to accelerate in 2004 to rates close to 3%. Reality proved to be substantially worse, with GDP falling sharply in 2003, thereby impacting medium term trend.
- 65 In a situation when economic growth relies strongly on exports, the downward revisions of European economic growth entailed a downward adjustment of external demand in 2003 and 2004 affecting forecasts for the remaining period.
- 66 The public finances consolidation path reflects this more downbeat scenario and a more subdued improvement of the global deficit is now foreseen. The global deficit, in the current update, should reach 1.1% of GDP in 2007.

Table IV-9 Comparison between actual and previous SGP forecasts

	2003	2004	2005	2006	2007
Real GDP growth					
Previous update	1.3	2.7	3.1	3.5	-
Latest update	-0.8	1.0	2.5	2.8	3.0
Difference	-2.1	-1.7	-0.6	-0.7	-
Budget balance (percentage of GDP)					
Previous update	-2.4	-1.9	-1.1	-0.5	-
Latest update	-2.9	-2.8	-2.2	-1.6	-1.1
Difference	-0.5	-0.9	-1.1	-1.1	-
Gross debt (percentage of GDP)					
Previous update	58.7	57.5	55.3	52.7	-
Latest update	59.5	60.0	59.7	58.6	57.0
Difference	0.8	2.5	4.4	5.9	-

Gráfico IV-1. GDP – real growth rate in previous and actual SGP (%)

V. STRUCTURAL REFORMS

PUBLIC ADMINISTRATION REFORM

- 67 Public Administration reform is a key area for the fulfilment of the goals of Portuguese economic and social policy, given its foreseen positive impact in overall productivity and competitiveness and for the sustainability of public finances. This reform is expected to release resources to the private sector, increase the amount of goods and services being offered and improve living standards of the Portuguese population.
- 68 Following the presentation of the general guidelines for the reform of Public Administration in June, the Government has presented to the Parliament five draft laws embodying the goals set out for the reform:

- *Direct Administration of the State;*
- *Public Institutes;*
- *Directors Statute;*
- *Integrated system of performance evaluation;*
- *Individual Labour Contract in Public Administration.*

The goals addressed by these legal proposals are:

- Identify core functions to be directly performed by the State, rationalize structures through new models of organization, promote use of ICT and the improvement of the quality of services;
- Foster performance oriented activity and accountability;
- Promote the modernization of public organisations by qualifying and motivating civil servants, innovating procedures and introducing new management methods;
- Introduce new forms of performance evaluation, for services and staff;
- Promote training for the enhancement of staff performance;
- Adapt management models to the nature of the activity developed, reducing red tape and excessive levels of decision.

- 69 The framework law on the **Direct Administration of the State** provides for a new organizational and operating model, establishing rules for the creation, merger and winding-up of these type of services and organizations. Greater flexibility in the internal organization of services has been foreseen, granting directors autonomy in its design, and legal formalities therefore were simplified.
- 70 The framework law on **Public Institutes** sets rules for the creation of public bodies with special regimes. While providing for increased flexibility in internal organization, the law prevents the proliferation of special regimes. For the carrying out of productive activities, Public Institutes may resort to outsourcing, to privatisation or to engage in the establishment of public private partnerships, so as to ensure competition and compliance with market mechanisms.
- 71 The new **Directors Statute** reinforces management responsibilities as a complement to the increased autonomy granted in the internal organization of services; Directors will also be granted more discretion in the appointment of senior civil servants through the replacement of the rigid selection procedures currently applied by a simpler system, fair and transparent, allowing for the setting up of cooperative teams. Services will be differentiated on the basis of the complexity and responsibility of missions assigned and of tasks performed and directors compensation will be established accordingly. Renewals of the appointment of Directors will be made contingent upon performance evaluation and the length in office limited to 12 years.

- 72 The **Integrated System of Performance Evaluation** sets rules for the evaluation of civil servants, directors, as well as of organizations and services. Main goals are the enhancement of performance and to achieve fairness and coherence in the overall management of the system. Evaluation shall foster differentiation based on merit. Public services and organizations will be audited by external entities, either national or foreign.
- 73 The draft law on the **Individual Labour Contract in Public Administration** introduces the regime of private sector contracts in Public Administration, adapting it to the characteristics of the public employer and to specific control needs. A maximum number of vacancies to be fulfilled by labour contracts will be established for services allowed to resort to this form of recruitment. The draft proposal establishes also provisions for collective labour relations.

HEALTH

- 74 The National Health Service (NHS) suffers from access and equity flaws, further compounded by a significant increase in public spending on health care. The current NHS should evolve towards a mix of health services, where public, private and social entities coexist in an articulated system of primary, differentiated and continuous care networks.
- 75 Ongoing reforms address the issues of financing and of management and regulation improvement. The reform foresees a progressive separation of the functions of regulation, financing and provision of health care. Mention should be made to following already adopted measures:
- The new **framework law on health services**, approved in 2002, introducing new models of financing and of performance evaluation, which together with the reinforcement of the monitoring system, will lead, in the medium term, to sustainable efficiency gains and to a reduction in costs.
 - **The legal status of 34 public hospitals was changed into 31 corporatized entities that are fully owned by the State.** Corporate hospitals activity plans are based on multi-annual contract-programmes, agreed upon with the Ministry of Health. Contracts set qualitative and quantitative targets, investment needs, as well as performance indicators. Funding will be calculated for each hospital on the basis of reference prices for the services performed –in-patients treatment, emergencies, appointments and out-patients treatment – adjusted by a case-mix index (severity of pathologies) and weighted according to the cluster (technological sophistication grid) in which the hospital is classified. Since efficiency levels differ widely across hospitals in Portugal, hospitals have been divided in four different efficiency categories that have different benchmark prices;

- **Public hospitals funding** will also be changed along similar lines, *e.g.* on the basis of a contract- programme establishing annual production targets for the whole period covered by the contract and pricing for the delivery of services and medical acts performed, adjusted by a case-mix index to take into consideration the complexity of the services provided. The contracts will allow for extra financial compensation to hospitals, as a result of outcomes and improved quality in the delivery of services and of the establishment of productivity incentives;
- A new legal **framework on health partnerships** has been adopted covering differentiated and specialised care at hospital level, primary health care, and long term care. Partnerships apply to contracts for the provision of clinical and non-clinical services and infrastructure. Contracts are subject to the rules of competitive bidding, with technical competence and economic terms offered being the most relevant criteria. Preceding the bidding, a public comparator (an estimation of the cost of the project if it were to be carried out by the public sector) shall be established, against which the bids of private partners will be evaluated. Following the adoption in 2003 of the first Government Programme for public-private partnerships, ten hospitals will be launched and enter gradually into operation as from the end of 2007;
- A new form of **financing of primary health care** was introduced whereby annual transfers from the state budget to each primary health care unit will be based on a per capita value established on the basis of the following criteria: demographic structure of both population and of users of primary health care services; degree of dependency of users; and geographic accessibility to the nearest hospital. A pilot project for management based on objectives and performance with a voluntary experimental compensation model for general practitioners is currently ongoing;
- **Drugs policy.** Following the launching of a new drugs policy in 2002, the market share of generics increased significantly. Another relevant change was the introduction of a system of reference prices for the co-payments made by the State under the NHS which are currently based on the highest price of the corresponding available generic. A new model of prescription by Common International Denomination was implemented together with the renewable medical prescription, of particular interest for chronic diseases.

EDUCATION

- 76 Education is one of the sectors with a significant share in public expenditure. The rationalization of educational offers, policies aiming at improving the quality of learning and the implementation of performance evaluation schemes are the main goals of the ongoing reforms. Measures already adopted and which will be further developed in 2004 include:

- The **restructuring of the network of basic schools**, promoting decentralization and closing down schools with fewer students in order to rationalise existing infrastructure. This measure was applied in 2003 to schools with less than 10 students, leading to a reduction in expenditure of 7,1 million euros;
- **Further development of the grouping of schools**: in the framework of the structural reform of the education system, this process is instrumental in restructuring educational offers, improving schools management, as well as the rationalization of resources and the improvement of learning. The process will be completed in 2004/2005;
- Launching in 2004/2005 of the **Reform of the secondary education curriculum** which will be articulated with basic and higher education and with vocational education and training;
- **Reorganisation of recurrent education**, introducing a system of accruing units and instruments that promote a more efficient allocation of resources;
- Expansion of the **ICT infrastructure** and promotion of digital learning through the compulsory learning of ICT and the equipment of secondary and upper secondary schools with ICT laboratories, over the next years;
- **Enlargement and enhancement** of the social network of pre-primary schools in order to reach a rate of coverage of 90% for the 3 to 5 year old, in the next few years;
- Development of initiatives aiming at **reducing early school dropouts**, namely, in 9 years schooling from 2,7% to less than 2% in 2006, and less than 1,8% in 2007 and concerning 12 years schooling, from 44,8% to below 35% in 2006 and less than 33% in 2007;
- **Reduction of the number of teachers without tuition time allocated**, as well as of teachers engaged in activities other than teaching; the implementation of this measure in 2003 is expected to generate savings of about 21 million euros;
- Introduce changes in the **recruitment system for teachers** (concurso) and revision of the **Teachers Statute** in order to introduce stricter and more demanding requirements in hiring and tenure of teachers, as well as in career progress;
- **Law on the Financing of Higher Education**: sets a general framework for the financing of higher education based on an formula and on contract programs, with a view to enhancing quality in higher education and the social relevance of the courses. Public higher education financing will take into account the performance of students. The law establishes the

maximum number of applications a student is allowed to make in the attended course, which, if reached, entails the loss of the entitlement to a new application; the student is prevented to apply to the same course or to any other course in the two following semesters; tuition fees may vary between an upper and a lower threshold, according to the quality and nature of the courses;

- **The Legal Regime of the Development and Quality of Higher Education:** the results of the evaluation of higher education institutions, if negative, may entail the reduction or the suspension of public financing; the creation of new higher education public institutions, as well as the transformation or merger of the already existing, will be made contingent upon its adequacy to the network of higher education offer; measures aiming at the rationalisation of this network may be introduced as a consequence of the decline in the number of applications to courses granting an academic degree, the lack of professional outlets and the existence of an excessive number of qualified professionals in certain scientific and technological areas; no new public financing will be granted to courses in these areas carried out by private sector institutions;
- **Rationalisation of the number of places available in higher education** in order to achieve a progressive reduction of regional disparities, improve efficiency and take account of labour market needs.

LABOUR LEGISLATION

- 77 The Government has given priority to the modernization and simplification of the labour legislation, with a view to facilitate the adjustment of the economy to evolving demand patterns and technological change and to reinforce productivity and competitiveness of the economy. The aim is to promote adaptability, flexibility of the work organization and the creation of conditions for a greater mobility of the workers. A new **Labour Code** has entered into force on the 1st December, summing up and systematizing in a single formal instrument the rules applicable to individual and collective labour relations. The most relevant or innovative features of the Code concern fixed term labour contracts, adaptability of working hours, night work, and mechanisms to overcome collective bargaining deadlocks.
- 78 **Fixed term contracts:** under the present legislation firms are allowed to resort to fixed term labour contracts to address temporary labour needs, only in a number of well-defined cases. The Code, while maintaining the same underlying rationale, actually extends the possibilities of resorting to fixed term contracts. The duration of the fixed term contract has been changed significantly. The basic rule is that it shall not exceed three years, renewals included, up to the maximum of two renewals. However, the introduction of a provision foreseeing that contracts may yet have another renewal, not shorter than one year and not longer than three years, allows in practice for a length of

up to 6 years. The length of the contract is shortened to two years in case of the start-up of an activity of uncertain duration or the start-up of an enterprise or plant. Long term unemployed and workers looking for the first job benefit from a special treatment limiting the length of the contracts to two years in the first case, and to eighteen months in the second.

- 79 Adaptability of working hours:** An innovative feature of the Labour Code is the provision for adaptability to be agreed upon between the employer and the workers, in which case the normal hours of daily work may be increased up to the maximum of two hours and the weekly duration of work to fifty hours, including in this limit the overtime rendered as a result of an increase in the activity of the enterprise. Adaptability under collective labour regulation has also been eased: the labour code provides for a maximum extension of the daily normal working time from two to four hours, as well as for raising the weekly duration of work from fifty to sixty hours.
- 80 Concerning night work,** which presently refers to the period between 8.p.m. and 7.a.m., the Labour Code establishes that, unless otherwise agreed by collective labour regulations, night work will encompass work rendered in the period between 10 p.m. and 7.a.m.
- 81 Collective bargaining:** the Labour Code provides instruments to overcome collective bargaining deadlocks. Under extreme situations where agreement on the revision of a collective agreement is not reached, the Code envisages the possibility of its termination.
- 82 Other issues.** In order to forestall false sickness leaves, the Labour Code establishes a set of mechanisms for controlling sickness situations, whenever the employer deems it necessary. The Code address also the regularization of false self-employment establishing a legal presumption of labour contract based on a set of elements that generally characterize the subordinate work. Telework and work at home are two other important issues addressed by the Labour Code.

MEASURES TO LIMIT THE GROWTH OF SOCIAL EXPENDITURE

- 83** A law introducing changes in the civil servants retirement system was recently approved by the Parliament. According to the new legislation:
- The retirement pension will be calculated on the basis of the compensation net of the rate of contribution to the civil servants pension system, e.g. gross compensation less 10%;
 - Early retirement for civil servants aged less than 60 years having completed 36 years of service is allowed only on proven sickness or disability grounds. A new modality for voluntary retirement of civil servants having completed 36 years of service was introduced, whereby civil servants may retire

irrespective of their age. Under this scheme the pension will be reduced by 4,5 % per each year of anticipation relatively to the normal retirement age; this penalty will be reduced by one year, per each three years of service above the statutory limit of 36 years;

- Pensions under the individual labour contract regime in Public Administration, which until now were calculated on the basis of the last compensation earned, will be established according to the monthly average of compensations over the last three years of work;
- 84** Several measures to control expenditures are foreseen in the area of social security, applying from 2004 onwards, in particular:
- Sickness allowances will be reduced in case of sickness leaves of less than 60 days;
 - Control of sickness leaves will be strengthened;
 - New legislation will be introduced allowing for more flexibility in the retirement age, with partial retirement pensions and discourage penalizing early retirement;
 - Revision of the conditions applying to unemployment benefits, the length of which will be established according to the contributory career of the beneficiary;
 - Preparatory work in view of the introduction in 2005 of an optional and of an upper contributory ceiling, in order to strengthen the financial sustainability of the social security system (see Chapter VI).

ECONOMIC REFORM MEASURES

85 Reinforcing competition:

- The *Competition Authority* came into force with an independent status and overall powers to ensure fair competition;
- A *New Competition Law* was approved introducing the following main changes: the enlargement of the scope of the law to all economic sectors; the clarification of the conditions under which the law applies to public enterprises and to enterprises that benefit from special or exclusive rights granted by the Government; and the restructuring of penalties.

86 Promotion of productive investment:

- The *Portuguese Agency for the Investment (API)* has entered into operation, its aim being to attract large investment projects, both domestic and international;
- The Incentives Programme for the Modernization of the Economy (PRIME), was launched in July 2003. Decision processes for granting incentives were streamlined; selectivity criteria and investment assessment were improved and rewards introduced for the most successful firms;
- The Programme for the Recovery of Depressed Areas and Sectors (PRASD) was set up including inter alia a positive discrimination in the net corporate tax (IRC) and tax incentives to investment in order to foster transition to

more advanced stages of activity in the value chain, as well as the reduction of regional disparities;

- The European Commission was notified on the Tax Reserve for Investment;
- An Investor's Guide was published as a first step for the establishment of an Investment Code;
- Enforcement of the new Labour Code as of December 1st.

87 Fostering R&D:

- *e-U Programme – Virtual Campus (Electronic University)* [www.e-u.pt]. The e-U Programme aimed at all academic communities throughout the country, promotes quick and easy access to knowledge within academic communities, through the set up of wireless broadband access networks, stimulating the cooperation among universities and between these and the market; *e-U* will be fully operational in 44 higher education institutions by December 2003;
- "*Quadros Programme*": cofinances the hiring of staff with a university degree in technological areas in small and micro enterprises;
- A New Industrial Property and Patents Code (CPI) was published in March 2003 (Decree-law no. 36/2003 of 5 March). It governs issues related to inventions, sets out and regulates the rights and duties concerned. It can be consulted on-line, via the website of the Instituto Nacional da Propriedade Industrial – INPI (Industrial and Intellectual Property Institute).

88 Simplifying administrative procedures for the creation, licensing, installation and development of enterprises:

- *New Industrial Licensing Code*: classifies industrial firms into 4 types, ranked by degree of potential hazards to humans and to the environment, corresponding to decreasing complexity in licensing rules and procedures;
- *Reform of the execution*: a new execution system was enforced in September of this year which will speed up the processing of the execution;
- The *Administrative Procedure Code* will be revised until the end of the year with a view to adapt it to the reform of the administrative dispute;
- Finalization of the *New Insolvency and Firms Recovery Code*: its objective is to regulate insolvency of individual and collective entrepreneurs and to speed up insolvency processes when the recovery of firms is not possible;
- Four new *Business Formality Centres* entered into operation.

89 Promotion of Foreign trade and Tourism:

- The first stage of the new model for the Promotion of Foreign Direct Investment (FDI) was implemented;
- An Information System for Firms was launched in January to facilitate the access of firms to information on markets, business opportunities, support measures and incentives.

90 Enhancement of SME financing:

- A Guarantee Fund for Securitised Credit was established allowing for the sharing of credit risk in the acquisition of securities on SME long term loans;
- Fostering Risk Capital: the process of constitution of Venture Capital Enterprises and Risk Capital Funds was simplified;

- Revision of the legal framework and of the tax system for Venture Capital Enterprises and Risk Capital Funds (strong reduction for the taxation of reinvested capital gains).

VI. LONG TERM SCENARIOS FOR SOCIAL SECURITY

- 91 Population ageing impacts on fiscal policy in the long term. The Economic Policy Committee of the European Union has recently made projections for age-related expenditures more sensitive to demographic changes, up to 2050. Expenditures with pensions, health, long-term care, education and unemployment transfers were considered (see Table VI-1 for a comparison between EU Member States). These projections try to measure just the impact of ageing. Thus they must be interpreted carefully, since they are not forecasts.
- 92 It is expected that, due to population ageing, until 2050 Portugal will spend more 3,5 percentage points of GDP with this sector, if no reforms are undertaken to contain these expenditures. The increase of expenditures with pensions is, naturally, the most significant. On the other hand, savings with education and unemployment transfers are clearly insufficient to offset the increase in expenditures with pensions and health care.

Table VI-1. Projection of the increase [in percentage points of GDP] in the expenditures related with ageing from 2000 to 2050

	Health		Long-term care	Education	Unemployment	Total
	Pensions	care			tTransfers	
Belgium	3.3	1.3	0.8	-0.6	-1.1	3.7
Denmark	2.9	0.7	2.1	-0.1	-0.2	5.4
Germany	5.0	1.4	-	0.0	-0.4	6.0
Greece	12.2	1.7	-	-0.7	-0.2	13.0
Spain	7.9	1.7	-	-1.3	-1.0	7.3
France	3.8	1.2	0.5	-0.9	-0.5	4.1
Ireland	4.4	0.0	-	-1.5	-0.2	3.1
Italy	0.3	1.5	0.4	-0.6	-0.1	1.5
Luxembourg	1.9	0.0	-	0.0	0.0	1.9
Neederlands	5.7	1.0	2.2	-0.1	0.1	8.9
Austria	2.5	1.7	1.0	-1.0	-0.2	4.0
Portugal	3.4	0.8	-	-0.6	-0.1	3.5
Finland	4.7	1.2	1.7	-0.7	-0.3	6.6
Sweden	1.7	1.0	2.0	-0.8	-0.3	3.6
United Kingdo	-1.1	1.0	0.8	-0.2	0.1	0.6
EU15	3.9	1.1	0.8	-0.6	-0.3	4.9

Source: EU, Economic Policy Committee /ECFIN/435/03¹

- 93 In the Social Security sector, following the approval of the new Basic Law, the calculation formula for pensions has been changed. This reform is an essential

¹ Available in

http://europa.eu.int/comm/economy_finance/epc/documents/2003/pensionmaster_en.pdf.

step towards the reinforcement of sustainability. The last available projections suggest that this reform will reduce the increase in expenditures with pensions in 1.1 percentage points of GDP, until 2050 (see Table VI-2).

Table VI-2. Projection of expenditures in social security pensions

	[Percentage of GDP]						Cumulative increase from 2000 to 2050 [in p.p.]
	2000	2005	2010	2020	2030	2050	
According to the Law 17/2000							
Expenditure with pensions 1/	9.8	10.9	11.5	12.3	12.5	12.1	2.3
Before the Law 17/2000							
Expenditure with pensions 2/	9.8	10.9	11.8	13.1	13.6	13.2	3.4

1/ National Strategy Report on the Future of Pension Schemes

2/ EU, Economic Policy Committee, EPC/ECFIN/435/03

- 94 Besides the change in the calculation formula for pensions, the convergence of minimal pension to the national minimum wage, net of the social tax, has started. This measure is essential to fight poverty in higher age groups. It is also foreseen a ceiling for social contributions, which will help to develop the second pillar, and will create a complement to public pensions.