PORTUGUESE REPUBLIC

STABILITY AND GROWTH PROGRAMME

2008 - 2011

January 2009 Update

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EXECUTIVE SUMMARY

This document updates the Stability and Growth Programme (SGP) of the Portuguese Republic for 2008-2011, in accordance with the provisions of the Stability and Growth Pact. It already includes the measures to be taken under the framework of the European Economic Recovery Plan and which are replicated, in particular, in Portugal's Investment and Employment Initiative (IEI). It will be sent to the European Commission following its presentation and discussion in the Portuguese Parliament together with the Draft Law establishing the IEI budgetary program, on 29 January 2009. The normal time limit established in the Pact's Code of Conduct for this update has been exceptionally exceeded due to the need to incorporate the abovementioned measures set forth in the European Economic Recovery Plan, including the required amendments to the State Budget for 2009.

The depth and extent of the international financial crisis, which severely worsened in the final quarter of 2008, is generating a heavy recessive impact on the world economy, particular on economic agents' confidence, credit restrictions and economic activity in general. The European Union's Member States have coordinated their efforts to fight the crisis and its impact. Such efforts are focussed on strengthening financial stability and, as proposed by the European Commission, adopting a plan to boost the European economy, which aims to strengthen economic agents' confidence by stimulating economic activity and employment. This plan fosters the coordinated consolidation of the anti-cyclical budgetary effort pursued by Member States and by EU's institutions, generating a budgetary stimulus in the region of about 1.5% of GDP.

In this context, after the period of budgetary consolidation and key structural reforms pursued in 2005-2008, the economic policy of the Portuguese Government is now focused on a significant anti-cyclical budgetary effort to support investment and employment, support the most vulnerable households and strengthen financial stability.

The main goals of the Initiative to Strengthen Financial Stability (ISFS) developed in the last quarter of 2008 are the normal financing of economic activity, particularly in relation to households and small and medium-size enterprises (SME), and safeguarding the savings of the Portuguese people. This Initiative has four fundamental pillars: (a) strengthening the information disclosure and transparency duties of financial institutions and revising the financial sector's sanctions scheme for infractions; (b) increasing the guarantee on bank deposits; (c) the granting of State guarantees to strengthen financial stability and the availability of liquidity in financial markets; (d) strengthening the financial soundness of credit institutions.

The outstanding anti-cyclical budgetary measures are those aimed at supporting households and enterprises implemented throughout 2008 and the "Investment and Employment Initiative" Programme. This Programme, which has a budgetary impact of 0.8% of GDP in 2009, is temporary in nature and, with a view to its effectiveness, is targeted and will be timely implemented. Though the measures of the IEI are occasional, they are fully consistent with the National Reforms Plan 2008-10, contributing to the strengthening of the country's modernisation and competitiveness, the qualification of the Portuguese people, energy efficiency and self-sufficiency, environmental sustainability and social cohesion.

This budgetary effort in 2009 is only possible due to the success of the budgetary consolidation process that began in 2005 and which ensured that the excessive deficit procedure was closed one year ahead of schedule and the lowest ever budget deficit in the history of Portuguese democracy was achieved in 2008. The Government will, as soon as the recovery of economic situation permits, resume the path to the Medium-Term Objective of a budgetary balance of -0.5% of GDP - at a deficit reduction rate of at least 0.5

p.p. of GDP per year - with the same determination it steered the budgetary consolidation over the last three years and which it now employs in 2009 to implement the measures required to fight the impact of the economic and financial crisis.

Other fundamental contributions to strengthening medium and long-term sustainability and the quality of public finances are the new Public Administration management control, planning and performance assessment systems, the upgrade to information systems that are compatible with those new systems, and, under the Programme Budgeting project, the establishment of multi-year budgeting framework with annual expenditure limits.

It is to be highlighted that the reforms of Social Security undertaken in recent years, and which are so essential to the system's medium and long-term sustainability, are now fully in force. The mechanisms established in those reforms - such as the rule for the annual update of pensions, the frontloading of the new rule for the calculation of the value of new pensions based on the entire contributory period, the additional financial penalty for early retirement and the sustainability factor vis-à-vis new pensions - have all been fully adopted, despite the current climate of economic and financial crisis.

Chapter 1

I. Economic Outlook

I.1 World Economy / Technical Assumptions

The world economy slowed down heavily in 2008, reversing the trend recorded in the previous four years, when average annual real growth was 5%. This slowdown was sharper in the advanced economies, especially the USA and the European Union (EU), while the emerging and developing economies, mainly the Asian ones (China and India), also recorded a dampening down of recent years' growth rates. This deterioration of worldwide growth was due to a combination of adverse factors which caused a fall in economic agents' confidence and the postponement of investment decisions, namely the uncertainty associated to the crisis in international financial markets, the ramifications of which were more restrictive conditions for obtaining credit, through the combined effect of the scarcity of liquidity and the increase of the risk premiums incorporated into loan interest rates. Moreover, the sharp rise in the price of energy raw materials and food products during the first half of 2008 had negative repercussions on households' real disposable income.

A large number of advanced economies went into technical recession in the third quarter of 2008, which originated the adoption of budgetary and financial policy measures aimed at strengthening confidence, re-establishing the normal functioning of financial markets and the stabilisation of economic activity. Monetary policy of most countries (particularly the USA, UK and Euro Area) became more accommodative given the fall in inflation recorded in the second half of 2008 and the occurrence of significant economic slowdown.

The main international organisations successively revised their growth forecasts for the majority of the world's economies downwards during the last few months of 2008, demonstrating the uncertainty that has assailed the world economy, which is now clearly in recession. Consumer and businesses' confidence hit their lowest ever levels and stock market indexes recorded their greatest falls in decades.

Against this background, Portugal's main trading partners (Spain, Germany, France, Italy and United Kingdom) recorded a marked slowdown of economic activity in 2008. The US economy also recorded a significant slowdown, which was fuelled by the fall in domestic demand, namely private investment and consumption, especially in the residential sector - which fell for the third consecutive year. In contrast, exports accelerated over the first three quarters, partly due to the real depreciation of the dollar, dampening the country's external accounts imbalance.

The financial crisis worsened in the final quarter of 2008, on account of the bankruptcy of Lehman Brothers in September. The crisis of confidence caused by this bankruptcy, its effect on the performance of our economies and the consequent repercussions on the functioning of the capital markets, led to several financial institutions in the USA and in Europe having to deal with a series of difficulties. These events shook confidence in the financial system and its institutions. The increased uncertainty in markets led to a significant rise in risk premiums, bringing about the decline of economic activity and the sharp rise in the unemployment rate.

Hence, the falling off of imports by our main trading partners in 2009 should entail a significant drop in external demand directed towards the Portuguese economy, particularly that from the Euro Area. The development of the Portuguese economy, which has a high degree of openness, with around three-quarters of exports destined for EU countries, is very dependent on the performance of those countries' overall demand. This will certainly be one of the factors that will most influence Portugal's macroeconomic development.

It is envisaged that the trend followed by external demand will be partially countered by the expected impact from the coordinated implementation of anti-cyclical budgetary policies by EU Member States and by the majority of developed countries. The fact that these policies are to be implemented in a consistent and coordinated manner should generate synergy and, accordingly, have a greater impact on the economies, both domestic demand and, via intensive economic relations within the EU, external demand. It is envisaged in Portugal that the Investment and Employment Initiative generate, by itself, an increase of 0.7 p.p. to economic growth in 2009.

Table I.1. below summarises the external technical assumptions underlying the macroeconomic scenario. It is assumed that in 2011 most of the variables would stabilise at around the values forecast for 2010. These assumptions encompass information available up to 16 January 2009.

Table I.1. International Environment – Technical Assumptions

	2007	2008(e)	2009(p)	2010(p)	2011(p)
Growth of relevant foreign markets (rate of change, %)	5.5	2.5	-2.8	1.3	2.1
Oil prices (Brent, USD/barrel)	72.5	96.9	51.0	61.0	61.0
Short-term interest rate (annual average, %) (a)	4.3	4.6	2.2	2.8	2.8
Long-term interest rate (annual average, %) (b)	4.4	4.6	4.2	4.4	4.1
Nominal Effective Exchange Rate (c)	0.8	1.3	-1.6	0.0	0.0
USD/EUR exchange rate (annual average)	1.370	1.471	1.337	1.331	1.331

Key: (e) estimate; (f) forecast. (a) 3-month Euribor rate; (b) 10-year Treasury Bonds. (c) Annual average rate of change, as % (positive/negative change means appreciation/depreciation of euro).

Source: Ministry of Finance and Public Administration.

I.2 Cyclical Developments and Current Prospects

The Portuguese economy, following real GDP growth of 1.4% and 1.9% in 2006 and 2007, respectively (see Table I.2), slowed down in 2008 due to the adverse external environment, to record estimated real growth of 0.3%. The adverse external impact will be more acute in 2009 and the real contraction of the GDP in the value of 0.8% is envisaged.

Table I.2. GDP and National Expenditure Components
(Growth rate, %)

	2006	2007	2008		
			I	II	III
GDP	1.4	1.9	0.9	0.7	0.6
Private Consumption	1.9	1.6	2.1	1.0	2.3
Public Consumption	-1.4	0.0	0.2	0.0	-0.1
Gross Fixed-Capital Formation	-0.7	3.2	3.7	3.2	-1.4
Domestic Demand	0.8	1.6	2.1	1.3	1.1
Exports	8.7	7.5	3.9	1.8	0.7
Imports	5.2	5.6	6.3	3.0	1.8
Contributions to the GDP rate of change (p.p.)					
Domestic Demand	0.9	1.8	2.3	1.4	1.2
Net Exports	0.5	0.1	-1.4	-0.7	-0.6

Source: INE.

The development of the Portuguese economy in 2009 should continue to be primarily influenced, just as it was in 2008, by a decline in the contribution to growth from net external demand, wherein, notwithstanding the 1.3% decrease in imports, it is estimated that exports may fall 4.4% (see Table I.4).

Domestic demand should likewise significantly slow down, reflecting the adjustment of economic agents' behaviour to the expected development of domestic and international economic activity. The real growth of domestic demand should fall from 1.6% recorded in 2007 to 0.6% in 2008 and 0.1% in 2009, driven by the unfavourable performance of private consumption and gross fixed capital formation (GFCF).

The real growth of private consumption should have slowed down to 1.2% in 2008 and it is forecast to slow down again in 2009, to 0.4%. This performance is influenced by the uncertainty underlying the current macroeconomic climate and by the scarcely favourable prospects for economic activity and the labour market. This slowdown should be made more acute by other factors such as the increase in savings by households in response to the current climate of uncertainty – following years of successive decreases in the savings rate, which should have recorded its lowest level in 2008 –, and the restrictions brought on by households' current level of indebtedness, despite the forecast fall in interest rates.

GFCF should reverse the favourable development recorded in 2007 and it is estimated to contract -0.8% in 2008 and forecast to decline -0.9% in 2009, primarily as a result of private investment's reaction to the decaying of business confidence driven by the expected slowdown of economic activity.

Public consumption will have recorded a fall in 2008, pursuing the path of budgetary consolidation required to balance the public accounts. Nevertheless, this expenditure component is forecast to accelerate in 2009 in line with the measures taken by the Government to tackle the current economic and financial crisis.

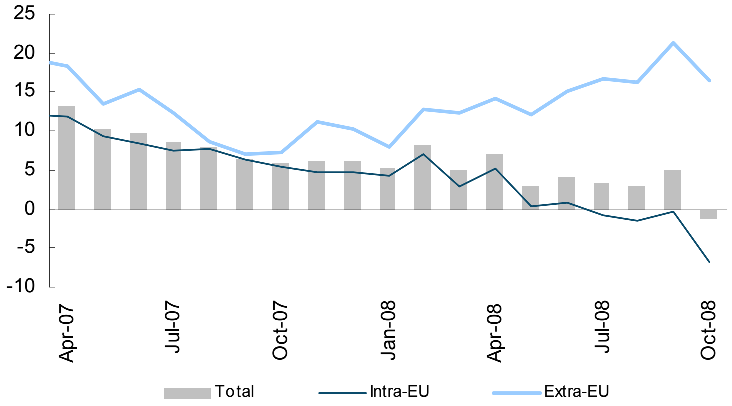
The performance of net external demand, on the other hand, will be driven by an adverse dynamic in exports, which should override the expected downwards development of imports. Exports slowed down markedly in 2008, and such a tendency is expected to continue in 2009. A reduction in real terms is expected, mirroring the developments of relevant external demand, propelled by the deceleration or contraction of economic growth in the majority of the main markets for Portuguese exports.

Thus the real growth of exports in 2008 should have decelerated to 0.1% (7.5% in 2007), and a decline of -4.4% is forecast for 2009. The downwards profile will be significantly sharper for goods than services, where gains in international competitiveness will permit the consolidation of the presence in the markets through the growth of market share in more recent years. This development may be mitigated by the expansion in markets outside the EU (see Chart I.1, which has traded in the dependency of Portuguese exports on the evolution of European economies for economies with higher growth rates. The share of exports this region held fell from 80% in 2005 to around 74% in October 2008, the month in which 11.2% of Portuguese exports were directed to the PALOP[1], Singapore, Malaysia, Russia and Brazil, countries that have demonstrated considerable growth in the recent past and which, despite not being immune to the worldwide economic crisis, should continue to grow at rates higher than those of the developed countries.

[1] PALOP – Portuguese -speaking African countries.

Chart I.1. Exports

(Nominal Year-on-Year Rate of Change, 3-month moving average)

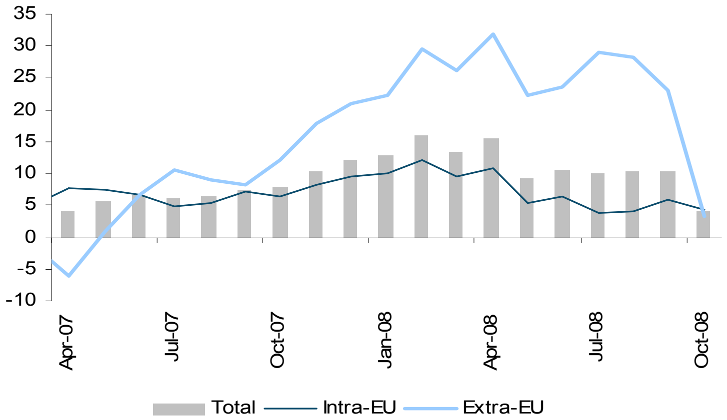


Source: INE.

The real growth of imports in 2008 must have been 1.0%, primarily reflecting a significant slowdown in non-energy goods (see Chart I.2) and services. This tendency will become more acute in 2009, and a real decrease of 1.3% is forecast, driven by the development of overall demand in Portugal.

Chart I.2. Imports

(Nominal Year-on-Year Rate of Change, 3-month moving average)



Source: INE.

The development of net external demand in 2008 is the basis for the decline of the current account balance measured as a percentage of GDP - energy needs heavily contributes to that development. Data available to the 3rd quarter indicates a heavy fall of the current account balance, equivalent to -11.4% of GDP (compared to -10.0% for 2007 as a whole), reflecting the adverse development of the balance on goods and services.

Table I.3. Portuguese Economy's Net Borrowing Position

(% of GDP)

	2007	2008(e)	2009(p)	2010(p)	2011(p)
Balance of Current and Capital accounts					
Net lending/borrowing vis-à-vis the rest of the world	-8.7	-10.5	-9.2	-8.4	-7.6
- Current Account Balance	-10.0	-12.1	-10.7	-9.9	-9.1
of which Balance of Trade	-7.4	-9.2	-9.0	-8.8	-8.2
- Capital Account Balance	1.3	1.6	1.5	1.5	1.5

Sources: INE and Ministry of Finance and Public Administration.

It is forecast to improve in 2009, benefiting from the fall in imports and improvement of income account, tied to the expected developments for interest rates. Net lending/borrowing vis-à-vis the rest of the world follows this trend, with an estimated 1.8 p.p. of GDP rise in 2008, despite the expected improvement to the capital account balance (Table I.3).

As regards inflation, the first half of 2008 was characterised by the continuation of the upward trend initiated in the third quarter of 2007, as a result of the systemic increase to the price of energy raw materials and food products over that period. However, the prices of those goods in international markets followed a downward trend in the second half of 2008, thus fuelling successive falls in year-on-year changes of the consumer price index. Inflation for 2008 as a whole was 2.6%, which is only marginally higher than the 2007 figure (2.5%). Inflation should significantly fall to 1.2%, in 2009. This trend is partly due to the slowdown of domestic economic activity, which will limit the growth of prices in the domestic market, but is mainly due to the slowdown of the world economy, and embodied in a significant decline in global demand and consequent modest growth of the price of raw materials and processed products.

The unemployment rate should fall back to 7.7% in 2008 despite the slowdown of economic activity. Nonetheless, unemployment rate should rise again in 2009 to 8.5% as a result of the economic slowdown in 2008 and in response to the decline of the domestic economy. Employment, which recorded zero growth in 2007, should have increased 0.6% in 2008, thus demonstrating the lag in its evolution to economic activity, just like the unemployment rate. Employment in 2009 is forecast to fall 0.7%.

Compensation per worker in 2008 will have displayed a certain time lag vis-à-vis the economic cycle, recording growth slightly up on 2007 (3.6% compared to 3.4%). The growth of compensation per worker in 2009 should, however, slow down (to 2.1%), partly due to the fall in output and the consequent impact on the labour market. The time lag between the economic cycle and the labour market will also be replicated with regards to labour productivity, and an increase in productivity is only expected to occur again in 2010 (0.5%) and 2011 (1%), driven by the impact of the structural reforms implemented under the Lisbon Strategy framework and the measures taken under the IEI.

Table I.4. Main Macroeconomic Indicators

(Rate of change, %)

	2007	2008(e)	2009(p)	2010(p)	2011(p)
GDP and expenditure components					
GDP	1.9	0.3	-0.8	0.5	1.3
Private Consumption	1.6	1.2	0.4	0.6	1.0
Public Consumption	0.0	-0.3	0.2	0.1	-0.1
Gross Fixed-Capital Formation	3.1	-0.8	-0.9	-0.3	1.7
Exports (Goods and Services)	7.5	0.1	-4.4	1.9	3.1
Imports (Goods and Services)	5.6	1.0	-1.3	1.3	1.7
Price developments					
GDP Deflator	2.9	1.6	2.4	2.5	2.5
CPI (a)	2.5	2.6	1.2	2.0	2.0
Labour market variables					
Employment growth	0.0	0.6	-0.7	0.1	0.3
Unemployment rate (%)	8.0	7.7	8.5	8.2	7.7
Labour productivity	1.9	-0.3	-0.1	0.5	1.0

Key: (e) estimate; (f) forecast.
Note: (a) Consumer Price Index average annual change.

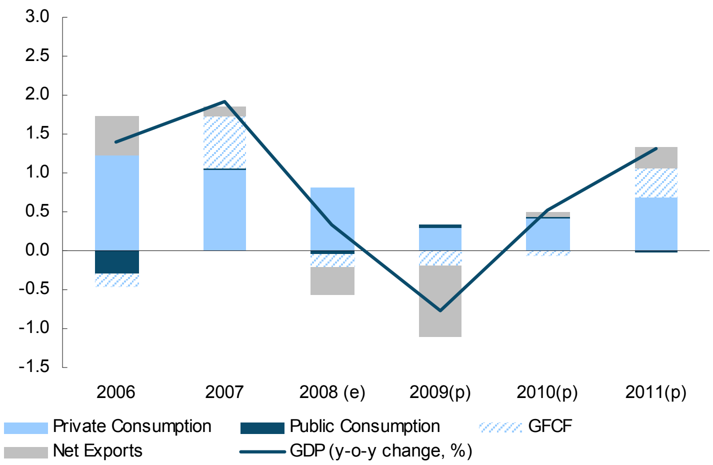
Sources: INE and Ministry of Finance and Public Administration.

I.3 Medium-Term Scenario

The medium-term scenario is shaped by a very large factor of uncertainty. The international financial crisis has spread to the real economy of Portugal and its main trading partners, a situation that is unlikely to be reversed before the final quarter of 2009. Despite the risk of an even more negative scenario being greater than that of a more favourable environment, the economic recovery measures implemented by the developed countries may have a more significant impact on the economies than that currently forecast.

Chart I.3. Contributions to GDP Growth

(Percentage points)



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

Source: INE and Ministry of Finance and Public Administration.

Private consumption is expected to significantly decrease in 2009 and recover to a certain degree in 2010 and 2011, when it is forecast to grow 0.6% and 1%, respectively, in response to the petering out of the economic and financial crisis. Investment will also recover in 2010 and 2011, following its decline forecast for 2009 (despite the fact that it is expected to benefit from the implementation of the Investment and Employment Initiative). It should be noted that these dates are, naturally, very dependent on the uncertainty regarding the occurrence of a scenario of economic recovery in the USA and EU.

Exports will undergo recovery in 2010 and 2011, in harmony with the trend that demand in external markets is expected to follow. Imports should also undergo adjustment, as a result of the less favourable performance of domestic overall demand, though such developments may not be enough to prevent the short-term fall in net exports' contribution to GDP growth. This situation should turn around at the end of the projection horizon, due to the swifter and sharper recovery of exports compared to imports. The Portuguese economy's net lending / borrowing vis-à-vis the rest of the world should follow a downwards trend throughout the projection period, primarily reflecting an improvement to the income account.

The labour market is expected to deteriorate in 2009 against an unfavourable economic background, though the unemployment rate, on the contrary, is forecast to develop downwards in 2010 and 2011 to reach a value of 7.7% in the latter, which is identical to the 2008 rate. Employment should mirror the trend of economic recovery in the medium-term, recording an average rate of change of 0.2% over 2010 and 2011, assuming a progressive increase in labour productivity in the period.

As regards the development of prices in the medium-term, the inflation rate is expected to stabilise at around 2% in 2010 and 2011 after dropping to 1.2% in 2009.

Chapter

2

II. ECONOMIC POLICY MEASURES

Against the current background of international economic and financial crisis, , after the period of budgetary consolidation and key structural reforms pursued in 2005-2008, the economic policy of the Portuguese Government is now focused on a significant anti-cyclical budgetary effort to support investment and employment, support the most vulnerable households and strengthen financial stability.

This budgetary stimulus, now integrated into the European Economic Recovery Plan through the Investment and Employment Initiative (IEI), is temporary in nature and, with a view to its effectiveness, is targeted and will be timely implemented. Though the measures of the IEI are occasional, they are fully consistent with the Lisbon Strategy, contributing to the strengthening of the country's modernisation and competitiveness, the qualification of the Portuguese people, energy efficiency and self-sufficiency, environmental sustainability and social cohesion.

The Government will, as soon as the recovery of economic situation permits, resume the path to the Medium-Term Objective of a budgetary balance of -0.5% of GDP - at a deficit reduction rate of at least 0.5 p.p. of GDP per year - with the same determination it steered the budgetary consolidation over the last three years and which it now employs in 2009 to implement the measures required to fight the impact of the economic and financial crisis.

II.1 National Plan of Reforms – New Cycle 2008-10

The National Reforms Plan – New Cycle 2008-10 (PNR 2008-10), approved in October 2008, is the Portuguese State's new programme of reforms that, in accordance with the Lisbon Strategy, succeeds the National Action Programme for Growth and Jobs (PNACE 2005-08). There has been a high level of compliance and also results in the implementation of the PNACE 2005-08 and the European Commission's assessment report approved at the 2008 Spring Council classified Portugal as a country making "Good Progress" in the implementation of its NRP.

The Government recognises that the sheer scale of some of the structural imbalances in key areas of the Portuguese economy means that the response to the economic crisis cannot half the reformist effort. Thus, in the PNR 2008-10 the Government gives priority, considering the high degree of effectiveness achieved by the PNACE, to the continuation and development of the reforms already initiated and underway, which are grouped into six areas: the Quality of Public Finances and Services; a Favourable Business Environment, especially for SME; Better Innovation Systems and more R&D; Combating Climate Change, Investing in Renewable Energies and Energy Efficiency; More Positive Mobility through Qualifications, Employment and Social Cohesion; Promoting an Intelligent Territory.

In the Quality of Public Finances and Services field, Portugal, on having achieved the targets for consolidating public accounts (one year ahead of schedule), as well as the sustainability targets for the social security systems and the targets for the modernisation of public services, as established in the PNACE 2005-08, will focus more in the PNR 2008-10 on the improvement of the quality of public finances in areas that encourage the country's growth potential and employment, and boost productivity. These reform measures of the PNR 2008-10 in the quality of public finances and in the Public Administration generally correspond to the budgetary consolidation measures envisaged in this Programme (see Chapter II.2) and those fostering the quality of public finances (see Chapter VI), in harmony with the strategy of keeping the structural nature of the budgetary consolidation process and guaranteeing coherence between the PNR and the Stability and Growth Programme (SGP).

The PNACE ensured the undertaking of reforms that turned Portugal into an example of good practices in the fields of cutting procedural red tape, transparency, fostering entrepreneurship and developing integrated responses to the needs of business, and SME in particular. The PNR 2008-10 will give priority to licensing, the procedural integration of different decision-making levels and the channelling of EU funds to create competitive environments that better favour businesses and entrepreneurs. Accordingly, the Simplex Programme will proceed with making administrative procedures simpler, more transparent and faster, thus facilitating the life of citizens and businesses and consolidating the strategy that associates simplification and e-government as one of the key factors to modernise and innovate in the design and distribution of public services.

Public investment in R&D duplicated over the time horizon of the PNACE and in 2007 private investment in R&D exceeded public investment for the first time. The priority of the PNR 2008-10 will be the consolidation of networks as technology and competitiveness hubs or as clusters, promoting collective efficiency as an instrument of innovation and creating worldwide competitiveness. The strengthening of human resources in communications and technology will be carried on, along with the development of thematic R&D networks and of consortia of scientific institutions, and the creation and participation in international knowledge networks.

The fostering of renewable energy and energy efficiency is a structural focus that aims to reduce carbon emissions and cut energy dependence on foreign sources, thus employing this path to increase competitiveness. These goals are pursued through compliance with renewable fuel targets, research into new sources of renewable energy and private investment in the latest generation of renewable energy generation systems.

In a country with low qualification levels and significant asymmetry in the distribution of wealth, the PNACE prioritised qualifications through the reform of the basic education system and the improvement of vocational qualifications through the *Novas Oportunidades* [New Opportunities] programme. The PNR 2008-10 will reinforce that priority, in particular the improvement of qualifications and social protection by stimulating positive mobility, against a background of modernisation of the labour market and improvement of social cohesion, in articulation with the principles of flexicurity and in a climate of liaison and trust with social partners.

The PNR 2008-10 will place priority on infrastructures that enhance the economic centrality of the Portuguese territory and do away with the periphery costs, increasing the capacity to attract qualified populations and high-value investment, such as new generation networks, port and airport infrastructures and the modernisation of the rail system, and also investment in basic services infrastructures, namely those of education and of science and technology, in the framework of a city and urban networks policy fostering integrated development and cohesion.

Table II.1 indicates the estimated direct budgetary impact on the General Government accounts of the main measures of the six areas of the PNR 2008-10. The figures for 2011 are projected estimates of the budgetary implications of the measures that plan to be continued in that year.

Table II.1. Direct Budgetary Implications of the Main Measures of the PNR – New Cycle (2008-10)
(% of GDP)

	2008	2009	2010	2011
Quality of Public Finances and Services	0.00	0.01	-0.01	-0.05
A Favourable Business Environment, especially for SME	0.02	0.02	0.02	0.02
Better Innovation Systems and more R&D	0.03	0.07	0.06	0.06
Combating Climate Change, Investing in Renewable Energies and Energy Efficiency	0.01	0.02	0.03	0.03
More Positive Mobility through Qualifications, Employment and Social Cohesion	0.7	1.1	1.4	1.2
Promoting an Intelligent Territory	0.1	0.2	0.3	0.3
Total	**0.8**	**1.4**	**1.8**	**1.6**

Notes: (1) The PNR 2008-10 establishes a total of 182 reform measures. (2) The budgetary impact basically corresponds to the expenditure associated to the implementation of the structural reforms.

Source: Ministry of Finance and Public Administration.

The budgetary implications of the reform measures are not necessarily directly related to their structural capacity to strengthen the competitiveness of the economy and job creation capacity. In actual fact, many of the reform measures incorporated into the PNR 2008-10 concern legislation and cutting red tape and, even though they may be of diminished financial scope, they are extremely important in raising the Portuguese economy’s potential. In contrast, some of the reform measures associated to budgetary consolidation (in the Quality of Public Finances and Services area) permits budget savings to be made that end up financing other reforms.

The financial effort in the pipeline through to 2011 in the policy area fostering knowledge and qualifications, employment and social cohesion is always greater than 1% of GDP and takes advantage of the significant increase in funds allocated to human potential in the NSRF (EU funds framework). Of further note is the fact that the investment projects in renewable energy are privately funded.

The direct budgetary implications of the main measures of the PNR 2008-10 are incorporated into the general government budgetary projections of this update of the Stability and Growth Programme.

II.2 Budgetary Consolidation Measures

The implementation of structural budgetary consolidation measures will carry on over the projection horizon, essentially with respect to the reforms of the Public Administration and fighting tax and contribution fraud and evasion. Moreover, the reforms of the social security and health systems will continue to provide budget gains vis-à-vis the pre-reform situation.

These measures strengthen the sustainability of public finances and guarantee that following the break associated to the action of automatic stabilisers and the temporary use of budgetary policy to fight the effects of the economic crisis, Portugal may carry on pursuing the Medium-Term Objective in a manner consistent with economic recovery.

The Reforms in the Public Administration

The reform of the Public Administration is a key area of the entire budgetary consolidation strategy and improvement to the quality of public finances. These reforms aim to improve the quality of governance within the Administration and increase the effectiveness and efficiency of the public service, contributing towards increasing the users’ satisfaction and the motivation of civil servants.

The highlights of the reforms undertaken in the Public Administration are those aimed at improving public managers’ capacity to increase the productivity of the (human, financial, material and real estate) resources that are allocated to the activity of the body that they manage, streamlining processes, in articulation with the introduction of new information and communication technology, cutting cost by means of economies of scale and scope, and improving the planning and control of the activity.

Associated to this trend is the decrease in the weight of compensation of employees, as the result of the continuation of the policies to control hiring, to foster better planning and internal mobility and to control the Public Administration wage bill, as well as the rationalisation of the acquisition of goods and services, where the intervention of the National Public Purchasing Agency will play a role.

Resizing the Public Administration's Structure

The structural resizing brought about by the Restructuring Programme for the State's Central Administration (PRACE) was concluded in 2007. It allowed central organic units to be reduced by 36.1% and the number of managerial posts to shrink by around 25%, thus contributing to the goal of reducing the share held by current primary expenditure.

The reorganisation of the State's decentralised local services has striven to geographically and financially rationalise the public services' distribution model, without losing proximity to citizens and achieving savings in setting-up and operating costs. Of particular note were the results obtained in the reorganisation of the basic education network (1st cycle), where approximately 2200 isolated schools with inadequate teaching conditions were closed during the 2006-07 and 2007-08 academic years; and the restructuring of the primary care and hospital care network, with the rearrangement of health centres as Family Health Units (USF) were created and implemented (150 in operation, covering about 1.8 million users). The USF structures are smaller, flexible and capable of improving citizens' access to local care, thus lessening demand for more specialised care, which has a higher average cost. Furthermore, the reform of the Portuguese consulate network led to the restructuring of 27 consular career positions and the reallocation of consular personnel, fostering their mobility and the rationalisation of their distribution, while implementing the renovation of the consular service. The Tax Office network was also the object of intervention, as eight Tax Offices were merged, leading to the optimisation of physical resources, the upgrade of these Tax Offices and the reassignment of employees, achieving a more balanced distribution of offices. More recently, Law No. 52/2008 of 28 August approved a new organisational and operational system for courts of law and reduced the number of judicial districts from 231 to 39. This intervention is the first step to transforming a generic supply of legal responses to one where each of the new districts, besides having better management conditions, has more specialised solutions to offer.

Human Resources Management

The new civil service employment scheme that has been implemented over the last three years is intended to converge towards the general scheme, striving to align managers and employees incentives with the need to improve services to the public using fewer resources. This new paradigm entails complementing normal compliance with legally determined administrative procedures, with the creation of incentives for managers and personnel by evaluating performance so that, through their own initiative and talent, they may be able to reach a level of excellence in terms of public services rendered to citizens.

The reform of the public employment scheme will be definitively consolidated in 2009, with the entry into force of the new employment contract scheme for civil servants, the new disciplinary regulations for civil servants, the legislative instrument that merges more than 1700 careers and categories to the current three general careers, the legislative instrument establishing the compensations of civil servants in the general careers, all of which have already been published, and the new single compensation table. Moreover, building on the process commenced in 2008, the legislative instruments that restructure the special careers schemes, under the terms and conditions of the contractual ties, careers and remuneration scheme will be approved with the intention of increasing the transparency of the compensation system.

It should be highlighted that the changes of remuneratory position become conditional on performance assessment and, in relation to changes in position not compulsory by law, they are based on management criteria. These criteria take into consideration available budgeted funds which, besides being allocated to changes in remuneratory position may also be allocated for the award of bonuses or the recruitment of new staff. This system aims to strengthen a culture of evaluation and accountability in the Public Administration, by focusing on a performance assessment process based on management by objectives which, by being subject to quotas, significantly mitigates the salary drift. Thus, in 2008 it was possible, for the first time in the history of the Portuguese Public Administration, to effectively apply the System for Management and Performance Evaluation of the Public Administration (SIADAP) and identify, through a selective and transparent procedure, a group of workers that stood out in terms of merit in 2007, and were accordingly awarded performance bonuses. Approximately 3500 workers earned performance bonuses in an overall value of around EUR 5.2 million.

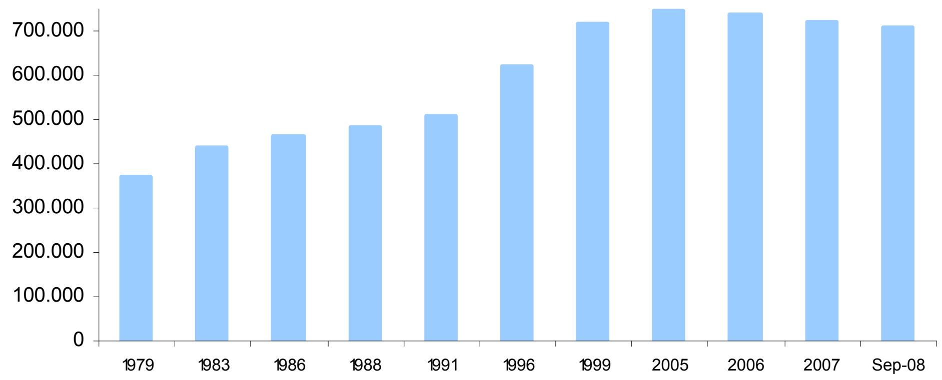
The Government will remain committed to the challenging personnel expenditure reduction targets, striving to counter a sustained growth trend, particularly in relation to the number of civil servants. To that end, the Government will continue to implement a strict policy of controlling the hiring and admission of personnel, by applying the recruitment rule of one new civil servant for every two leaving. Between December 2005 and September 2008 this rule permitted a landmark net reduction of 51 486 civil servants.

Table II.2. Reduction of Personnel in the Public Administration

	2006	2007	Sep-08	Total
Employees In	8.915	12.679	5.479	27.073
Employees Out	30.272	30.692	17.592	78.556
Balance	-21.357	-18.016	-12.113	-51.486

Source: Ministry of Finance and Public Administration.

Chart II.1. Development of the Number of Civil Servants in Portugal



Source: Ministry of Finance and Public Administration.

Another highlight of the new civil service employment scheme is the strengthening of the mobility of human resources as a mechanism to foster the motivation of workers seeking new professional experiences and also to complement and guarantee effectiveness in the planning and management of the Public Administration's human resources. The new special mobility mechanism, which has replaced the supernumerary scheme, had already accounted for the placement of 2541 workers in a situation of special mobility by December 2008, as a direct result of the implementation of the services' reorganisation mechanisms originating from PRACE.

Shared Management of Resources

In 2007, the Government began the implementation of shared services in the Public Administration, employing a strategy to improve the internal management of the services, focusing them on their missions with the aim being to achieve growing savings through efficiency gains in the support activities.

The Company for the Shared Management of Resources of the Public Administration (GeRAP) has been developing the basic structures for the gradual provision of shared services to the Public Administration's services in a sustained and informed manner, based on the model designed, tested and monitored as proof of the concept in some of the bodies of the Ministry of Finance and Public Administration (MFAP).

The target of implementation of the POCP (Official Public Accounting Plan) in 50 bodies of the State by 2010 (see Chapter VI for details) is established, in regard to the shared services systems in the field of **financial and accounting management**.

The objective in the **human resources management** field is the processing of the wages of 60 000 civil servants via shared services, by 2010. In this regard, and carrying forward the current model, the contract specifications relative to the implementation of a working model of human resources shared services in the Public Administration will shortly be published.

Where **purchasing** processes are concerned, the model for the centralisation of procurement competences was defined and approved during 2008. The aim is to improve efficiency and effectiveness, make the maximum from the gains in scale and generate savings. This model is being implemented in 3 phases:

- Centralisation in National Public Purchasing Agency (ANCP) of the responsibility to conclude framework agreements for the purchasing of the main horizontal cost categories of goods and services;
- Centralisation in Ministerial Purchasing Units (UMC) of the acquisitions to be made under the framework agreements, aggregating the needs of all the bodies and entities of the respective ministries;
- Centralisation in the ANCP of the acquisitions to be made under the framework agreements, aggregating the needs of the UMC.

The ANCP is implementing a plan to issue public calls for tender relative to the conclusion of new Framework Agreements to replace the former Public Procurement Contracts (CPA) as well as broaden the respective scope. The framework agreements will cover procurement in fifteen headings of goods and services horizontal to the Public Administration (doubling the categories previously covered), the value of which is estimated at EUR 700 million. The savings forecast for the first two years the framework agreements are in force (2009-2010) for Groups I and II are EUR 150 million euros (Table II.3)

Table II.3. ANCP Framework Agreements – Estimated Saving

Goods and Services Categories Group I and Group II	Annual Public Expenditure (thousand euros)	Estimated Saving (thousand euros)
Land-based Mobile Service	20.000	6.000
Road Fuels	88.000	5.223
Paper and Office Material	19.350	5.805
Copies and Printing	45.150	13.545
Computer Equipment	107.000	21.400
Software Licensing	91.000	21.840
Motor Cars and Motorcycles	87.000	26.100
Motor Insurance (1)	n/a	3.000
Energy	70.000	4.200
Hygiene and Cleaning	89.000	21.360
Surveillance and Security	72.000	21.600
TOTAL	**688.500**	**150.073**

Note: (1) An average saving of 200 euros per vehicle/year is estimated.

Source: Ministry of Finance and Public Administration.

The new legal scheme for the **management of the State's vehicle fleet** established by Decree Law no. 170/2008, of 26 August, aims at eliminating waste resulting from an ad-hoc management of the approximately 29 000 vehicles that make up the fleet that is scattered, heterogeneous and aged (an average age of 11 years). This law envisages the centralisation of purchases and management in the ANCP, the contracting by ANCP and the user services of the terms and conditions underpinning the assignment of the vehicles, the creation of general standards for the assignment of vehicles, carrying out their normalization in order to control expenditure, and the preference for an environmentally advanced fleet of cars.

Simultaneously, the public call for tenders for the conclusion of a framework agreement relative to motor vehicles, issued in August 2008, and with a deadline for completion set to the start of 2009, is in progress. Such a framework agreement will permit the selection and qualification of the suppliers capable of offering the best prices, guaranteeing the service levels and the environmental and quality requirements appropriate to public needs.

The combination of the entry into force of the new motor vehicle framework agreement and the implementation of the new management model for the State's motor vehicle fleet, which favours the operational leasing of motor vehicles over acquisition, will allow an annual saving of around EUR 13 million.

Management of Public Real Estate

The new legal scheme governing the State's real estate assets aims to control the use of public real estate through the introduction of payment rules and inter-generational equality, and the establishment of more exacting management, control and property evaluation standards, under the principles of the good administration and protection of public goods.

The need for timely, relevant and more reliable information led to the completion of the Survey of the Public Administration's Real Estate (RIAP), thus permitting the accurate appraisal of the State's real estate, with a view to making it more cost-effective. The survey covered a universe of 1665 entities and around 4400 properties, with a total gross area of approximately 7.9 million m^2. The collected data contributed to the preparation of real estate sales operations, which were likewise driven by the freeing up of space under PRACE, further fostering more efficient management and occupation.

The Public Real Estate Management Programme 2009-2012, approved by Council of Ministers Resolution no. 162/2008 of 24 October, establishes measures concerning the management of the State's real estate in the areas of carrying out inventories, ensuring legal conformity of real estate, usage schemes, occupancy planning, maintenance and renovation, and management of the public domain.

The implementation of the principle of paid use is to be highlighted, which, in an initial phase, will take the real estate analysed under the RIAP as a starting point, focusing on the urban properties not assigned to any special or differentiated function. The implementation of the principle will be gradual, so that it is compatible with the requirements of the budgetary consolidation process. The MFAP will set the value of the rent of the occupied real estate, which will be globally taken into account in the preparation of the State Budget for 2010.

Moreover, occupation plans will be drawn up in all ministries in order to plan the occupation of space in the Public Administration, with reference to the 2009-2012 period and encompassing data on real estate to be freed up, requirements concerning the surface area to be occupied and occupancy targets to be achieved.

Budgetary Impact of the Public Administration Reform Measures

Table II.4 quantifies the impact (savings) that the reforms undertaken in the Public Administration have had since 2005, particularly in relation to cutting personnel expenditure.

Table II.4. Budgetary Impact of the Public Administration Reform Measures

	Share of GDP in 2005 (a)	Saving (% GDP)					
		2006	2007	2008	2009	2010	2011
Compensation of Employees	**13.1**	**0.7**	**1.5**	**1.6**	**2.0**	**2.1**	**2.4**
Control of Admissions and Recruitment		0.3	0.6	0.8	1.0	1.2	1.3
Restraining Salary Drift		0.2	0.2	0.2	0.2	0.2	0.1
Salary Restraint		0.1	0.1	0.1	0.0	0.0	0.0
Others (b)		0.0	0.6	0.5	0.8	0.8	0.9

Note: Total savings is calculated, in each year, through the comparison of the budgetary scenario underlying this Programme and a no-policy change scenario. In the no-policy-change scenario it is assumed that the share of GDP of personnel expenditure determined in 2005 is maintained throughout the period analysed (2006-2011).

Key: (a) Value already adjusted to the change in method of registering the State subsidy to *Caixa Geral de Aposentações* (see Chapter III for details); (b) Includes other savings, namely those arising from the transfer of civil servants to special mobility status, the reduction of overtime, the review of remuneratory supplements, and the convergence of the healthcare sub-systems. This item also includes the impact of the transformation of some entities of the Public Administration sector into corporate public entities, which occurred in 2006, 2007 and 2008 (an impact accounting for around 0.2% of GDP in each year), and which is not considered a saving.

Source: Ministry of Finance and Public Administration.

The control of admissions and recruitment of personnel is the main contributor of the reforms in the Public Administration to budgetary consolidation. In actual fact, if the Government had not implemented in 2005 the recruitment rule of two civil servants out for every new one, it would be realistic to expect that in 2009, for example, compensation of employees were around 1.0 p.p. of GDP greater than the value set for this year in this Programme, which is equivalent, in other words, to a saving of at least EUR 1700 million[2].

Sustainability of the Social Security and Health Systems

Sustainability of the General Social Security Scheme and *Caixa Geral de Aposentações*

In order to foster the sustainability of the Social Security schemes, the Government has strengthened the legislation enacted up to 2007, which notably includes, in the ambit of the Framework Law on Social Security (Law no. 4/2007 of 16 January), the following measures agreed with the social partners:

- New pensions scheme (Decree Law no. 187/2007 of 10 May);
- Revision of the social security financing framework (Decree Law no. 367/2007 of 2 November);
- Implementation of the Public Capitalisation Scheme (Decree Law no. 26/2008 of 22 February).

Accordingly, measures such as the frontloading of the new rule for calculating the value of new pensions, the new pension update rule and the additional financial penalty in the event of early retirement, which have already come into force in 2007, were supplemented by the inclusion of the sustainability factor into new pensions, which was applied from January 2008 onwards.

A highlight of these measures is the Public Capitalisation Scheme (RPC), consisting of voluntary subscription for individual accounts, which constitutes a new means available to beneficiaries of compulsory social protection schemes (Social Security, *Caixa Geral de Aposentações* or any other compulsory contribution scheme) to boost the value of their pension income. Thus, and all through their careers, beneficiaries may channel an additional monthly contribution to the RPC, corresponding to a percentage of the contribution's basis of assessment. Accordingly, the beneficiaries are credited with investment units in an individual account, which capitalise according to the return assured by the fund's global assets, and are then converted into a monthly lifelong income when the beneficiary becomes a pensioner. This income thus complements the beneficiary's pension and offsets the impact arising from the sustainability factor that applies to Social Security and CGA beneficiaries.

The reforms undertaken in the social security systems - both the general scheme and the civil service social security schemes, in particular the establishment of the sustainability factor, the pension updating rules, and the fostering of active ageing, have allowed the systems to increase their capability to absorb adverse changes in demography, therefore permitting the lessening of the non-sustainability risk associated to the development of public expenditure sensitive to the ageing of the population (especially pension expenditure). The long-term forecasts for pension expenditure, which already reflect the impact of these reforms, have already undergone a peer review by the Ageing Working Group, which assists the Economic Policy Committee of the European Union's Economic and Finance Council on such matters. Portugal's classification as a high-risk country was reduced to medium-risk, in harmony with the expected results of the reform engaged in.

In relation to the civil service social protection system, the adaptation of the main reform measures in the General Social Security scheme is embodied in Law no. 52/2007 of 31 August, and Law no. 11/2008 of 20 February, and they are in force since January 2008. A gradual increase in employers' contributions to the

[2] The assumption that GDP share remains unchanged in a no-policy change scenario can be considered prudent in regards to compensation of employees, especially if we consider the development of this item prior to 2005. Thus, it would even be reasonable to admit that its GDP share would tend to increase in the absence of correction measures, which would result in an even greater savings estimate.

CGA was undertaken, converging on the Social Security system (Law no. 53-A/2006 of 29 December, and Law no. 67-A/2007 of 31 December), for autonomous bodies and those already legally required to do so. Accordingly, all integrated services start to contribute to CGA from January 2009 (at an initial rate of 7.5% on the compensation of all civil servants and agents underwriting the CGA). Thus, there is a convergence with the practices of the general social security scheme while, at the same time, the transparency and discipline in the evaluation of labour costs in the public Administration are increased, thereby contributing to the more efficient allocation of its human resources[3].

Sustainability of the Health System

The Government has pursued a streamlining policy in the use of public resources allocated to the health area, with the aim of improving healthcare and ensuring its sustainability. Such policy is based on the introduction of macro-based structural cost control measures and the boosting of operational efficiency.

- At the macro level, the following structural measures stand out:
- The strengthening of the service provider contracting process, with quantified cost and outcome development objectives with associated financial incentives (penalties);
- The centralisation in electronic format of budget control information;
- The implementation of a disciplined medicaments policy. The reduction of the public retail price of medicaments, including the main medicaments of the Portuguese market, due to the duplication of the market share of generic medicaments to 20% by the final quarter of 2008, cuts the price paid by the consumer and the Ministry of Health’s costs related to medicament co-payments in pharmacies (these decreased 1.4% in 2006 and 1.7% in 2007, an unprecedented fact in recent years). The 30% cut on the maximum retail price of the majority of the generic medicaments, approved by Ordinance no. 1016-A/2008 of 8 September, will contribute to larger savings for consumers and the State. Of equal importance in this regard is the implementation of rules and procedures introducing innovation and the continuation of the hospital medicament programme, wherein the establishment of the first hospital pharmacy open to the general public and dispensing medicaments in single doses (on an experimental basis) is to be highlighted;
- The establishment of medicament expenditure monitoring mechanisms in the hospital and outpatient environments.

Efficiency measures at the micro level continued to be implemented, in particular the restructuring of the primary care network with the aggregation of resources and management structures and the rearrangement of health centres as family health units were created (smaller, more flexible structures capable of improving citizens’ access to local care and lessening demand for more specialised care, which has a higher average cost), with 150 currently in operation (a total of 250 such units in operation by the end of 2009 is planned). The restructuring of the secondary (hospital) care network through the reform of the national network of maternities and emergency wards is currently underway. The process of transforming hospitals into corporate entities was further reinforced with the net creation of an additional three corporate public entities in 2007 and six more in 2008. In parallel, a network of continued care for the elderly and persons in a state of dependency is undergoing development, and the Government decided to bring forward to 2009 the target of 8200 beds in the continued care network, which had originally been established for 2010.

[3] The non-existence of an explicit cost (price) associated to the use of the recourse can generate the illusion that no cost exists, which would be reflected in less efficient management.

At the micro level, the following operational measures stand out:

- The implementation of the *Saúde* 24 telephone and internet assistance service which aims to improve access to health care and rationalise resources, the investment in information systems to improve epidemiological vigilance and the definition of clinical quality indicators;
- The strengthening of hospitals' strategic planning processes, the integrated monitoring of performance with management information made electronically available on a monthly basis and systematic screening of performance, an internal control system based on the best international practices, establishment of the position of internal auditor in each hospital unit and the external auditing of the hospitals;
- The use of shared services, with the creation of three consortia of companies in 2007 (*Somos Pessoas, Somos Compras and Somos Contas*). It is estimated that the centralised procurement and logistics entity of the Hospitals' Common Use Service (SUCH) achieved savings of EUR 8.2 million in 2008, its first year of operation.

The economic and financial results of the measures undertaken are notable, and in 2006, 2007 and 2008 amending budgets in the National Health Service were not required for the first time in decades, as the budget situation remained close to equilibrium. The control of costs was notable in primary care and in hospitals, particularly corporate public hospitals, where total costs fell more than 1% and operating costs growth was 2% down in 2006 on the 2005 figures, which comprised a reversal of the double digit growth of recent years. Total costs fell 0.6% in 2007, while operating costs rose slightly by 0.9%.

In addition to the control of costs, the increase in expenditure efficiency is demonstrated by the growth of output production, increasing the citizens' access particularly in outpatient areas, and the 20% reduction to surgery waiting lists from 2005 to 2006 and 35% reduction from 2006 to 2007 (around 49% between 2005 and April 2008).

Tax and Contribution System

The Government's tax policy strives to guarantee, in a fair manner and minimising red-tape costs, adequate and sufficient revenue for the implementation of public policies, while increment and supporting the voluntary compliance with obligations by taxpayers and fighting tax fraud and evasion and abusive tax planning.

The strengthening of the fight against tax fraud and evasion and abusive tax planning, which aims to raise the effectiveness and efficiency of the tax system and foster greater equality in the division of the tax burden among taxpayers, has a positive impact on public finances. In 2008, the most significant measures in this field focused on:

- Fraudulent VAT reporting – especially in the "scrap" and civil construction sectors;
- Issue of false invoices - establishing a "reverse charge" system to settle VAT to be applied to civil construction services (construction contract and subcontract work) and to the sale of real estate, in relation to which the renunciation of exemption has been established;
- Abusive tax planning – Decree Law no. 29/2008 of 25 February establishes measures to prevent and combat abusive tax planning through a set of obligations requiring tax planning agents to communicate, inform and clarify the Tax Administration of such planning, these agents being credit institutions and other financial institutions, statutory auditors and statutory audit firms, lawyers, law firms, solicitors, solicitor firms, accountants and other entities providing accounting services;

- Distortion of billing software - impacting on the basic assessment value for personal and corporate income tax;
- Parallel economy – combating the development of economic activities wholly outside of the coverage of tax legislation, which cause the loss of tax revenue and the distortion of competition.

The Government remains committed to strengthening the equality and effectiveness of the tax system, in order to assure a fairer division of the tax burden among taxpayers. Thus, a number of measures will be taken in 2009 to this end, including:

- Clarification of the taxation scheme in relation to external signs of wealth, comprising the immediate settlement of the tax as well as the cessation of bank account confidentiality, entailing immediate authorisation to analyse bank accounts;
- Clarification of the processing, in terms of personal income tax, of the payment on account of profits by shareholders in companies that are subject to the tax transparency scheme;
- Breakdown of the tax courts to three levels of specialisation, according to the number of cases, creation of tax courts with wider territorial jurisdiction, creation of tax courts of the first instance and creation of an office to provide technical assistance to magistrates;
- Implementation of an integrated information system supporting the work of the tax inspectorates, from planning and control through to the performance of procedures, permitting an increase in the efficiency of the tax inspectorate, steering it towards the control of taxpayers considered a risk and permitting the use of computer software to detect frauds.

II.3 Initiative to Strengthen Financial Stability

In the context of a concerted effort by the Member States of the European Union to strengthen national financial systems to combat the impacts of the international financial crisis, in the final quarter of 2008 the Portuguese Government approved a set of measures embodied in the Initiative to Strengthen Financial Stability (IREF). Accordingly, the commitments made by Finance Ministers at the ECOFIN Council of 7 October and by the Heads of State and Government at the Paris Meeting on 12 of the same month are satisfied, which underlined the need for a global, coordinated and across-the-board response in order to re-establish the confidence of economic agents and the normal functioning of the financial markets..

The main objectives of the IREF are to ensure the normal financing of economic activity, particularly where households and SME are concerned, and guarantee the protection of the Portuguese people's savings. It has four areas of intervention: (a) strengthening the information disclosure and transparency obligations of financial institutions and revising the punishments in the financial sector; (b) strengthening deposit guarantees; (c) granting State guarantees to strengthen financial stability and provide liquidity support to financial markets; (d) strengthening the financial soundness of credit institutions.

Strengthening the Information Disclosure and Transparency Obligations of Financial Institutions and Revising the Punishments in the Financial Sector

Decree Law no. 211-A/2008 of 3 November and Draft Law no. 227/X strengthen the information disclosure and transparency obligations of financial institutions to their clients and to the supervisory authorities, from a medium and long-term perspective. The measures envisaged are preventive in nature and encompass four fundamental areas: (i) strengthening information disclosure and transparency obligations; (ii) revising the punishments for criminal and administrative offences; (iii) greater accountability of market agents and management teams; (iv) strengthening the concerted exercise of roles by supervisors in matters of mutual interest.

The information disclosure and transparency obligations are strengthened through Decree Law no. 211-A/2008 of 3 November, and they entail, on the one hand, the information that the financial institutions are obliged to provide to the supervisory authorities, namely to gauge their level of exposure to different types of financial instruments, the risk management and control practices, and the methods used in asset valuation. On the other hand, the information disclosure relative to complex financial products is reinforced and any publicity relative to the same requires the approval of the competent supervisory entity. A further obligation that has been established is to notify the supervisory authorities of shareholdings and stakes held or managed by public limited financial institutions and corporations in corporations with registered office in a State that is not a member of the European Union.

The greater accountability of market agents and management teams is also envisaged by widening the liability of legal persons to include infringements performed by personnel without managerial posts when the holders of such posts may have failed in their monitoring role.

In relation to strengthening the coordinated action of supervisors, and despite the fact that, in practice, institutional relations among supervisors and between these and the Ministry of Finance and Public Administration (MFAP) have ensured adequate liaison in the effective pursuit of the financial stability objectives, it was decided the settlement of rules regarding the concerted action of supervisors in the National Financial Supervisors Council (CNSF). Thus, the competences of the CNSF are strengthened where the joint action of the supervisory authorities in matters of common interest and the exchange of information among supervisors and between these and the MFAP are concerned, whenever such information is deemed relevant to matters of financial stability.

The revision of the punishments for criminal and administrative offences, under the Draft Law no. 227/X, consists of: (i) the update of the criminal and administrative sentences; (ii) the increase in the maximum fine payable when the economic benefit doubled exceeds that maximum fine; (iii) the escalation in the nature of administrative offences associated to the infringement of information disclosure obligations and of the establishment or contribution to compulsory guarantee funds; (iv) the introduction of the accelerated summary process in the banking and insurance sector; (v) the extension to the bank and insurance sector of the scheme to publish verdicts in administrative offence proceedings.

Lastly, rules are established on the remuneration policy of members of the management and supervision bodies of entities of public interest, which envisage the compulsory submittal of this policy to the General Meeting for approval.

Strengthening the Deposit Guarantee

The ceiling of the deposit guarantee was raised from EUR 25 000 to EUR 100 000 and the reimbursement timeframes reduced, in compliance with the decision of the ECOFIN Council on Deposit Guarantee Funds (Decree Law no. 211-A/2008 of 3 November).

The granting of guarantees by the State to strengthen financial stability and provide liquidity support to financial markets

A special State guarantee scheme was created with the objective of ensuring the renewal of the funding operations of credit institutions with registered offices in Portugal. This scheme is established in response to the current liquidity restrictions in financial markets and consequent difficulties credit institutions face as regards the access to and conditions under which they finance or refinance their activities.

Thus, Law no. 60-A/2008 of 20 October and Ordinance no. 1219-A/2008 of 23 October establish the possibility of the extraordinary granting of guarantees by the State in the financial system, creating a flexible scheme permitting a timely intervention, adapted to the market's situation, which is temporary in nature (remaining in force only while normal market conditions are not restored) and safeguards depositors and taxpayers' interests. The intention of this measure is not for the State to serve as a substitute for market mechanisms, namely in relation to the provision of liquidity, but rather to support credit institutions' access to market mechanisms.

All credit institutions with registered offices in Portugal and complying with the solvency criteria established in law can apply for the granting of a State guarantee, even if facing, in the current environment, difficulties in accessing liquidity. The guarantee application is submitted by credit institutions to the Portuguese Central Bank, which analyses it in conjunction with *Instituto de Gestão da Tesouraria* e do *Crédito Público* (*Portuguese Treasury and Government Debt Agency)*, taking into consideration the beneficiary entity's contribution to the financing of the economy and the credit's financial conditions and its necessity, and conveying the recommended decision to the Minister of Finance.

The granting of the State guarantee is conditional on the payment of a fee by the beneficiary credit institution, established according to commercial conditions and its level of risk. The calculation of the value of the fee is based on the ECB recommendations, using the credit default swap spread of the credit institutions as a reference.

The Directorate General for the Treasury and Finance, in articulation with the Portuguese Central Bank and *Instituto de Gestão da Tesouraria* e do *Crédito Público*, is responsible for guaranteeing and monitoring compliance with the responsibilities arising from the guarantees granted, as well as follow-up and assure the management of the guarantees following their issue. The Portuguese Central Bank is further responsible for monitoring the activity of the beneficiaries holding guarantees.

In the event the guarantee is activated due to default by the beneficiary, the State is empowered to (i) convert the credit it holds in the beneficiary into share capital in the same, following consultation of the Portuguese Central Bank; (ii) decide on the adoption of good corporate governance principles, dividend policy and the remuneration of the members of the management and supervisory bodies; (iii) appoint one or more temporary directors. The adoption of this initiative thus allows for the current shareholders and managers of the banks to be held accountable, whenever deemed necessary, and it fosters the adoption of good corporate governance principles.

This scheme can be revised at any time (and it is compulsorily reanalysed a maximum of every six months), especially if market conditions justify so or if such is required for Euro Zone and European Union coordination.

The announcement of the Portuguese State's scheme to grant guarantees was welcomed by most Portuguese banking institutions. It was approved by the European Commission on 29 October 2008, which acknowledged its adequacy and scale in light of the recommendations issued by that institution[4]. Guarantees have been granted, to date, to four of Portugal's main banks, given the swift implementation of this measure, made possible by the speed of action and good coordination among the authorities

[4] Consult http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:009:0001:0003:PT:PDF

involved. Those banks have already successfully implemented the finance operations that were guaranteed by the State (see Table II.5 for details). In the three cases (Portugal's three largest banks) where the operations entailed the issue of non-subordinated bonds, demand, which primarily originated from international investors, was high despite the instability currently assailing financial markets.

Table II.5. Utilization of the State Guarantees to Strengthen Financial Stability
(to 16 January 2009)

Bank	Value	Type and repayment conditions	Fee to State	Status
CGD	EUR 2 billion	Bond issue, with reimbursement on maturity of 3-year term. Bonds with 3-year maturity have a coupon of 3.875% (85 basis points above «mid swaps»).	0.865% per year	Total value of issue: EUR 1.25 billion
BES	EUR 1.5 billion	Bond issue, with reimbursement on maturity of 3-year term The BES issue was placed at a price equivalent to the 3-year midswaps rate, plus a 100 basis point spread.	0.948% per year	Total value of issue: EUR 1.5 billion
BCP	EUR 1.5 billion	Bond issue, with reimbursement on maturity of 3-year term Placed at a price equivalent to the 3-year midswaps rate, plus a 100 basis point spread	0.948% per year	Total value of issue: EUR 1.5 billion
BANIF	EUR 50 million	Schuldschein loan, with repayment on maturity of the 1-year term. 3 or 6-month Euribor rate plus a spread between 0.60% and 0.75%	0.50%	Total value of loan: EUR 50 million

Source: Ministry of Finance and Public Administration.

Strengthening the Financial Soundness of Credit Institutions

Law no. 63-A/2008 of 24 November was also approved under the Initiative to Strengthen Financial Stability. This law aims to create conditions for credit institutions to strengthen ownership equity, as has been undertaken in other EU countries (e.g. United Kingdom, France, Germany and Spain). The intention of this scheme is for credit institutions possessing adequate soundness as evaluated according to applicable legislation to achieve a higher level of solvency - considering the requirement of the Portuguese Central Bank that credit institutions have a Tier 1 capital ratio of at least 8% - in order to guarantee their access to liquidity under adequate conditions and consequently the normal financing of economic activity. The Government's intention is to place domestic credit institutions in a position comparable to that of their European counterparts benefiting from similar measures.

This measure aims to create a specific legal framework for direct public intervention in the processes of financial restructuring and recovery of credit institutions with core capital' levels below the legal minimum.

Public investment is undertaken through the specification of balanced conditions and reciprocal contributions, in accordance with the principles of proportionality, return and guarantee of the invested capital and the minimisation of the competition distortion risk.

The scheme established in Law 63-A/2008 of 24 November was defined, just like the scheme to grant State guarantees, using the European Commission's recommendations as a reference, namely: (i) the temporary basis of State support; (ii) the subsidiary nature of these operations when compared to shareholders' equity issuance operations; (iii) the commitment to recovery plans by those credit institutions provided support in their capitalisation undertakings; (iv) the distinct treatment of structurally sound credit institutions and those with solvency problems.

The access to public investment to strengthen ownership equity is dependent on the application submitted by the interested credit institution to the Portuguese Central Bank, which analyses the same and conveys its duly reasoned decision recommendation to the member of the Minister of Finance. The Minister will weigh up the interested credit institution's contribution to financing the economy and the need to strengthen ownership equity when making the final decision.

While the credit institution is the object of public investment to strengthen ownership equity it is bound by the conditions and charges established in the ministerial order issued by Minister of Finance, with particular focus on: (i) the use of the resources supplied, particularly where the credit institution's contribution to the financing of the economy is concerned, especially the financing of households and SME; (ii) the adoption of good corporate governance principles, which can include increasing the number of independent directors; (iii) dividend policy and the remuneration of the members of the company's management and supervisory bodies, as well as the possibility of limiting other compensation, irrespective of its nature, that the holders of such office may be entitled to; (iv) taking measures aimed at preventing any distortion of competition; (v) the possibility of the need to raise contributions to deposit guarantee funds; (vi) the adoption of mechanisms that allow public disinvestment to occur under market conditions guaranteeing a suitable return on the capital invested, thus ensuring the protection of taxpayer's interests.

The Portuguese Central Bank is responsible for following up and supervising the performance of the proposed measures as well as drawing up, on at least a monthly basis, individual reports on each credit institution encompassed by these measures, supplying them to the Minister of Finance, who will inform the Portuguese Parliament every half-year of the capitalisation operations undertaken.

The resources provided for the granting of State guarantees and the strengthening of the financial soundness of credit institutions are obtained by allocations from the State Budget and by government debt issues, to a total ceiling of EUR 20 billion (the calculation of the sum assigned to strengthening the financial soundness of credit institutions – EUR 4 billion – was based on the capital requirements of credit institutions with registered office in Portugal in order to achieve a baseline Tier 1 capital ratio of 8%).

Other Isolated Interventions to Assure Financial Stability

The Government, further to its commitment to take all necessary measures to guarantee the stability of the Portuguese financial system and safeguard the deposits held by credit institutions with registered office in Portugal, and considering the specific circumstances, took the following isolated and exceptional measures at the end of 2008: a) the nationalisation of *Banco Português de Negócios*, S.A. (BPN); b) the granting of the State guarantee to *Banco Privado Português*, S.A. (BPP) pursuant to Law no. 112/97 of 16 September (general scheme for granting State guarantees).

The intervention was made in the BPN in order to prevent imminent defaulting on the bank's payments (it is a small bank with a market share of around 2%, and in which a series of impairments were detected, giving rise to inquiries and the institution of several administrative offence proceedings and the filing of a report with the Office of the Public Prosecutor of the Republic), as a result of the bank's evident difficulties in obtaining liquidity due to the fact that it was insolvent. The main objective of this decision was to safeguard the deposits held by that institution (around 230 000 depositors).

As regards the BPP, the Government guaranteed (with the BPP assets provided as collateral) the loan provided by six banks to BPP, considering the risk of this institution ceasing to meet commitments undertaken in the strict ambit of its activity as a credit institution. BPP is a small bank that is primarily orientated to portfolio and asset management (assets that were not covered by this intervention). It possesses the deposits of private individuals and other small credit institutions on its liabilities sheet and the loss of such would affect many thousands of small depositors in such institutions. In current financial market conditions of heavy uncertainty, such a loss would certainly affect the confidence of the majority of bank depositors in general, and thus place the stability of the financial system at risk.

II.4 Investment and Employment Initiative

The depth and extent of the international financial crisis, which severely worsened in the final quarter of 2008, is generating a heavy recessive impact on the world economy, particular on economic agents' confidence, credit restrictions and economic activity in general. The European Union's Member States, as proposed by the European Commission, have initiated a coordinated plan to boost the European economy by strengthening economic agents' confidence through the stimulation of economic activity and employment. This plan encompasses timely, temporary and targeted measures and, taking advantage of the flexibility envisaged in the Stability and Growth Pact in exceptional circumstances, fosters the coordinated consolidation of the anti-cyclical effort pursued by several Member States, striving to generate a budgetary stimulus in the region of about 1.5% of GDP. The initiatives promoted by the European Commission and the European Investment Bank will account for around 0.3% of GDP, and Member States must contribute with the remaining 1.2% of GDP.

Accordingly, the Portuguese Government, taking advantage of the good results achieved to date in terms of budgetary consolidation, presented the Investment and Employment Initiative (IEI), which encompasses the Portuguese contribution to this Europe-wide coordinated anti-cyclical effort. The effectiveness of this initiative to combat the impact of the crisis depends on Europe's capacity to implement a common and coordinated response. The impact of an isolated Portuguese initiative would, in actual fact, most probably not be very significant.

The IEI consists of a set of additional measures to those already established in the State Budget for 2009. As a matter of fact, the Portuguese Government had already during 2008 proceeded with several measures to support households and businesses that embrace the spirit of this European plan, but which were aimed at combating the initial impact of the crisis: the rise in interest rates and the price of raw materials and food products, and credit restrictions.

Measures to Support Households and Businesses Taken During 2008

The highlights of the measures focussed on households taken during 2008 are:

- **Support provided to the owners and leasers of real estate having difficulty complying with their inherent financial commitments**, comprising the reduction of Municipal Real Estate Tax (IMI) and extension of the period of exemption, the introduction of a regressive loading of the values of personal income tax deductions vis-à-vis housing costs, the approval of a special scheme applying to real estate corporations and funds for renting housing and the increase of the tax saving of households on the sale of the own and permanent dwelling.

- **Fighting poverty**, through measures such as extending the application of the Solidarity Supplement for the Elderly, strengthening protection concerning absolute disability or reinforcing the insertion of beneficiaries of the Social Integration Income.
- **Protection of households,** through the extension of the value and beneficiaries of School Welfare, raising the Family Allowance, creating a transport pass for young people aged between 4 and 18 years, as well as strengthening the protection provided to disabled persons.
  - The Government also approved during 2008 measures to support business, with particular focus on the development of the business activities of SME, namely:
- Creation of a general **reduced corporate income tax bracket,** which benefits the large majority of SME, and the reduction of the advance tax payment by those businesses;
- Creation of a mechanism in the NSRF (EU funds framework) to permit the **advance payment of EU funds granted to businesses**;
- Creation of the **PME Investe credit lines**, totalling EUR 3350 million, fostering corporate investment and with improved financing conditions.
- Implementation of the **Programme for the Extraordinary Settlement of the States' Debts** (described in detail in Chapter VI).

Table II.6 illustrates the direct budgetary impact of the measures taken during 2008 to combat the effects of the crisis.

Table II.6. Measures Taken During 2008 to Combat the Effects of the Crisis
(% of GDP)

Measure	Direct budgetary impact in 2009
1 p.p. reduction of maximum rate of Municipal Real Estate Tax and extension of the period of exemption	0.06
Loading of personal income tax deductions of housing costs	0.03
Fighting poverty	0.07
Protection of households	0.12
Cut in corporate income tax for SME (creation of reduced rate and reduction of advance tax payment)	0.05
PME Investe I, II and III credit lines	0.03
Programme for the Extraordinary Settlement of the States' Debts	0.04
Total	**0.4**

Source: Ministry of Finance and Public Administration.

"Investment and Employment Initiative" Programme

The worsening of the financial crisis and the recessive impact on the economy in the last quarter of 2008 has meant that the current focus of the measures aimed at combating those effects is on strengthening public investment, supporting private investment and employment.

The Draft Law creating the "Investment and Employment Initiative" Programme, presented to the Portuguese Parliament on 19 January 2009 together with the January 2009 update of the SGP, contains five structural measures containing several projects or actions. These measures are aimed at generating an anti-cyclical economic impact on investment and employment, and they are also consistent with the framework of the Lisbon Strategy, contributing to strengthening the country's modernisation and competitiveness, the qualification of the Portuguese people, energy efficiency and self-sufficiency, as well as environmental sustainability and fostering social cohesion.

In this Initiative the Government strives to benefit from the European Council's decision of 13 December to support the simplification of procedures and the faster implementation of programmes financed by the Cohesion Fund, Structural Funds or by the European Agricultural Fund for Rural Development with a view to increasing investment in infrastructure and energy efficiency, as well as the decision by the European Social Fund to swiftly implement additional measures to support employment, especially for the benefit of the most vulnerable groups in the population, paying particular attention to the smallest undertakings by reducing non-wage labour costs.

Moreover, the European Council supports the use for 2009 and 2010 of the accelerated procedures admitted in the public procurement directives, which is justified by the exceptional nature of the current economic situation, in order to reduce from 87 to 30 days the length of the tendering process for the most commonly-used procedures for major public projects.

Table II.7 illustrates the direct budgetary impact of the measures in the IEI to combat the effects of the crisis. The budgetary impact of the IEI in 2009 rises to EUR 1300 million, equivalent to close on 0.8% of GDP. The Initiative's financing takes the form of an approximate 0.5% of GDP increase in expenditure while the measures that entail a fall in revenue will amount to around 0.3% of GDP.

Table II.7. Direct Budgetary Impact of the Investment and Employment Initiative
(% GDP)

Measure	Direct budgetary impact in 2009
Modernisation of Schools	0.18
Fostering Renewable Energies, Energy Efficiency and Energy Transmission Infrastructure	0.15
Modernisation of technological infrastructure – new generation broadband networks	0.03
Special support to economic activity, exports and SME	0.23
Protecting employment and strengthening social protection	0.18
Total	**0.8**

Source: Ministry of Finance and Public Administration.

The Minister of State and Finance is responsible for coordinating and monitoring the IEI, ensuring that the required high degree of budgetary control discipline is complied with. The performance of the measures will be monitored and assessed and the Government will maintain the necessary flexibility to carry out any adjustments deemed appropriate in view of the development of the economic situation and the level of effectiveness shown by the measures.

Measure 1 – Modernisation of Schools

The School Modernisation Programme will be strengthened by frontloading the reconstruction and modernisation of more than 100 State schools throughout the country in the 2009-2011 periods. This investment is financed from the State Budget and the *Parque Escolar* (state-owned company) is responsible for its implementation.

The modernisation and renovation of schools will also encompass the investment to be made in all the country's schools under the Technological Plan for Education.

Measure 2 – Fostering Renewable Energies, Energy Efficiency and Energy Transmission Infrastructure

The Government has stipulated investment in the energy sector as a priority, as a means of cutting carbon emissions and reducing energy external dependence, thus increasing the economy's competitiveness. Therefore, it has included projects intended to foster renewable energies, energy efficiency and energy transmission infrastructure in the IEI.

Installation of solar panels and micro-generation units (mini-wind turbines)

Exceptional support will be provided during 2009 to the installation of 300 000 m^2 of thermal solar panels in the residential sector, inducing their use by consumers and galvanising the cluster of domestic photovoltaic panel industries and having a positive impact on the construction activity related to the installation of panels.

Further exceptional support will be provided during 2009 to the installation of 12 500 micro-generation units, mainly mini-wind turbines, in the domestic and services sectors, galvanising the domestic cluster of industries manufacturing such technology and having a positive impact on the metalwork and mechanical engineering, moulds and electrical equipment sectors.

Investment in energy transmission infrastructure

The investment plan for very high voltage energy transmission infrastructures will be frontloaded, comprising, in particular, the construction of new network infrastructures that underpin the implementation of national structural projects and guarantee the reinforcement of energy supply security and the convergence of the price of electricity with Spain (investment in interconnection). This investment will boost economic activity upstream, with an impact on approximately 100 qualified suppliers in sectors such as the cable, metalwork and mechanical engineering, electrical equipment and construction industries.

Improved energy efficiency of public buildings

The State will invest in solutions to improve the energy efficiency of a set of the most energy-consuming public buildings (hospitals, universities, law courts, offices of public services, etc.), which will galvanise the construction, metalwork and mechanical engineering and energy consultancy sectors, while also driving direct gains through the reduction of energy expenditure.

Investment in energy metering networks

This measure aims to install intelligent energy metering systems in 10% of all domestic electricity consumers, allowing consumers to optimise consumption and cut energy costs, automating the management of the national grid and improving service quality, as well as fostering energy efficiency and environmental sustainability. This investment will permit the creation of an equipment manufacturing cluster and it will heavily impact on the construction segment geared to electrical installation.

Measure 3 – Modernisation of Technological Infrastructure – New Generation Broadband Networks

The focus on the development of the information society is largely centred on undertaking investment in new generation broadband networks. Such investment is territorially dispersed, ensures better communications which has significant repercussions on the efficiency of the economy and economic agents, thereby decisively stimulating the development of the country through relevant impact on business dynamics and on job creation, in combating info-exclusion, in its capacity to attract foreign investment and in the return on national R&D potential that is generated by a range of instruments, including the Technological Plan.

The investment, which is forecast to reach EUR 1 billion, will be fundamentally made by communications operators, some of whom have already subscribed to the State's Protocol on new generation networks. All investors intending to make investments in this area can subscribe to this Protocol.

The State, through this commitment, will foster the necessary conditions for opening pipelines that may be used to convey fibre optic cables and it will pass legislation to remove the existing obstacles to the installation of fibre optics indoors and outdoors, while also encouraging investment in remote areas or areas with lower demand through the provision of incentives and/or tax relief.

The State's duties also include the coordination of EU funds awarded to our country, identifying those that can be allocated to new generation broadband network construction projects, and assuring the conditions for the creation of a EUR 800 million credit line for investors in this project.

Measure 4 – Special Support to Economic Activity, Exports and SME

Businesses' access to financing in well-balanced conditions is a pre-requisite for investment and employment. Thus, the Government, in addition to the measures that are established in IREF to restore normal conditions to the granting of credit by financial institutions, now establishes new measures to support economic activity, in particular the improvement of the conditions for financing the economic activity of SME.

SME credit line

This credit line for SME, which is to be implemented following the total exhaustion of the credit lines currently in force (PME Investe I, II and III), comprises the award of bank loans to businesses registered in Portugal with a guarantee stood by mutual guarantee corporations, the partial subsidisation of the interest rate and full subsidisation of the guarantee fee.

The aim of this measure is to facilitate businesses' access to bank credit under more favourable conditions and, therefore, ensure the provision of liquidity to businesses in order to guarantee the financing of their activity, especially investment projects. The value of this credit line can rise to EUR 2 billion.

The State's contribution to the Mutual Counter-guarantee Fund in order to reinsure the risks taken on by the mutual guarantee corporations will total EUR 75 million.

Industrial restructuring fund

A fund will be created with an appropriation of EUR 175 million. This fund constitutes a mechanism of co-financing domestic and international mergers and acquisitions operations, wherein the State intervenes as a financial partner of the national SME involved in such procedures in order to raise their critical dimension, thus improving their capacity to face globalisation. The State's shareholding in a merger and acquisition can be as much as 33%, therefore the estimated value of such operations may attain at least EUR 525 million (EUR 350 million form private investment), in the event the funds are fully employed.

Support to export credit insurance mechanisms

This measure aims to temporarily guarantee conditions for national SME to develop their economic activity through trade transaction in external markets, providing them with additional credit risk coverage for sales in OECD countries and non-OECD countries, up to a total of EUR 4 billion.

The New Credit Insurance Scheme establishes a leveraging of the credit insurance ceilings by the five insurers operating in the domestic market, through the National Mutual Guarantee System for OECD countries and by direct guarantee of the State for markets outside the OECD, the latter of which entail a political risk in addition to a commercial risk.

This measure meets the new requirements of Portuguese businesses in view of the dropping of ceilings that has been registered since the second quarter of 2008.

Support to promotion abroad

Actions promoting the country abroad will be implemented. The aim is to achieve an additional 200 000 visitors in 2009, and the investment is forecast to generate EUR 250 million in tourism revenue, besides the other positive impact that such would have for the sector.

The promotion of the supply of Portuguese goods and services will have three main points of focus:

- Diversification of markets;
- Consolidation of the share held by Portuguese goods and services in traditional markets;
- Broadening the exporter base.

Initiatives will be implemented to provide Portuguese companies with access to emerging markets, or those markets where the effects of the economic and financial crisis may not have the same impact as they have had on the traditional Portugal's trading partners.

Other actions to maintain market share in anchor markets for Portuguese companies, in both the USA and EU, will be concurrently implemented.

Lastly, in harmony with the Government's strategy to foster exports, efforts will be made so that SME are accompanied ever closer and those that have not yet initiated their process of internationalisation may do so. The involvement of an ever greater number of national companies in foreign markets will occur via their participation in promotional initiatives and via capacity building initiatives aimed at Portuguese businesses to provide them with more know-how as regards international business.

Support to private investment projects in agriculture and agro-industry

This measure provides financial support to agricultural and agro-industry investment projects co-financed by EAFRD, under the Rural Development Programme (PRODER), through the allocation of sufficient funds to guarantee the national contribution. This investment will permit the maintenance of employment in agricultural and agro-industry sectors as well as create 5000 new jobs, including the establishment of young farmers, in projects of modernisation and capacity building of companies.

Creation of a credit facility supporting agriculture and agro-industry exports and competitiveness

This measure consists of the creation of financial support in the form of a credit line for agriculture and agro-industry exports and competitiveness totalling EUR 175 million, which is promoted by the Institute for the Financing of Agriculture and Fishing. This facility will ensure the strengthening of the competitiveness of companies undergoing restructuring, preventing financially and economically viable companies from being rocked by the international crisis to the point where they are forced to shed jobs.

Tax credits for investment

A new tax scheme supporting investment made in 2009 will be created (RFAI 2009). In fact, the creation of an investment incentive system regulated by the State has proven to be a valuable anti-cyclical tax policy instrument.

This instrument has four basic requirements: be adjustable, persuasive, selective and coherent.

As regards the first requirement, two tax relief thresholds are proposed for 2009 in order to partially improve the existing scheme, considering the contractual tax benefits scheme applying to investment set forth in Article 41 of the Tax Benefits Code. The projects are to be encompassed by a simplified scheme of automatic tax benefits that will depend on the investment value (lower than or greater than EUR 5 million) and which provides for:

- Corporate income tax deduction (up to 25% of the same) of the following values, for investments made in regions eligible for support under incentives provided with a regional objective:
  - (a) 20% of the relevant investment for an investment totalling up to EUR 5 million;
  - (b) 10% of the relevant investment for an investment above EUR 5 million.
- Up to 5-years exemption from the payment of Municipal Real Estate Tax on the properties constituting a relevant investment.
- Exemption from the payment of Municipal Real Estate Sales Tax on properties constituting a relevant investment.
- Exemption from the payment of Stamp Duty in relation to the purchase of properties constituting a relevant investment.

As regards the second requirement, the RFAI complies with a discriminatory purpose since not only does it broaden the scope of the tax benefits applying to investment, through tax coverage for small investment projects, but it also differentiates between investments where their capacity to achieve the different objectives involved is concerned.

The selectivity requirement, which arises indivisible from the coherence requirement, highlights the temporary nature of the tax scheme as well as the strict supervision and a *posteriori* justification scheme, to be shared by the Directorate General of Taxes and the General Inspectorate of Finances. Thus, the scheme embraces severity exceptions, for large scale projects, and easiness exceptions, for small projects submitted by companies.

Complementing RFAI 2009 in the field of the Tax Benefits Code, a significant amendment to the tax scheme for holding companies is made, extending that scheme to corporations established in other Member States, as a result of the recent decision of the Court of Justice of the European Communities in case no. C-210/06 (Cartesio Judgement), of 16 December 2008. This is an important investment support measure that encourages the transfer of capital to the national territory, promoting an open regime with effective tax competitiveness.

Lastly, the scope of the tax incentive system for corporate research and development (SIFIDE) is expanded to permit 32.5% of research and development expenditure to be tax deducted, as well as increase the ceiling of the incremental rate, which rises from EUR 750 000 to EUR 1 500 000.

VAT Reverse-charge in the provision of goods and services to Public Administration

This measure, which requires approval by the European Council of the application for derogation submitted by the Portuguese State, benefits companies' cash situation, and consists of the State, Autonomous Regions, Local Councils and other legal entities governed by public law being obliged to settle and pay output tax instead of this being done by the suppliers (reverse charge), where it concerns goods and services supplied through public contracts equal to or greater than EUR 5000 in value.

This mechanism of reversing the taxable person will be applied to public entities already registered as a VAT taxable person as at the transaction date, even if such is the case only in regards to a small portion of their activities. In such circumstances, the suppliers of goods and services to legal persons governed by public law, under contracts governed by public law, will not refer to VAT in their invoices and will have no output tax. The public entities acquiring the goods and services calculate the respective VAT and pay the output tax, notwithstanding any deductions that they may be entitled to.

Reduction to the VAT reimbursement threshold

The measure aims to facilitate conditions for VAT taxable persons to apply for VAT reimbursements. Thus, under the current rules, when the respective tax credit does not last for more that 12 months, the minimum value to apply for reimbursement is around EUR 10 600 and, in very special cases, around EUR 5300. This measure creates one single, greatly reduced minimum value of EUR 3000.

Reduction to the advance tax payment

The minimum advance tax payment for corporate income tax is cut to EUR 1000 from EUR 1250. This measure aims to strengthen the cash flow of companies.

Measure 5 – Protecting employment and strengthening social protection

Protecting employment

The employer's contribution to Social Security in micro and small enterprises will be cut by 3 percentage points for workers aged over 45 years, in order to protect employment. This measure requires that employment will be maintained in 2009. The number of workers that this measure covers is estimated at 513 000, while the average value of the support is 331 euros per job.

Furthermore, a temporary (six month periods) and exceptional (2009) plan is adopted to support companies and workers in a situation of temporary decline in business (lay-off), namely through the Qualification-Employment measure - this support is estimated to cover 450 companies and 20 000 workers. This measure is aimed at protecting employment and raising qualifications in periods of extraordinary decline in business of companies that are economically viable and with strong prospects of the total recovery of productive capacity, and requires that employment will be maintained and that mass redundancies will not be undertaken. Profit-sharing and any increase in the compensation of members of the company bodies are prohibited in such companies in which this measure is implemented.

Support young people in access to employment

This is an objective that will be achieved by combining: (a) the creation of more than 12 000 professional training placements for young people, especially young higher education graduates in areas of low employability; and (b) the payment to the employer of recruitment aid totalling EUR 2000, plus exemption for 2 years relative to the payment of Social Security contributions for the recruitment of young people on an unlimited term contract (employers may alternatively opt for 3-years total exemption of the payment of contributions), wherein the net creation of employment for a period of three years is compulsory.

These temporary measures (only in force in 2009) are aimed at facilitating the transition to working life, by: (a) increasing the number of young people supported through professional placements to 37 000, allowing them to come into contact with the labour market and implying, for young people trained in fields of low employability, a period of training to ensure their reconversion; (b) providing financial support to companies that contract young people aged under 35 years seeking first employment, encompassing around 20 000 young people.

Support the return to work

The Government establishes the following, to support the return to work of the unemployed, particularly the long-term unemployed and the unemployed aged over 55 years:

- The payment to the employer of recruitment aid totalling EUR 2000, plus exemption for 2 years as regards the payment of Social Security contributions for the recruitment of long-term unemployed people (employers may alternatively opt for 3-years total exemption as regards the payment of contributions), wherein the net creation of employment for a period of three years is compulsory. This support is for employers that contract long-term unemployed persons on an unlimited term, full-time contract. It is estimated that this measure may benefit 8000 long-term unemployed persons.
- 50% cut in the rate of the employer's contribution to social security when an unemployed person aged over 55 years, unemployed for more than six months, is recruited on a fixed term contract. It is estimated that this measure may benefit 4000 unemployed persons.
- Creation of the new Qualification-Employment professional placement programme intended for unemployed persons to improve their qualifications, irrespective of their age. The beneficiaries of the measure are unemployed persons that have completed or will complete: i) basic or secondary education, particularly under the *Novas Oportunidades* initiative; ii) module-based training courses of at least 250 hours duration; iii) Technology Specialisation Courses; iv) new licentiate degrees. The programme consists of the payment of up to 60% of the remuneration for a period of nine months. It is estimated that this measure may benefit 10 000 unemployed persons.

- Support to the creation of 1600 new companies (and around 3000 new jobs) by unemployed persons, through the subsidised EUR 100 million credit line specifically created to this end.
- Support to the integration of 30 000 unemployed persons in not-for-profit institutions, through the Employment-Insertion Contract, for a maximum of one year. It is estimated that this measure may benefit 30 000 unemployed persons.
- Broadening of the supply of double certification courses (e.g. EFA and CET) to include unemployed persons in specific regions especially affected by unemployment. The application procedure is exceptional in nature, only occurring in 2009, and it is estimated that it may cover 5000 unemployed persons.

Expanding social protection

The Government will temporarily extend social support provided to long-term unemployed persons for those beneficiaries concluding in 2009 the time limit for entitlement to initial or subsequent unemployment assistance. The support will be equivalent to an additional 6-months entitlement to the benefit, equivalent in value to 60% of the Social Support Base Rate (plus 10% of the Social Support Base Rate per each child in the household, up to a maximum of 1x Social Support Base Rate). It is estimated that the measure may cover 50 000 beneficiaries.

Moreover, in situation of rapid return to the labour market (six months or less), the unemployed persons will maintain in full all previous contribution periods for the purpose of any future determination of the duration of an eventual unemployment benefits. The Government's aim is to strengthen the protection guarantees of unemployment, providing incentive for a quick return to work.

Chapter 3

III. General Government Balance and Debt

III.1 Budget Implementation in 2008 and State Budget for 2009

In July 2008, one year earlier than expected, the excessive deficit procedure Portugal was placed under in 2005 by the European Commission was closed. The budgetary consolidation process commenced in 2005 permitted a 3.5 p.p. of GDP fall in the general government budget deficit in only two years, which is an improvement of close to 1.2 p.p. of GDP on the figure forecast in the December 2005 update of the SGP. The reduction to expenditure and the increase in revenue both contributed to this result. In the expenditure field, the shrinkage of current primary expenditure by more than 0.5 p.p. stands out; while on the revenue side, the results obtained from the measures to combat tax and contribution fraud and evasion deserve to be highlighted.

It is estimated that the general government deficit in 2008, based on the budget implementation data currently available, is 2.2% of GDP. The budget target for 2008 had already been revised downwards, from the figure forecast in the December 2007 update of the Stability and Growth Programme, when the definitive budget implementation value for 2007 was announced (in March 2008). Thus, notwithstanding the worsening of the macroeconomic conditions during the second half of 2008, Portugal proceeded with the budgetary consolidation process.

Table III.1 shows that the improvement to the budgetary balance in 2008 resulted from the 0.6 p.p. increase in the primary balance to 0.8% of GDP. Tax revenue fell 0.1 p.p. of GDP, pushed by the decline in indirect taxes (down 0.3 p.p. of GDP), which was primarily due to the lower revenue from VAT as a result of the one percentage point reduction to the standard VAT rate, which came into force from July 2008. In contrast, contribution revenue grew 0.2 p.p. of GDP, driven by the fight against contribution evasion and fraud and by the recovery of the labour market, which reacted with a certain time lag to the developments of the goods and services market (see Chapter I)

On the expenditure side, the downward trend of compensation of employees in terms of GDP, initiated in 2005, was maintained. This trend has been obtained as a result of the application of the “2 out for every 1 in” rule, the control of salary drift and restraint in salary updates in the civil service. Social benefits increased by 0.2 p.p. of GDP, reflecting the development of public expenditure on pensions, which retained a slightly upwards trajectory, and the impact of the new social support measures taken in the interim. That growth is only partially offset by the fall in expenditure on unemployment benefits. Intermediate consumption rose by 0.3 p.p. of GDP in 2008, partly due to the change in the general government universe associated to the inclusion of new non-market enterprises.

Interest expenditure rose 0.2 p.p. of GDP in 2008 due to the increase in interest rates during the first half of the year and the increase of government debt stock. This growth in expenditure lessened the impact of the improvement to primary balance.

In terms of capital operations, receivable EU funds grew in importance, though an overlap of Community Support Framework III (QCAIII) and National Strategic Reference Framework (QREN) funds, and public investment increased. The reporting under national accounts of the dam concession transactions enshrined in the National Plan of High Potential Hydroelectric Dams, as a sale of State-owned assets, contributed 0.4 p.p. of GDP to reducing the relative weight of other capital expenditure reported in 2008. This Plan’s objective is to provide Portugal with a hydroelectric capacity of more than 7000 MW by 2020.

The frontloading of the implementation of this plan is one of the anti-cyclical measures taken by the Government.

Table III.1. General Government Accounts

	Million Euro			% of GDP			Difference (p.p. of GDP)	
	2007	2008	2009	2007	2008	2009	08/07	09/08
1. Tax Revenue	40 440.5	41 024.9	41 572.2	24.8	24.7	24.6	-0.1	-0.1
Taxes on Production and Imports	24 535.2	24 552.4	25 030.4	15.0	14.8	14.8	-0.3	0.0
Taxes on Income and Wealth	15 905.3	16 472.5	16 541.8	9.8	9.9	9.8	0.2	-0.1
2. Social Contributions	20 717.0	21 287.9	19 235.0	12.7	12.8	11.4	0.1	-1.4
of which: Actual Social Contributions	19 077.0	19 815.9	17 614.3	11.7	11.9	10.4	0.2	-1.5
3. Other Current Revenue	7 752.9	7 663.5	9 767.1	4.8	4.6	5.8	-0.1	1.2
4. Total Current Revenue (1+2+3)	**68 910.4**	**69 976.3**	**70 574.3**	**42.3**	**42.1**	**41.7**	**-0.2**	**-0.3**
5. Intermediate Consumption	6 754.8	7 440.2	7 706.7	4.1	4.5	4.6	0.3	0.1
6. Compensation of employees	21 059.3	21 305.7	18 717.9	12.9	12.8	11.1	-0.1	-1.7
7. Social Transfers	31 333.5	32 362.4	35 120.2	19.2	19.5	20.8	0.2	1.3
8. Interest Expenditure	4 591.6	5 047.6	5 626.0	2.8	3.0	3.3	0.2	0.3
9. Subsidies	1 900.9	1 874.2	3 209.6	1.2	1.1	1.9	0.0	0.8
10. Other Current Expenditure	3 260.0	3 583.5	3 910.2	2.0	2.2	2.3	0.2	0.2
11. Total Current Expenditure (5+6+7+8+9+10)	**68 900.2**	**71 613.6**	**74 290.7**	**42.2**	**43.1**	**43.9**	**0.8**	**0.9**
of which: Current Primary Expenditure (11-8)	**64 308.6**	**66 566.0**	**68 664.6**	**39.4**	**40.0**	**40.6**	**0.6**	**0.6**
12. Gross Saving(4-11)	**10.2**	**-1 637.3**	**-3 716.4**	**0.0**	**-1.0**	**-2.2**	**-1.0**	**-1.2**
13. Capital Revenue	**1 461.9**	**2 406.8**	**3 988.2**	**0.9**	**1.4**	**2.4**	**0.6**	**0.9**
14. Gross Fixed Capital Formation	3 761.9	3 912.0	4 820.5	2.3	2.4	2.9	0.0	0.5
15. Other Capital Expenditure	1 928.3	584.1	2 103.7	1.2	0.4	1.2	-0.8	0.9
16. Total Capital Expenditure (14+15)	**5 690.2**	**4 496.1**	**6 924.2**	**3.5**	**2.7**	**4.1**	**-0.8**	**1.4**
17. Total Revenue (4+13)	**70 372.3**	**72 383.1**	**74 562.5**	**43.2**	**43.5**	**44.1**	**0.4**	**0.6**
18. Total Expenditure (11+16)	**74 590.3**	**76 109.7**	**81 214.9**	**45.7**	**45.8**	**48.0**	**0.0**	**2.3**
of which: Total Primary Expenditure	**69 998.7**	**71 062.1**	**75 588.8**	**42.9**	**42.7**	**44.7**	**-0.2**	**2.0**
19. Net Lending/ Borrowing of General Government (17-18)	**-4 218.1**	**-3 726.7**	**-6 652.4**	**-2.6**	**-2.2**	**-3.9**	**0.3**	**-1.7**
of which: Primary Balance (19+8)	**373.5**	**1 321.0**	**-1 026.3**	**0.2**	**0.8**	**-0.6**	**0.6**	**-1.4**
Current Primary Balance(19+8-13+16)	**4 601.8**	**3 410.3**	**1 909.7**	**2.8**	**2.1**	**1.1**	**-0.8**	**-0.9**
20. Public Debt	**103 702**	**109 570**	**117 817**	**63.6**	**65.9**	**69.7**	**2.3**	**3.8**
Memo item:								
Nominal GDP	163 083	166 339	169 092					

Sources: INE (2007) and Ministry of Finance and Public Administration. (2008 and subsequent years).

It is to be noted in respect of actual social contributions and compensation of employees that the method for reporting the State's subsidy to *Caixa Geral de Aposentações* (CGA) was altered in the State Budget for 2009, though this change does not have any implication on the general government budgetary balance. The State's social contributions to CGA were recorded up to 2008 as a State subsidy to that entity, classified in full, on the expenditure side, as compensation of employees, and as actual social contributions on the revenue side. From 2009, following the decision to expand contributions to CGA to the services under the State's direct administration, the value equivalent to 7.5% of the gross compensation subject to deduction of the contribution is still recorded under actual social contributions. The remaining value, corresponding to the subsidy from the State to guarantee the funding of the CGA is reported under current transfers. The following table indicates the budgetary headings affected by this method change, adjusting the values of prior years (2007 and 2008) in accordance with the reporting method to be applied in 2009, so that comparability with the forecast 2009 general government account is possible.

Table III.2. General Government Accounts Adjusted to reflect the Change in the Method of Recording the State Subsidy to CGA

	Million Euro			% of GDP			Difference (p.p. of GDP)	
	2007	2008	2009	2007	2008	2009	08/07	09/08
Total Revenue	68 188.3	70 090.1	74 562.5	41.8	42.1	44.1	0.3	2.0
Current Revenue	66 726.4	67 683.4	70 574.3	40.9	40.7	41.7	-0.2	1.0
Social Contributions	18 533.0	18 995.0	19 235.0	11.4	11.4	11.4	0.1	0.0
of which: Actual Social Contributions	16 893.1	17 523.0	17 614.3	10.4	10.5	10.4	0.2	-0.1
Total Expenditure	72 406.4	73 816.8	81 214.9	44.4	44.4	48.0	0.0	3.7
Current Expenditure	66 716.2	69 320.7	74 290.7	40.9	41.7	43.9	0.8	2.3
Compensation of Employees	18 875.4	19 012.8	18 717.9	11.6	11.4	11.1	-0.1	-0.4

Source: Ministry of Finance and Public Administration.

In view of the exceptional circumstances existing in the current economic situation, marked by a heavy contraction of activity, and benefiting from the budgetary margin achieved by the budgetary consolidation process in the meantime, it was decided to strengthen the use of budgetary policy instruments to support investment and employment, considering the current economic climate. Thus, the Portuguese Government, in the context of the coordinated Europe-wide anti-cyclical effort, underlying the European Economic Recovery Plan, approved the Investment and Employment Initiative (IEI), which complemented the household and business support measures taken during 2008 (see Chapter II).

The impact of these measures on the budgetary balance will be temporary, and are expected to be concentrated in 2009, when the budget deficit is forecast at 3.9% of GDP. The resumption of the budgetary consolidation trajectory should occur from 2010. The structural adjustment of 1.6 p.p. of GDP in 2010 and 2011 jointly is greater than that forecast in the last SGP update.

Actual social contributions in 2009, removing the impact on national accounts associated to the change in the method of recording the State subsidy to CGA, should record a slowdown in growth (0.5%, compared to 3.7% the previous year) due to the temporary reduction of social contributions as a result of the employment support and the evolution of employment itself. This slowdown is partially offset by increased revenue from the fight against contribution fraud and evasion. The growth in revenue from income taxes is likewise expected to slow down, falling 0.1 p.p. in terms of GDP, also due to the economic slowdown. Revenue from taxes on production and imports are forecast to remain unchanged from 2008, in terms of share of GDP.

The increased importance of social transfers, subsidies to economic agents and public investment as a % of GDP (1.3 p.p., 0.8 p.p. and 0.5 p.p. of GDP, respectively) will essentially be generated by the anti-cyclical budgetary effort. These expenditure increases will be partially co-funded by the EU, and a frontloading of the provision of funds from the NSRF - both funds of a current nature (associated to the European Social Fund) and those taking the form of capital transfers - is forecast. Current operating expenditure of general government should record significant shrinkage as a result of the reforms in the Public Administration (see Chapter II.2), embodying a decrease of the share of GDP held by personnel expenditure (including too the impact of the method change for the recording of the State subsidy to CGA).

The decrease in the general government balance associated to the budgetary stimulation measures, as well as the financial asset acquisition operations (in the form of capital uplifts and loans granted under the Programme for the Extraordinary Settlement of the State's Debts) and the settlement of trade debts through their substitution for financial debt, led to a 3.8 p.p. of GDP increase to the general government debt to GDP ratio, which is forecast to reach 69.7% of GDP by the end of 2009, compared to 65.9% in 2008. The non-undertaking of initially established privatisation operations (due to the crisis in financial markets) as well as the effect of the budgetary measures impacting on the general government debt, such as the “Pay on Time” Programme and the settlement of the trade debts held by the hospitals of the National Health Service, will have heavily contributed to the increase in that ratio.

III.2 Medium-Term Budgetary Objectives

Following a budgetary consolidation process that should result in 2008 in the lowest budget deficit of the last 30 years, exceptional economic circumstances require that the focus in 2009 is on a strong anti-cyclical budgetary effort to support investment and employment, the most vulnerable households and the strengthening of financial stability. As soon as the recovery of economic conditions permits, the path to the Medium-Term Objective of a budgetary balance of -0.5% of GDP - at a deficit reduction rate of at least 0.5 p.p. of GDP per year - will be resumed.

Table III.3. General Government Account Projections
(% of GDP)

	Million Euro			% of GDP			Difference (p.p. of GDP)	
	2009	2010	2011	2009	2010	2011	08/07	09/08
1. Tax Revenue	41 572.2	42 903.6	44 789.2	24.6	24.6	24.8	0.0	0.1
Taxes on Production and Imports	25 030.4	26 130.0	27 181.2	14.8	15.0	15.0	0.2	0.0
Taxes on Income and Wealth	16 541.8	16 773.6	17 608.0	9.8	9.6	9.7	-0.2	0.1
2. Social Contributions	19 235.0	20 012.4	20 656.0	11.4	11.5	11.4	0.1	-0.1
of which: Actual Social Contributions	17 614.3	18 343.1	19 036.7	10.4	10.5	10.5	0.1	0.0
3. Other Current Revenue	9 767.1	9 332.3	9 625.6	5.8	5.4	5.3	-0.4	0.0
4. Total Current Revenue (1+2+3)	**70 574.3**	**72 248.3**	**75 070.8**	**41.7**	**41.5**	**41.5**	**-0.3**	**0.0**
5. Intermediate Consumption	7 706.7	8 086.9	8 296.3	4.6	4.6	4.6	0.1	-0.1
6. Compensation of employees	18 717.9	19 044.6	19 310.2	11.1	10.9	10.7	-0.1	-0.3
7. Social Transfers	35 120.2	36 294.0	37 485.9	20.8	20.8	20.7	0.1	-0.1
8. Interest Expenditure	5 626.0	5 853.3	6 071.3	3.3	3.4	3.4	0.0	0.0
9. Subsidies	3 209.6	1 847.2	1 901.2	1.9	1.1	1.1	-0.8	0.0
10. Other Current Expenditure	3 910.2	3 878.1	3 742.4	2.3	2.2	2.1	-0.1	-0.2
11. Total Current Expenditure (5+6+7+8+9+10)	**74 290.7**	**75 004.1**	**76 807.3**	**43.9**	**43.1**	**42.4**	**-0.9**	**-0.6**
of which: Current Primary Expenditure (11-8)	**68 664.6**	**69 150.7**	**70 735.9**	**40.6**	**39.7**	**39.1**	**-0.9**	**-0.6**
12. Gross Saving(4-11)	**-3 716.4**	**-2 755.8**	**-1 736.5**	**-2.2**	**-1.6**	**-1.0**	**0.6**	**0.6**
13. Capital Revenue	**3 988.2**	**3 703.8**	**3 856.0**	**2.4**	**2.1**	**2.1**	**-0.2**	**0.0**
14. Gross Fixed Capital Formation	4 820.5	4 128.9	4 486.8	2.9	2.4	2.5	-0.5	0.1
15. Other Capital Expenditure	2 103.7	1 891.6	1 742.6	1.2	1.1	1.0	-0.2	-0.1
16. Total Capital Expenditure (14+15)	**6 924.2**	**6 020.4**	**6 229.4**	**4.1**	**3.5**	**3.4**	**-0.6**	**0.0**
17. Total Revenue (4+13)	**74 562.5**	**75 952.1**	**78 926.8**	**44.1**	**43.6**	**43.6**	**-0.5**	**0.0**
18. Total Expenditure (11+16)	**81 214.9**	**81 024.5**	**83 036.7**	**48.0**	**46.5**	**45.9**	**-1.5**	**-0.6**
of which: Total Primary Expenditure	**75 588.8**	**75 171.2**	**76 965.3**	**44.7**	**43.2**	**42.5**	**-1.5**	**-0.6**
19. Net Lending/ Borrowing of General Government (17-18)	**-6 652.4**	**-5 072.4**	**-4 109.9**	**-3.9**	**-2.9**	**-2.3**	**1.0**	**0.6**
of which: Primary Balance (19+8)	**-1 026.3**	**781.0**	**1 961.5**	**-0.6**	**0.4**	**1.1**	**1.1**	**0.6**
Current Primary Balance(19+8-13+16)	**1 909.7**	**3 097.6**	**4 334.8**	**1.1**	**1.8**	**2.4**	**0.6**	**0.6**
20. Public Debt	**117 817**	**122 719**	**126 664**	**69.7**	**70.5**	**70.0**	**0.8**	**-0.5**
Memo item:								
Nominal GDP	169 092	174 189	180 948					

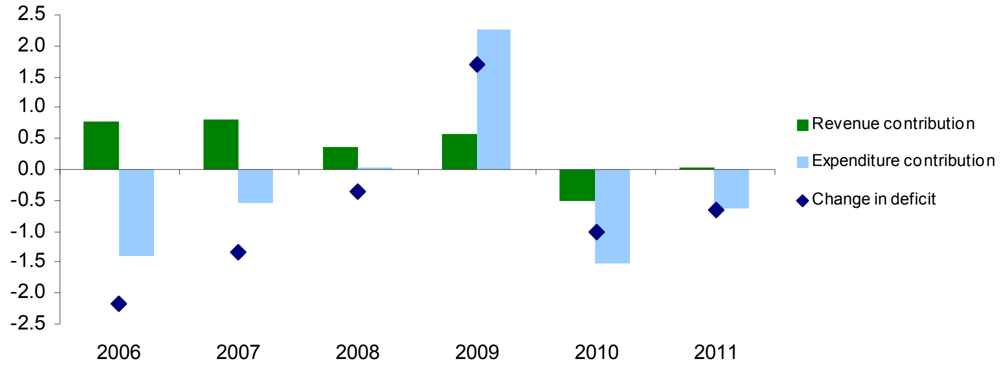
Source: Ministry of Finance and Public Administration.

Notable on the expenditure side is the decisive contribution from the structural reforms aimed at curbing personnel expenditure, such as the control of admissions using the two out for every one in rule and the new contractual ties, careers and remuneration scheme in the civil service. Other structural measures, in particular the reforms in the social security systems, will continue to impact on expenditure on social transfers in the medium and long-term, contributing to the sustainability of public finances.

The development of tax and contribution revenue was an important component of the budgetary adjustment process began in 2005. However, the decline in the collection of taxes in 2009, associated to the measures to fight the impact of the crisis and to economic slowdown will lead to its weight of GDP shrinking, which will again be reversed from 2010.

The consolidation profile followed since 2005 has concentrated on expenditure, especially current primary expenditure, and on revenue, mainly through the impact of the improved voluntary compliance by taxpayers and the good results achieved in the fight against tax and contribution fraud and evasion (Chart III.1). Following the temporary stoppage of the budgetary consolidation process that will occur in 2009, resumption of the path to the Medium-Term Objective will be primarily focus on the expenditure side.

Chart III.1. Budgetary Consolidation Programming
(Change as p.p. of GDP)



Sources: INE and Ministry of Finance and Public Administration.

Table III.4 illustrates the structural nature of the corrective action undertaken on the structural deficit to 2008, which was the year initially forecast for compliance with the deficit nominal rule. The decrease in 2006 was very significant (2 p.p. of GDP), which demonstrated the frontloading of adjustment. In 2007 and 2008, the structural deficit fell 0.9 p.p. and 0.5 p.p. of GDP, respectively. This evolution will be temporarily interrupted in 2009, due to the impact from the cyclical use of budgetary policy to combat the effects of the economic crisis and the action of automatic stabilisers. The recovery of budgetary consolidation in structural terms is expected from 2010, with a structural adjustment of 1.2 p.p. of GDP forecast for 2010 and 0.5 p.p. forecasts for 2011.

Table III.4. General Government Balances

	2005	2006	2007	2008	2009	2010	2011
Overall balance	-6.1	-3.9	-2.6	-2.2	-3.9	-2.9	-2.3
Primary balance	-3.5	-1.2	0.2	0.8	-0.6	0.4	1.1
Structural balance	-5.6	-3.6	-2.7	-2.2	-3.3	-2.1	-1.7
change (in p.p. of GDP)		*2.0*	*0.9*	*0.5*	*-1.1*	*1.2*	*0.5*
Structural primary balance	-3.0	-0.8	0.1	0.9	0.0	1.2	1.7
change (in p.p. of GDP)		*2.1*	*0.9*	*0.8*	*-0.8*	*1.2*	*0.4*

Note: The calculations of structural adjustments were made following European Commission methods.

Source: Ministry of Finance and Public Administration.

The general government debt to GDP ratio should increase in 2008, 2009 and 2010, after falling in 2007, due to the impact of the various measures that are implemented to combat the effects of the economic and financial crisis, in particular the programmes to settle the State's debts and the Investment and Employment initiative. The ratio is expected to fall from 2010, in harmony with the favourable growth of GDP and the primary balance.

Table III.5. General Government Debt Dynamics

(% of GDP)

	2007	2008	2009	2010	2011
General Government consolidated debt (% GDP)	63.6	65.9	69.7	70.5	70.0
Change in debt (p.p. of GDP)	-1.1	2.3	3.8	0.8	-0.5
Primary balance effect	-0.2	-0.8	0.6	-0.4	-1.1
Dynamic (Snow-ball) effect	-0.2	1.8	2.3	1.4	0.7
Interest effect	2.8	3.0	3.3	3.4	3.4
GDP nominal growth effect	-3.0	-1.2	-1.1	-2.0	-2.6
Other	-0.6	1.3	0.9	-0.2	-0.1

Sources: INE and Ministry of Finance and Public Administration.

Chapter

4

IV. Sensitivity Analysis and Comparison with the December 2007 Update

IV.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 ascendant 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, Chart IV.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 2009 and that the impact is permanent.

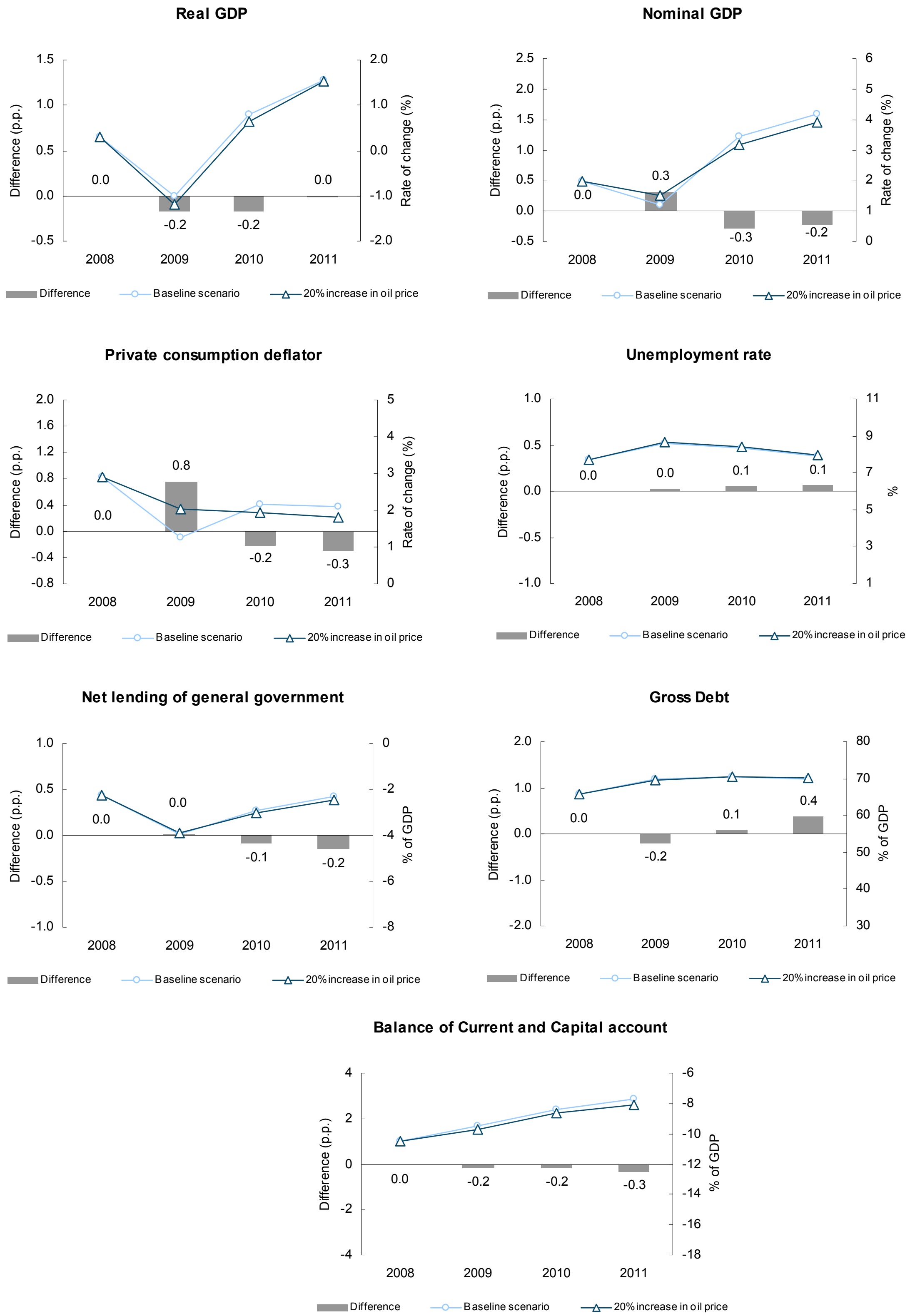
It is to be noted that the interpretation of the results produced by the sensitivity analysis undertaken must be considered against the backdrop of the current cyclical situation, where the evolution of the oil price and interest rates mirrors the reduced prospects of economic growth and worldwide demand, as well as the financial instability, bringing into question their validity as reactions to the exogenous shocks described.

The simulation indicates a negative impact on real GDP growth in 2009 and 2010, which is especially due to the adverse effects on domestic demand. This fall in real economic activity negatively impacts on the labour market, and a slight increase to the employment is observed over the entire projection horizon.

Nominal GDP, just like consumer prices, rises in 2009 compared to the baseline scenario, reflecting the impact on inflation. This movement reverses in subsequent years, 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, with a gradually higher impact over the forecast horizon.

As regards the impact on public finances, a slight improvement to the budgetary 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. Public debt, in harmony with this trend, shows a temporary improvement in 2009 on the baseline scenario, followed by a gradual increase over the rest of the forecast horizon.

Chart IV.1. Sensitivity Analysis to a 20% Increase in the Oil Price



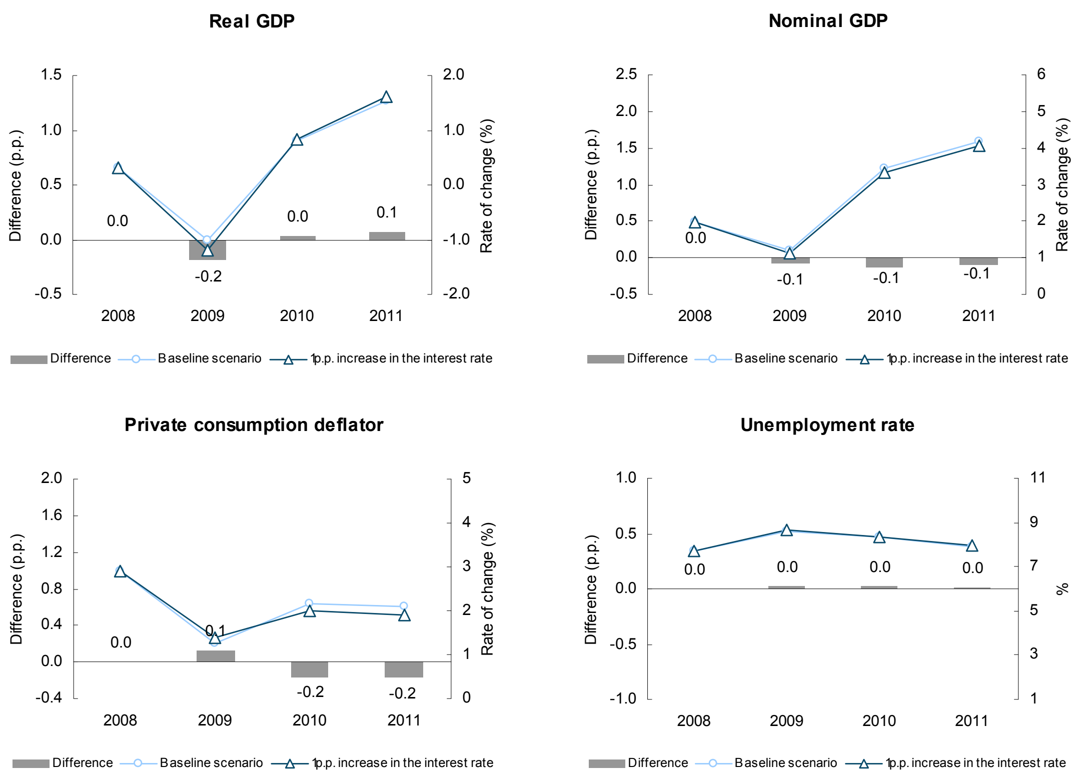
Source: Ministry of Finance and Public Administration.

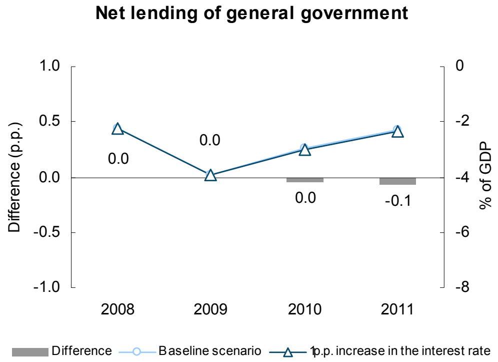
It is assumed in the simulation of the domestic economy's response to a scenario of higher interest rates that the short-term rates remain 1 p.p. above the value projected in the baseline scenario throughout the projection horizon. Chart IV.2 illustrates the main results of the projection in this new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

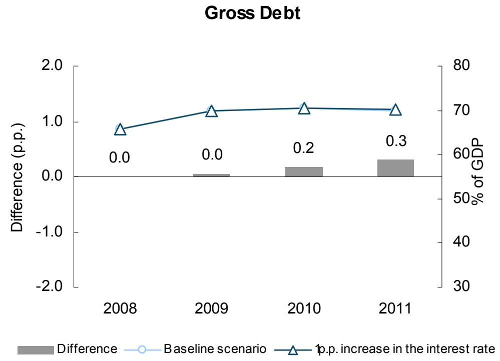
The adverse effects on the real growth of the domestic economy are limited to 2009 owing to a considerable contraction of domestic demand. The acceleration of consumer prices is also observed in this period. The adverse effects on the labour market are less than in the oil price shock scenario since the negative impact on real economic activity is exclusively confined to 2009.

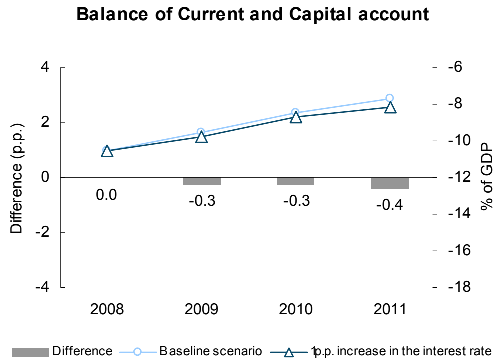
The negative impact of the higher interest rates on the external deficit is most notable through the higher value of interest paid abroad. This impact is most marked at the end of the projection horizon. The financial burdens associated to public debt are also higher than those of the baseline scenario, a situation that causes a worsening of the budget deficit between 2009 and 2010, and a consequent progressive decline of the level of public debt.

Chart IV.2. Sensitivity Analysis to a 1 p.p. Increase of the Short-term Interest Rate









Source: Ministry of Finance and Public Administration.

IV.2 Comparison with the December 2007 Update

The extraordinary circumstances that have moulded the current economic climate, causing an economic slowdown in 2008 and which should induce the contraction of the economy in 2009 have lead to the current update of the Stability and Growth Programme embracing a less favourable performance of the overall general government balance and public debt, compared to the December 2007 update (Table IV.1).

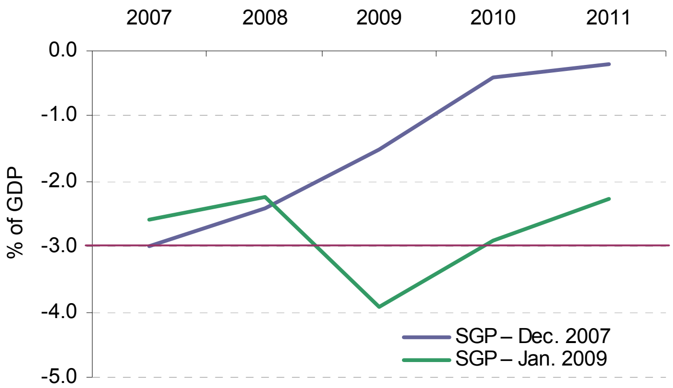
Table IV.1. Stability Programme – Comparison with the December 2007 Update

	2007	2008	2009	2010	2011
GDP (real growth rate in %)					
December 2007 update	1.8	2.2	2.8	3.0	3.0
January 2009 update	1.9	0.3	-0.8	0.5	1.3
difference	0.1	-1.9	-3.6	-2.5	-1.7
Net Lending/ Borrowing of General Government (% of GDP)					
December 2007 update	-3.0	-2.4	-1.5	-0.7	-0.2
January 2009 update	-2.6	-2.2	-3.9	-2.9	-2.3
difference	0.4	0.2	-2.4	-2.2	-2.1
General Government Debt (% of GDP)					
December 2007 update	64.4	64.1	62.5	59.8	56.7
January 2009 update	63.6	65.9	69.7	70.5	70.0
difference	-0.8	1.8	7.2	10.7	13.3

Source: Ministry of Finance and Public Administration.

The reduction to the values forecast for overall balance and general government debt in the period 2009 to 2011 reflects the impact on the budget and on debt of the current economic situation and the budgetary measures taken to stimulate the economy. The overall balance will, in 2009, temporarily exceed the reference value of 3% of GDP, and it will recover the preceding trajectory from 2010.

Chart IV.3. Overall Balance of General Government
(Comparison with December 2007 update)



Source: Ministry of Finance and Public Administration.

General government balance was also revised in structural terms, attaining a deficit of 3.1% of GDP in 2009, though it will return to the previously forecast consolidation path from 2010.

Table IV.2. Budgetary Prospects
(% of GDP)

	2007	2008	2009	2010	2011
Net Lending/ Borrowing of General Government					
SGP – Dec. 2007	-3.0	-2.4	-1.5	-0.4	-0.2
BPSR - May 2008	-2.6	-2.2	-1.5	-0.7	-0.5
SGP – Dec. 2008	-2.6	-2.2	-3.9	-2.9	-2.3
Structural Balance					
SGP – Dec. 2007	-2.1	-1.6	-1.1	-0.4	-0.4
BPSR - May 2007	-2.2	-1.8	-1.0	-0.5	-0.5
SGP – Dec. 2008	-2.7	-2.2	-3.1	-2.1	-1.7

Source: Ministry of Finance and Public Administration – Stability and Growth Programme, December 2007 Update and January 2009 Update and Budget Policy Steering Report, May 2008.

The general government debt to GDP ratio is higher than that established in the December 2007 update for the 2008 to 2011 period. This rise not only reflects the larger deficit compared to the previous update but also the arithmetic impact of the lower GDP growth, as well as, with reference to 2009, the adjustments already referred to in the previous section that impact on debt.

Chapter

5

V. Sustainability of Public Finances

The analysis presented herein is based on the methodology recommended by the Code of Conduct of the Stability and Growth Pact. In particular, the presented projections[5] use the assumptions defined in 2005 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. As a consequence of the reform of the public social security systems in Portugal, which came into force in 2007, the long-term projections for pension expenditure presented herein underwent the Peer Review process by the AWG in October 2007[6]. All other age-related expenditure maintained the trajectory defined by the AWG and the services of the European Commission in 2005[7].

Pension Expenditure Projection

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

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 (i.e. lower remuneration values have higher pension accrual rates).

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

Table V.1. Pension Expenditure
(% of GDP)

	2005	2010	2020	2030	2050	Change 2005-2050
Pre-reform (2006)	11.5	11.9	14.1	16.0	20.8	9.3
Post-reform (2007)	11.0	11.9	12.6	13.4	16.0	5.0

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

[5] In this chapter and in Table A.9 of the Annex.
[6] In actual fact, the projections were analysed in the AWG meeting of 4 October 2007, approved at the EPC meeting of 29 October and included in the December 2007 update of the Stability and Growth Programme.
[7] The AWG is currently drawing up new long-term projections concerning the age-related expenditures, to be published in 2009, and which incorporate the new demographic projections of EUROSTAT (Europop 2008, Convergence Scenario), among others.

Analysis of Sustainability Indicators

The pension expenditure trajectory determines the development of all age-related expenditure, despite being dampened by the impact of the reform measures (Table V.2).

Table V.2. Sustainability of Public Finances
(% of GDP)

	2005	2010	2020	2030	2050	Change 2005-2050
Age -related expenditure	24.3	24.7	25.3	26.0	29.6	5.3
Pensions	11.0	11.9	12.6	13.4	16.0	5.0
Health and Long-term Care (1)	7.2	7.3	7.2	7.2	8.1	0.9
Other (1)	6.1	5.5	5.5	5.3	5.6	-0.5
Revenue from social contributions (2)	9.8	9.8	9.4	9.2	9.3	-0.5

Notes: (1) In accordance with the 2005 projections of the AWG; (2) Includes actual social contributions to the Social Security and *Caixa Geral de Aposentações* systems.

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

Population ageing, which is caused by the combination of low fertility rates and higher average life expectancy, will double the ratio of the population aged over 65 years over the active population (15-64 years) to above 50% in 2050, which means a considerable increase in pensioners over the number of contributors. Furthermore, over the coming decades the social security system will achieve maturity, leading to pensions of relatively higher value since they correspond to complete contributory careers, whereas currently a significant percentage of new pensioners have incomplete contributory careers and, consequently, lower statutory pensions.

The development of general government expenditure on health and long-term care as a share of GDP grows in quite a restrained manner, while other population ageing-related expenditure, i.e. education and unemployment benefit expenditure, tend to reduce their share on GDP.

Thus, a 5 p.p. of GDP increase in age-related expenditure is forecast between 2005 and 2050, while contributions revenue contracts 0.5 p.p. of GDP. The gap between future general government expenditure and revenue can be gauged by the public finances sustainability indicators calculated by the European Commission and published in the 2006 Sustainability Report[8].

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

The indicator values obtained for Portugal are detailed in the following table[9].

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

[9] These indicators are usually constructed for two scenarios: one with the projection baseline year as a reference (assuming, in this particular case, that the structural primary balance remains unchanged at the 2007 level), and the other assumes compliance with the medium-term objective in 2010: -0.5% of GDP for the structural balance and 2.5% of GDP for the structural primary balance. Any one of the indicators can be broken down into the contribution of the initial budgetary position (IBP) and the long-term change resulting from the expenditure associated to the ageing of the

Table V.3. Sustainability Indicators
(% of GDP)

	S1	IBP	DR	LTC	S2	IBP	LTC
Baseline scenario 2007	**1.9**	0.2	0.0	1.7	**3.6**	0.4	3.2
Medium-term scenario	**0.2**	-1.4	-0.1	1.7	**2.0**	-1.2	3.2

Source: European Commission.

The continuing budgetary deficit in 2007, with a general government debt ratio slightly above the reference value, entailed a risk factor to long-term sustainability even before the cost associated to the ageing of the population (LTC) were equated. Nonetheless, the contribution from the latter component fell by around 3,.5 p.p. of GDP with the impact of the measures to reform the public social security system, permitting convergence with the European Union average. This result generated notable improvement in the sustainability indicators and, as has been recognised by the European Commission, Portugal went from being a high risk country to a medium risk country in terms of the sustainability of public finances, after those reform measures had been implemented.

Scenario of the Social Security Sustainability Report (State Budget for 2009)

The projections of the Report on the Sustainability of the Social Security attached as an annex to the State Budget for 2009 Report demonstrate that the financial sustainability of the Social Security Scheme is strengthened. The underlying scenario is based on a higher real GDP growth rate, namely 2% per year from 2030, while in the EPC's 2005 scenario a rate lower than 1% is used. Thus, according to those projections, the burden with pensions for those corresponding solely to the pensions of the Social Security's Contributive System follow a more restrained trajectory, as a percentage of GDP (Table V.4). The higher balances that are obtained permit an increased accumulation of assets in the Social Security Financial Stabilisation Fund (FEFSS), a fact that makes a positive contribution to the sustainability of public finances in Portugal.

Table V.4. Financial Prospects of Social Security
(Long-Term Macroeconomic Scenario of the Report on the Sustainability of the Social Security attached to the State Budget for 2009 Report)
(% of GDP)

	2008	2010	2020	2030	2050
Social Security Pension Expenditures	5.6	5.7	6.2	6.4	7.2
Social Contributions	7.7	8.2	8.3	8.3	8.3
Assets of Social Security Trust Fund	5.0	7.3	13.9	16.9	14.0

Note: (a) Expenditure corresponding to pensions of the contributive system.

Source: Ministry of Labour and Social Solidarity.

population (LTC). The S1 indicator also contains a component relative to the additional reduction of debt required to achieve the objective of 60% of GDP by 2050 (DR). See the December 2007 update of the Stability and Growth Programme for a more detailed explanation of these indicators.

VI. Quality of Public Finances

The investment in the quality of public finances, through fostering the long-term sustainability of public finances and the creation of a stable macroeconomic environment that facilitates economic growth, comprises the fundamental strategic guide steering budgetary policy.

Table VI.1 indicates the main measures taken to improve the quality of public finances (excluding budgetary consolidation measures) since the previous update of the Stability and Growth Programme, as well as those undergoing implementation.

Table VI.1. Medium-Term Measures Improving the Quality of Public Finances

Measure	Legislation	Description of the Measure
Management planning, control and evaluation in public services	Law no. 66-B/2007 of 28 December (SIADAP)	• Evaluation of Public Services (implemented) • Integration of services' evaluation into their annual management cycle (implemented) • Public services annually draw up a QUAR – Framework of Assessment and Accountability (implemented) • Publication of QUAR on the service's internet page (implemented)
New Governance System of the State-Owned Company Sector	Decree Law no. 300/2007 of 23 August; Resolution of Council of Ministers no. 70/2008 of 22 April; Decree Law no. 71/2007 of 27 March; Decree Law no. 167/2008 of 26 August	• New legislative framework (implemented) • Issue of strategic guidelines by the State for its corporate sector as a whole (implemented) • Issue of strategic guidelines by the State for State-owned companies (in progress) • Contracting the granting of state subsidies (in progress) • New economic and financial information system (implemented) • Financial information provided on a quarterly basis, instead of annually (in progress) • Establishment of debt ceilings for State-owned companies (in progress) • Launch of restructuring programmes for public transport companies (in progress)
Improved Competitiveness of the Tax System	Law no. 64-A/2008 of 31 December	• Creation of a general reduced rate bracket of corporate income tax (12.5%) applied to a basic taxable amount ceiling of EUR 12,500 (implemented) • Simplified accounting scheme (in progress) • Continued focus on the internet channel as a means of interaction with the taxpayer (in progress)
Programme Budgeting and Multi-Year Cycles	-	• The OECD Review of Budgeting in Portugal (concluded) • Implementation of three pilots in 2009: Cooperation Pilot, Integrated Continuous Care Network Pilot and the Social Services in Higher Education Pilot (in progress) • Establishment of the multi-year budgeting framework, defining expenditure ceilings (in progress)

Redesign Financial Management Processes in the Public Sector	-	• Redesign the financial processes in the different stages of the budgetary control and planning process – drafting the budget, budget implementation and reporting the accounts (in progress) • Introduce the accrual and analytical reporting of accounts – POCP, based on the RIGORE software (in progress)
Improve the Quality and Credibility of Information	-	• Progressive expansion of the universe and provision in good time of budget implementation data (in progress)
Pay on Time Programme	Resolution of Council of Ministers no. 34/2008 of 22 February; Decree Law no. 41/2008 of 10 March	• Monitoring and publishing the average payment duration of public entities (implemented) • Granting a total of around EUR 330 million in medium and long-term loans to the Autonomous Regions and local councils to pay debts to suppliers (implemented) • Simplification of budget amendment circuits through the decentralisation of competences from the Minister of Finance to the other ministers (implemented)
Programme for the Extraordinary Settlement of the State's Debts	Resolution of Council of Ministers no. 191-A/2008 of 27 November Decree Law no. 228/2008 of 25 November	• Payment of outstanding debts of national health service bodies and entities, totalling around EUR 1 billion (concluded) • Creation of a one-stop shop (implemented) which operates as the final instance to which private creditors of Central Government services may request the payment of outstanding debts (in progress, by 15 April 2009) • Granting a total of around EUR 1.25 billion in medium and long-term loans to the Autonomous Regions and local councils to pay debts to suppliers (in progress) • Reinforcing the monitoring and control of average payment durations (implemented)

Source: Ministry of Finance and Public Administration.

VI.1 Expenditure Efficiency and Effectiveness

The efficiency and effectiveness of public expenditure has benefited in recent years from the positive impact of the structural reforms implemented by the Government, with the aim of streamlining and eradicating waste in the use of public resources, in particular the reform of the management methods and rules in the Public Administration. The scale and depth of the implemented measures are tangible proof of the Government's strategic commitment to modernising the Public Administration, improving governance and human resource management quality, increasing the effectiveness and efficiency of the provision of the public service, and contributing to increasing the satisfaction of citizens and civil servants' motivation.

2009 will be the year in which the reforms carried out in the Public Administration will peak as they fully enter into force. Thus, a phase of intensified monitoring of the application of the different areas of reform is expected. Hence, the promotion and generalisation of the instruments to undertake management planning, control and evaluation in public services has been made a strategic goal of the Government.

Moreover, the implementation of the new governance system of the State-owned company sector makes an important contribution to the long-term sustainability of public finances.

Management Planning, Control and Evaluation in Public Services

The development of mechanisms for the planning, control and evaluation of activities facilitates the management of public resources and the creation of value, therefore the Government has set the bolstering and generalisation of their introduction as a strategic goal. Thus, the public services will reinforce their orientation towards management by objectives, the linking up of the current mechanisms for evaluating services, employees and managers, and also the capacity of management information systems to provide timely, relevant and reliable information that enables managers and staff to take the best possible decisions.

The new System for Management and Performance Evaluation of the Public Administration (SIADAP), approved by Law no. 66-B/2007 of 28 December, set forth new planning and control mechanisms for the activities of services, managers and workers, embodying an integrated approach to the management and evaluation systems and making the different services more accountable for their performance. The integrated management of performance translates into a management cycle in which the effective performance is measured, reported and evaluated, according to the goals that have been set, assuming a goal-focused form of management. The definition of the objectives is an important component of the process. The goals must meet a common set of characteristics, such as the clear definition of the beneficiaries of the service provided, they must be measurable, achievable, relevant, set out in a schedule and aligned with government policies, the mission and the management strategy. The new SIADAP comprises an important step towards a better implementation of Programme Budgeting.

The transparency of the process is deemed fundamental, allowing the criteria to be known and making the objectives and results visible to all, in addition to its inclusion in the annual report of activities published on the service’s internet site together with its QUAR (Framework of Assessment and Accountability). The QUAR has ensured its articulation with the instruments on which management planning and control in public services had previously been based – the activities’ plan, budget and report of activities. The QUAR introduced the evaluation component, which is fundamental to a more productive public service. The QUAR herald an unprecedented shift to a new management paradigm in the Public Administration, and in 2008, the first year of application, 98.3% of public services and bodies published their respective QUAR.

The implementation of robust information systems is essential to support this new methodology, as such systems are needed to provide relevant, reliable and timely data on performance. It is thus necessary to guarantee the upkeep of an ongoing performance monitoring system that can be audited by an external entity.

The New Governance System of the State-Owned Company Sector

The process of revising the legislative framework of the State-Owned Company Sector (SEE), marshalling the company’s activities into a framework of corporate streamlining, constant optimisation of efficiency levels, the quality of the service provided and economic, financial and environmental sustainability, has been an area of special focus for the Government, and its improvement encompasses an important contribution to the long-term sustainability of public finances.

Thus, the publication of Decree Law no. 300/2007 of 23 August set forth the revision of the legal scheme governing the SEE. The intention of this revision is to ensure an effective definition of the guidelines for this sector, with a view to its more rational, effective and transparent management, and the strengthening of the financial control mechanisms and the special information disclosure obligations of State-owned companies. The State's strategic guidelines for its corporate sector were defined in Council of Ministers' Resolution no. 70/2008 of 22 April. An example of this is the establishment of objectives for a universe of 24 companies that includes CGD, the five port administrations, *Carris, Sociedade de Transportes Colectivos do Porto*, TAP, *Transtejo*, RTP, CTT, AdP, *Estradas* de Portugal, ANA, NAV and *Parpública*.

Consistency between the legal scheme of SEE and the new Public Manager Regulations (Decree Law no. 71/2007 of 27 March) was also sought, promoting convergence with the figure of managing director of a private company, as stipulated in commercial law. This innovation accordingly places the emphasis on performance assessment, making the variable portion of the remuneration, if such exists, dependent on attaining pre-established objectives. The document also defines the need to comply with ethics and good practices rules.

Moreover, Ministerial Order no. 14277/2008 of 14 May, of the Minister of State and Finance, established that State-owned companies must disclose information for the purpose of financial control and monitoring, sending timely information to the Inspectorate General of Finance and the Directorate General of the Treasury and Finance through a new information system – (SIRIEF - System to collect economic and financial information, which came online in the second half of 2008). This measure promotes the curbing of public expenditure and discipline in the management of the available resources. Further in the financial reporting field, the more frequent provision of reports is envisaged, wherein reports are to be submitted on a quarterly basis from 2009.

A new legal scheme applying to the granting of state subsidies was implemented (Decree Law no. 167/2008 of 26 August). This new scheme introduces general and transparent criteria for the definition of the financial contributions funded by the State Budget and provided to entities developing general public interest services. The provision of the service of general public interest becomes based on a contract concluded with the State, which defines the parties' obligations, the contract term, the means of calculating the compensatory payments and the monitoring procedures and entities responsible for such.

Additionally, maximum debt ceilings for State-owned companies will begin to be set, taking into account the proposed investment plan, current debt levels and borrowing capacity, with the intention of ensuring increased financial management discipline, notably in relation to the optimisation of investment and financing decisions. As regards those State-owned public transport companies requiring medium to long-term financial restructuring operations, opportunities for the improvement of internal efficiency, in relations with the State (notably with reference to the contracting of the public service) and in the management of current debt will be identified and then set down in management contracts to be signed by the State in its capacity of shareholder and management boards. These measures aim to reduce the risk that the accumulation of negative financial results and debt by the State-owned companies may affect the sustainability of public finances.

The overall positive evolution encourages the continued reformist drive, wherein the priorities are maximising the return on equity, broader use of good governance principles, strengthening the financial monitoring and control of the companies, expanding the universe of companies with management by objectives set out in contract, and setting out the provision of the public service and the respective financial contributions in contract.

VI.2 Tax System

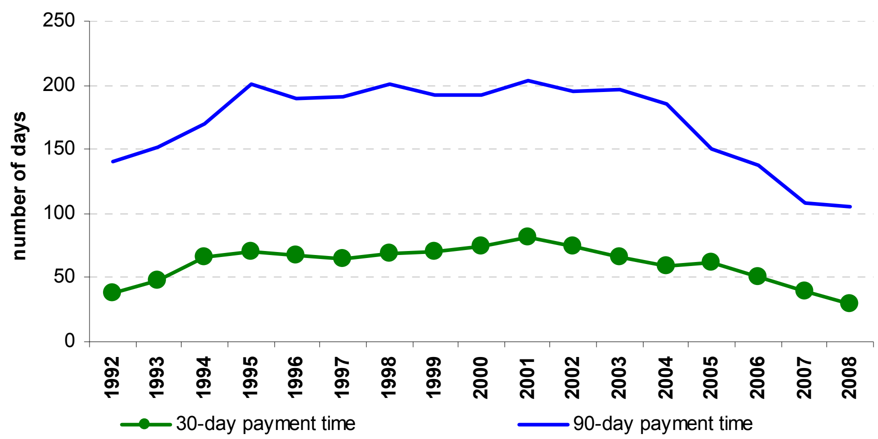
The tax system has been the focus of measures to support competitiveness, which contribute to the development of business activity, particularly in relation to the SME, as well as administrative simplification measures that cut the red-tape costs borne by taxpayers to comply with their tax obligations.

The State Budget for 2009 Law enshrines business support measures with special focus on the development of SME business, namely through the creation of a general reduced corporate income tax bracket (12.5%) for a basic taxable income up to 12 500 euros; the progressive abolition of the current simplified tax scheme by having no new admissions from 2009, with the establishment of a transitory scheme, and its substitution for the simplified accounting scheme; and the waiving of VAT exemption and consequent deduction of the VAT borne, in cases of subleasing in real estate leasing operations. These new tax measures supporting economic competitiveness complement others that the Government took in 2008, in particular cutting the standard rate of VAT from 21% to 20%, which came into force on 1 July.

Moreover, new simplification measures will be implemented, besides promoting quality in the assistance provided to taxpayers, focusing in particular on the Internet channel as a means of interaction.

The average VAT reimbursement time is a good indicator of the Tax Administration’s effort to improve service quality to taxpayers and, accordingly, reduce red-tape costs for business.

Chart VI.1. Average VAT Reimbursement Times



Source: Ministry of Finance and Public Administration.

VI.3 Institutions, Processes and Budget Rules

Strengthening the credibility, transparency and quality of public finances through the increase in the quality of the information available in the Public Administration is one of the core objectives underlying the Government’s definition of the rules associated to the process of drafting, implementing, monitoring and evaluating public bodies’ budgets. This effort currently embodies areas such as developing programme budgeting, redesigning the financial management processes in the public sector or improving the quality and credibility of general government statistics and the positive impact on budgetary discipline generated by such intervention contributes to the sustainability of public finances.

Programme Budgeting and the Multi-Year Cycle

Programme budgeting consists of a multi-year cycle of planning, programming, budgeting, controlling and assessing State's performance with a view to introducing, in a transparent manner and employing consistent indicators, a performance-based orientation to its execution.

The driving force for the establishment of programme budgeting based on a multi-year cycle with annual expenditure ceilings defined for the horizon of the governmental mandate is twofold: to foster budgetary discipline and increase the quality of public expenditure, raising its efficiency and effectiveness. The budget is no longer centred on resources but now focused on results. Thus, the definition in advance of the objectives associated to a specific body and respective indicators, which will subsequently permit the monitoring of the effectiveness of expenditure, is more important than determining the financial envelope to allocate each body. Thus, programme budgeting is a significant step in progressively aligning public management to performance, and it follows on the back of other initiatives, such as the implementation in the beginning of 2008 of the new version of the System for Management and Performance Evaluation of the Public Administration (SIADAP), supported by the Framework of Assessment and Accountability (QUAR).

It is essential, given its importance and complexity, that the definition of its methodology is founded on the best international practices, thus benefiting from the experience of programme budgeting implementation in other countries. It is also important that it is adapted to the specific resources and conditions of the Portuguese Public Administration. Hence, two important undertakings were effected in 2008, on the initiative of the Ministry of Finance and Public Administration: that carried out by the OECD (Review of Budgeting in Portugal) and that carried out by the Programme Budgeting Committee (COP), a structure of experts that has been analysing this subject and its transposition to the national situation since 2007 (see Box 1)

Box 1. Contributions by COP and OECD to Programme Budgeting

1 – RECOMMENDATIONS OF COP

COP is created by Order no. 3858-A/2007 of 1 March, of the Minister of State and Finance, and its primary mission is to draw up a proposal for structuring public expenditure on a programme budgeting basis, ensuring a multi-year approach as well as application of an expenditure rule. COP has made a series of recommendations, some of which have already been implemented in the form of pilots by a specific team with this purpose - the Working Party for the Implementation of Programme Budgeting (GTIPOP), created by Order no. 4639/2008 of 31 January, of the Minister of State and Finance. In October 2008, a chapter of the State Budget for 2009 was devoted to programme budgeting and its implementation, comprising three pilots: the Cooperation Pilot, Integrated Continuous Care Network Pilot and Social Services in Higher Education Pilot, with costs in 2009 of EUR 162.9, EUR 183.8 and EUR 228.6 million, respectively.

This committee makes the following recommendations, as regards the definition of a methodology and programme budgeting implementation and monitoring plan in Portugal:

A. Methodology

The proposed methodology of COP introduces three major innovations:

- Focus on results: the programme's strategic goals must reflect the intended results in an objective and measurable manner, therefore the budgeting of a programme should be informed by recent performance and complemented by a performance evaluation.

- A multi-year budgeting framework: implying financial programming for the government mandate, and establishing it as a strategic planning tool that imposes a medium-term perspective on the State's action. This concept envisages the definition of goals in an extended timeframe, founded on the development over time of actions deemed essential to that end. The main advantage is that an insight is provided into the expenditure areas that will be a priority over the term in office, requiring greater discipline, accountability and transparency in formulating goals.
- Expenditure rules: the creation of an expenditure rule consists of each Government, at the start of the term in office, compulsorily committing to annual expenditure ceilings for that term.

B. Control of Budget Implementation

Considering the pilots that were implemented, the follow-up and monitoring will be carried out in 2009. The coordinator of each Pilot is responsible for the financial evaluation and compliance with the proposed results. This appraisal will consist of evaluating the effectiveness of the performance of the actions compared to the defined objectives, and explaining any divergence from the targets set out. The purpose for the existence of the figure of a coordinator in the political and institutional spheres is to foster better harnessing of human and financial resources.

Since this is a pilot phase, the multi-year targets established for each one of the indicators of the different pilots must be considered indicative and for orientation purposes. This phase is to be used to define / construct / utilise management instruments that permit the fine-tuning of the analysis process, a task that is just as important as achieving a certain target. This intervention in the analysis process will facilitate the identification of the cause of variations to targets and the implementation of the necessary corrective measures, thus developing the analytical capacities that may make the generalisation of the application of the methodology possible.

2 – RECOMMENDATIONS OF THE OECD

The OECD, through its Review of Budgeting in Portugal, carried out in 2008, recognises the work done and steps taken in Portugal towards the adoption of programme budgeting, and it considers that there is still a way to go in the reform of the budgeting process, a component part of the broader process of reform of the Public Administration. The steps still to be implemented are: the profound revision of the public sector's financial management processes, the definition of a multi-year budgeting framework, the creation of mechanisms that permit more reliable and prudent macroeconomic projections or the creation of conditions to ensure the accountability of ministries, which must shoulder the principal responsibility for budget implementation and the management of the programmes.

In this analytical work, the OECD, based on experiences in other countries, makes a series of recommendations covering programme budgeting's entire life cycle, ranging from the definition and implementation of the methodology to controlling its execution:

A. Methodology

- A medium-term budgeting framework: a multi-year expenditure framework is needed to lend stability and credibility to the budgetary objectives, allowing the establishment of detailed multi-year estimates for all ministries and programmes for the baseline year plus three years out. This medium-term perspective will improve economic forecasting capability;
- Performance budgeting: changes that guarantee greater transparency of the budget are necessary. Focusing

on programmes will raise public understanding of the manner in which public money is being used. The investment budget (PIDDAC) should be integrated with the operating budget by programme. Summary information on investments should include approved levels and remaining commitments. Information on public-private partnerships (PPP) should include risk analyses for all PPP over their lifetime;

- Performance management: according to the OECD, the methodology to be used should be simple, using information on performance as an additional (not determining) element on which to base decisions or the assessment. It is essential that the management of the programmes focuses on indicators and not targets, placing emphasis on the development of relevant information and not on the objective of achieving targets “at any cost”;
- Independent panel to review macroeconomic scenarios: the creation of a panel of independent experts to review the Government’s macroeconomic scenarios would increase its credibility;
- Expenditure rule: the adoption of an expenditure rule would help to promote budgetary discipline. It is important that the rule is as simple and as comprehensive as possible, to ensure it is effectiveness;
- Accountability: it is necessary that broad support for the reforms is obtained/guaranteed from the main political agents with responsibilities in this area – the Government, Portuguese Parliament and main opposition leaders –, and from senior and middle management of the Public Administration. It is further important to find and disseminate good practices and foster broad debate on the work of COP and the OECD as regards budget reform, before deciding on the specific design of the programme budgeting model;
- Involving other structures: it is suggested that Parliament and the Parliamentary Budget Technical Unit should be involved, and that the role of parliamentary committees in the budgeting process should be revised;
- Creation of the necessary conditions: the creation of a structure within ministries to accompany programme budgeting is suggested. Such a structure would be connected to the financial controllers and to the Office of Planning, Strategy, Assessment and International Relations (GPEARI) of each ministry. The implementation of accrual accounting across government is also suggested.

B. Implementation

Given the complexity of adopting programme budgeting, the OECD advises:

- The definition of a realistic implementation calendar, taking into consideration that it is a long-term process involving trial and error that requires heavy investment in capability as well as other fields, such as the adaptation of information systems. This reform must be considered the first step of a lengthy process, involving learning by doing;
- The step-by-step implementation of programme budgeting. The first stage consists of the development of a programme budget and a multi-year expenditure framework; the second stage involves the development of meaningful performance information for programmes and ministries, and the design and implementation of the necessary information systems; the third stage is the integration of performance information into budgetary decision-making;
- By 2010, a broadly consensual political decision on the design of the new budgeting system should be made; an implementation plan should be set, including a timetable of the different steps that must be taken for the transition to the steady-state; a limited number of pilots should be up and running (already in progress in the State Budget for 2009).

C. Control of Budgetary Implementation

The OECD has the following recommendations on implementation control for the various entities involved in programme budgeting:

Portuguese Parliament:

- Extension of the period of time for debating the budget in Parliament to at least three months, to ensure sufficient time for Parliament to review and make decisions;
- The Parliamentary Budget and Finances Committee should change its approach to one approving the overall results, leaving the role of detailed analysis of the budget allocations, performance indicators and results of individual programmes to the sectoral committees.

Ministries**:**

- Make ministries responsible for the execution of the budget and management of the programmes (each minister becomes his/her own minister of finance);
- Strengthen the accountability of the sectoral ministries vis-à-vis how they fulfil their new financial management duties;
- Each ministry should have a financial department, which is responsible for budget implementation and monitoring programme budgeting within that ministry;
- The programme coordinators must likewise report to their respective minister;
- It is also feasible that inter-ministerial committees are created to supervise and analyse performance.

Government**:**

- Political involvement can embrace periodic reporting of the progress achieved, by the group coordinator of the programme budgeting, to the Minister of Finance or the Prime Minister.

The Government considers that the gradual introduction of programme budgeting permits a learning process of the methodological principles associated, providing greater benefits than what would be obtained from an immediate 100% implementation. Moreover, the adoption of programme budgeting implies changes to law and modus operandi, namely the redesign of financial management processes in the public sector, and the complexity of such makes implementation time-consuming.

The start of a new mandate in 2009 means that the appropriate conditions for the development of this reform are now in place, thus allowing the new Government to implement a multi-year financial programme for the mandate, whereby it commits to complying with the annual expenditure ceilings it has set itself. Thus, the legislative instruments needed to establish the multi-year budgeting framework in law will be developed in 2009, namely the revision of the Budget Framework Law. This is an essential strategic planning tool since it imposes a medium-term perspective on the State's action. This concept envisages the definition of objectives in an extended timeframe, founded on the development over time of actions deemed essential to that end. The main advantage is that an insight is provided into the expenditure areas that will be a priority over the mandate, requiring greater discipline, accountability and transparency in formulating the objectives. In the current context, where budgetary policy is exceptionally and temporarily used in an anti-cyclical effort, the existence of planning and control mechanisms of this nature is fundamental, strengthening the opportunity for the implementation of this reform.

Redesining the Financial Management Processes in the Public Sector

The current financial management processes in the public sector are out of step with the best financial management practices and the capabilities offered by information and communication technology. The redesign of the financial processes and circuits in the different stages of the planning and budget control stages – drawing up the budget, budgetary implementation and reporting the accounts – thus arises as a priority for the upcoming years. It should take into account the best practices and be based on a multi-year expenditure framework, on the transparency of processes and on management independence and accountability for the results.

The target established, in order to increase cost control, to create management decision-making support information and to strengthen transparency in the management of public money and the financial relations of the State, is the accrual and analytical reporting of accounts under the POCP (Official Public Accounting Plan), through the RIGORE software, by 50 integrated services of the State's Direct Administration, by 2010.

Improve the Quality and Credibility of Information

The improvement of the quality and credibility of information is crucial to the transparency of public accounts and the timely control of budget implementation. Policies fostering transparency and improvement to the quality of the statistics of public finances have impacted on the progressive widening of the universe and timeliness of the information. Thus, it has been possible to publish:

Monthly:

- Information on budget implementation by the State;
- Information concerning the other Autonomous Services and Funds;
- Information on implementation by Social Security account;
- Information on implementation by *Caixa Geral de Aposentações.*

Quarterly:

- Information concerning the National Health Service;
- Information on budget implementation by Local and Regional Government;
- Average payment duration to suppliers of public entities;
- Financial and non-financial quarterly national accounts estimates, and general government debt.

Annually:

- Publication of the list of creditors of the State;
- Financial information of the State-owned company sector and Evaluation Report on Good Governance Principles;
- Report on Public-Private Partnerships.

VI.4 Impact of Public Finances on Market Functioning

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

In this area, the Government is implementing the Pay on Time Programme and the Programme for the Extraordinary Settlement of the State's Debts.

Pay on Time Programme

The objective of the "Pay on Time" Programme, approved by Council of Ministers' Resolution no. 34/2008 of 22 February, is the structural and significant reduction of payment duration practised by public entities to suppliers of goods and services, striving to improve the business environment, reduce financing and transaction costs, introduce greater transparency in the settlement of prices and create conditions for healthier competition.

Thus, the comprehensive monitoring and publication of the average payment duration of public entities was guaranteed for the first time, based on existing account reporting systems, thereby permitting greater transparency and better understanding of the payment practices of public entities. The average payment duration of general government in 2007 was, based on provisional data available in April 2008, 96 days.

Mechanisms to substitute debts to suppliers for medium and long-term loans, with the aim of altering the financing structure, were established for the autonomous regions and municipal councils. Thus, autonomous regions and municipal councils that complied with the eligibility criteria defined in the Programme were able to apply for medium and long-term funding intended solely for paying short-term debts to suppliers. Loans totalling around EUR 330 million were contracted through this Programme in 2008, thus contributing to the reduction of the average payment duration.

Furthermore, the budget amendment circuits were simplified through the decentralisation of competences from the Minister of Finance to the other ministers, which was enacted in the Decree Law on Implementation of the Budget for 2008.

Programme for the Extraordinary Settlement of the State's Debts

More recently the Government has sought, considering the current international economic situation, which creates added difficulties for businesses to access financing, especially the SME, to strengthen the guarantee of payment to private creditors of the outstanding debts held by the services and bodies directly and indirectly administered by the State, the autonomous regions and municipal councils, by creating the Programme for the Extraordinary Settlement of the State's Debts to suppliers (Council of Ministers Resolution no. 191-A/2008 of 27 November).

Accordingly, the Ministry of Finance and Public Administration created a one-stop shop that operates, extraordinarily, as the final instance where private creditors of Central Government services may request the payment of outstanding debts. The debts tied to applications made at the one-stop shop will be paid over the first few months of 2009, and the conclusion of the process is estimated for 15 April.

As regards the institutions and services of the National Health Service (NHS), the NHS Payment System Support Fund underwent restructuring to broaden its scope (Decree Law no. 228/2008 of 25 November). Around EUR 600 million was injected into the fund, and still in 2008 the institutions and services of the NHS paid close on EUR 1 billion in outstanding debts to suppliers.

The opening of a medium and long-term credit line for the autonomous regions and municipal councils to pay debts to suppliers was also significant. The total value of this credit facility, including the bank financed tranche, can rise to EUR 1.25 billion. The loan application period occurred until 15 January 2009, and it is expected that the first payments to creditors may occur before the end of the first quarter.

Lastly, the monitoring and control of average payment duration was strengthened through the establishment of penalty measures for services with extensive average payment duration and the introduction of measures that reinforce the transparency framework for information disclosure duties.

ANNEX

Statistical Tables

Table A.1. Macroeconomic Prospects

	ESA Code	2007	2007	2008	2009	2010	2011
		Level (10^6 euros)	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP[1]	B1*g	158414.5	1.9	0.3	-0.8	0.5	1.3
2. Nominal GDP	B1*g	163083	4.9	2.0	1.7	3.0	3.9
Components of real GDP							
3. Private Consumption expenditure	P.3	103231.4	1.6	1.2	0.4	0.6	1.0
4. Government Consumption expenditure	P.3	32136.1	0.0	-0.3	0.2	0.1	-0.1
5. Gross fixed capital formation	P.51	34819.8	3.1	-0.8	-0.9	-0.3	1.7
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P53	798.9	0.3	0.3	0.3	0.3	0.3
7. Exports of goods and services	P.6	51803.0	7.5	0.1	-4.4	1.9	3.1
8. Imports of goods and services	P.7	64374.7	5.6	1.0	-1.3	1.3	1.7
Contributions to real GDP growth							
9. Final domestic demand		-	1.8	0.7	0.2	0.5	1.0
10. Changes in inventories and net acquisition of valuables	P.52 + P53	-	0.0	0.1	0.0	0.1	0.0
11. External balance of goods and services	B.11	-	0.1	-0.4	-0.9	0.1	0.3

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

Table A.2. Price Developments

	ESA Code	2007	2008	2009	2010	2011
		rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		2.9	1.6	2.4	2.5	2.5
2. Private consumption deflator		2.7	2.9	1.2	2.0	2.0
3. HICP		2.4	2.6	1.2	2.0	2.0
6. Export price deflator (goods and services)		2.7	3.3	2.1	3.0	3.0
7. Import price deflator (goods and services)		1.4	6.7	-0.7	2.6	2.4

Table A.3. Labour Market Developments

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment (thousand individuals)		5124.6	0.0	0.6	-0.7	0.1	0.3
2. Employment (thousand individuals, adjusted with hours worked)		4903.0	-0.1	0.6	-0.7	0.1	0.3
3. Unemployment rate (%)			8.0	7.7	8.5	8.2	7.7
4. Labour productivity, persons (10^3 euros)[1]		25.7	1.9	-0.3	-0.1	0.5	1.0
5. Labour productivity (10^3 euros, adjusted with hours worked)		26.9	2.0	-0.3	-0.1	0.5	1.0
6. Compensation of employees (10^6 euros)	D.1	80163.8	3.1	4.4	1.5	2.2	2.6
7. Compensation per employee		19.3	3.4	3.6	2.1	2.0	2.2

[1] GDP (2000 prices) per worker.

Table A.4. Sectoral Balances

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-8.7	-10.5	-9.2	-8.4	-7.6
of which: - Balance on goods and services		-7.4	-9.2	-9.0	-8.8	-8.2
- Balance of primary incomes and transfers		-2.6	-2.8	-1.7	-1.1	-0.9
- Capital account		1.3	1.6	1.5	1.5	1.5
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	-6.1	-8.3	-5.3	-5.5	-5.3
3. Net lending/borrowing of general government	B.9	-2.6	-2.2	-3.9	-2.9	-2.3

Table A.5. General Government Budgetary Prospects

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-4218	-2.6	-2.2	-3.9	-2.9	-2.3
2. Central government	S.1311	-5216	-3.2	-3.1	-4.6	-3.1	-2.5
3. Local government	S.1313	-132	-0.1	0.0	0.0	0.0	0.0
4. Social security funds	S.1314	1130	0.7	0.8	0.6	0.2	0.1
General government (S13)							
5. Total revenue	TR	70372	43.2	43.5	44.1	43.6	43.6
6. Total expenditure	TE	74590	45.7	45.8	48.0	46.5	45.9
7. Net lending/borrowing	EDP B.9	-4218	-2.6	-2.2	-3.9	-2.9	-2.3
8. Interest expenditure	EDP D.41	4592	2.8	3.0	3.3	3.4	3.4
9. Primary balance		374	0.2	0.8	-0.6	0.4	1.1
10. One-off and other temporary measures		0	0.0	0.0	0.0	0.0	0.0
Selected components of revenue							
11. Total taxes (11=11a+11b+11c)		40450	24.8	24.7	24.6	24.6	24.8
11a. Taxes on production and imports	D.2	24535	15.0	14.8	14.8	15.0	15.0
11b. Current taxes on income, wealth, etc	D.5	15905	9.8	9.9	9.8	9.6	9.7
11c. Capital taxes	D.91	10	0.0	0.0	0.0	0.0	0.0
12. Social contributions	D.61	20717	12.7	12.8	11.4	11.5	11.4
13. Property income	D.4	1202	0.7	0.7	0.7	0.7	0.7
14. Other (14=15-(11+12+13))		8003	4.9	5.3	7.4	6.8	6.7
15=5. Total revenue	TR	70372	43.2	43.5	44.1	43.6	43.6
p.m.: Tax burden (a) (D.2+D.5+D.61+D. 91-D.995)		59527	36.5	36.6	35.0	35.2	35.3
Selected components of expenditure							
16. Compensation of employees + intermediate consumption	D.1+P.2	27814	17.1	17.3	15.6	15.6	15.3
16a. Compensation of employees	D.1	21059	12.9	12.8	11.1	10.9	10.7
16b. Intermediate consumption	P.2	6755	4.1	4.5	4.6	4.6	4.6
17. Social payments (17=17a+17b)		31334	19.2	19.5	20.8	20.8	20.7
17a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	6621	4.1	4.1	4.6	4.6	4.6
17b. Social transfers other than in kind	D.62	24713	15.2	15.3	16.2	16.3	16.2
18.=8. Interest expenditure	EDP D.41	4592	2.8	3.0	3.3	3.4	3.4
19. Subsidies	D.3	1901	1.2	1.1	1.9	1.1	1.1
20. Gross fixed capital formation	P.51	3762	2.3	2.4	2.9	2.4	2.5
21. Other (21=22-(16+17+18+19+20))		5188	3.2	2.5	3.6	3.3	3.0
22=6. Total expenditure	TE	74590	45.7	45.8	48.0	46.5	45.9

(a) Excluding imputed social contributions (D612).

Table A.6. General Government Debt Developments

% of GDP		2007	2008	2009	2010	2011
1. Gross debt		63.6	65.9	69.7	70.5	70.0
2. Change in gross debt ratio		-1.1	2.3	3.8	0.8	-0.5
Contributions to changes in gross debt						
3. Primary balance		-0.2	-0.8	0.6	-0.4	-1.1
4. Interest expenditure		2.8	3.0	3.3	3.4	3.4
5. Stock-flow adjustment		-0.6	1.3	0.9	-0.1	-0.1
of which: - Differences between cash and accruals						
- Net accumulation of financial assets		-0.8	-0.1	0.1	-0.4	-0.2
of which: - privatisation proceeds		0.5	0.3	0.6	0.3	0.2
- Valuation effects and other						
p.m. implicit interest rate on debt		4.6	4.9	5.1	5.1	5.0

Table A.7. Cyclical Developments

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Real GDP growth (%)		1.9	0.3	-0.8	0.5	1.3
2. Net lending of general government	EDP B.9	-2.6	-2.2	-3.9	-2.9	-2.3
3. Interest expenditure	EDP D.41	2.8	3.0	3.3	3.4	3.4
4. One-off and other temporary measures		0.0	0.0	0.0	0.0	0.0
6. Output gap		0.3	-0.1	-1.4	-1.8	-1.3
7. Cyclical budgetary component		0.1	-0.1	-0.6	-0.8	-0.6
8. Cyclically-adjusted balance (2-6)		-2.7	-2.2	-3.3	-2.1	-1.7
9. Cyclically-adjusted primary balance (2+3-6)		0.1	0.9	0.0	1.2	1.7
10. Structural balance (7-4)		-2.7	-2.2	-3.3	-2.1	-1.7

Table A.8. Divergence from Previous Update

	ESA Code	2007	2008	2009	2010	2011
Real GDP growth (%)						
Previous update		1.8	2.2	2.8	3.0	3.0
Current update		1.9	0.3	-0.8	0.5	1.3
Difference		0.2	-1.9	-3.5	-2.4	-1.7
General government net lending (% of GDP)	EDP B.9					
Previous update		-3.0	-2.4	-1.5	-0.4	-0.2
Current update		-2.6	-2.2	-3.9	-2.9	-2.3
Difference		0.4	0.2	-2.4	-2.5	-2.1
General government gross debt (% of GDP)						
Previous update		64.4	64.1	62.5	59.7	56.7
Current update		63.6	65.9	69.7	70.5	70.0
Difference		-0.8	1.7	7.2	10.7	13.3

Table A.9. Long-term Sustainability of Public Finances

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	43.1	47.8	44.7	44.6	44.8	50.5
Of which: age-related expenditures	20.0	24.3	24.7	25.3	25.9	29.7
Pension expenditure	8.4	11.0	11.9	12.6	13.4	16.0
Social Security subsystem	5.6	7.0	7.6	8.3	9.1	13.2
Old-age and early pensions	3.8	5.1	5.7	6.5	7.4	10.9
Other pensions (disability, survivors)	1.8	1.9	1.9	1.8	1.8	2.3
Civil servants subsystem (CGA)	2.8	3.9	4.3	4.3	4.2	2.8
Health care	5.3	6.7	6.8	6.7	6.6	7.2
Long-term care *(this was earlier included in the health care)*	0.3	0.5	0.5	0.5	0.6	0.9
Education expenditure	5.1	5.1	4.7	4.7	4.5	4.8
Other age-related expenditures	0.9	1.0	0.8	0.8	0.8	0.8
Interest expenditure	3.0	2.6	2.7	2.0	1.6	3.5
Total revenue	40.7	42.1	44.8	44.8	44.7	44.7
Of which: property income	0.5	0.5	0.6	0.6	0.5	0.5
of which: from pensions contributions (or social contributions if appropriate)	9.4	9.8	9.8	9.4	9.2	9.3
Pension reserve fund assets	2.5	4.2	6.0	7.0	5.5	-35.3
Of which: consolidated public pension fund assets (assets other than government liabilities)	0.7	1.9	2.8	3.2	2.5	-16.2
Assumptions						
Labour productivity growth	1.1	0.4	2.1	2.5	1.7	1.7
Real GDP growth	3.9	0.5	2.4	2.2	1.0	1.0
Participation rate males (aged 20-64)	85.2	85.5	86.5	86.8	85.9	86.3
Participation rates females (aged 20-64)	68.4	72.4	75.1	77.7	78.2	79.1
Total participation rates (aged 20-64)	76.6	78.8	80.7	82.3	82.1	82.7
Unemployment rate	4.1	7.4	5.4	5.3	5.3	5.2
Population aged 65+ over total population	16.4	17.0	17.7	20.3	24.3	31.9

(a) Valores a partir de 2005 com base nas projecções do CPE e dos serviços da Comissão Europeia. (b) Hipóteses consideradas no exercício do GTE de Outubro de 2007.

Table A.10. Basic Assumptions

	2007	2008	2009	2010	2011
Short-term interest rate (annual average)	4.3	4.6	2.2	2.8	2.8
Long-term interest rate (annual average)	4.4	4.6	4.2	4.4	4.1
USD/€ exchange rate (annual average)	1.37	1.47	1.34	1.33	1.33
Nominal effective exchange rate (annual change)	0.8	1.3	-1.6	0.0	0.0
World excluding EU, GDP growth	5.2	3.9	2.4	3.6	4.4
EU GDP growth	2.8	1.4	0.2	1.1	1.5
Growth of relevant foreign markets	5.5	2.5	-2.8	1.3	2.1
World import volumes, excluding EU	7.8	6.0	3.1	4.7	4.7
Oil prices, (Brent, USD/barrel)	72.5	96.9	51.0	61.0	61.0