



# PORTUGAL

## FISCAL TRANSPARENCY EVALUATION

October 2014

This pilot Fiscal Transparency Evaluation for Portugal was prepared by a staff team of the International Monetary Fund based on the July 2013 version of the revised Fiscal Transparency Code and the information available at the completion of their visit to Lisbon on May 14, 2014.

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Statistics Department**



**PORTUGAL**

**FISCAL TRANSPARENCY EVALUATION**

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September 2014

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## Abbreviations

BFL	Budget Framework Law
BdP	Banco de Portugal
CFP	Conselho das Finanças Públicas
CGD	Caixa Geral de Depósito
CGA	Caixa Geral de Aposentações
CGE	Conta Geral do Estado
COA	Court of Auditors
COFOG	UN Classification of Functions of Government
DEO	Documento de Estratégia Orçamental
DGAL	Direção-Geral Das Autarquias Locais
DGO	Direção-Geral do Orçamento
DGTF	Direção-Geral do Tesouro e Finanças
ESA 95	European System of National and Regional Accounts
EC	European Commission
FAD	Fiscal Affairs Department of the International Monetary Fund
FGD	Fundo de Garantia de Depósitos
FTC	Fiscal Transparency Code
FTE	Fiscal Transparency Evaluation
GFSM	Government Finance Statistics Manual
GPEARI	Gabinete de Planeamento, Estratégia, Avaliação e Relações Internacionais
IGCP	Agência de Gestão da Tesouraria e da Dívida Pública
IGF	Inspeção-Geral de Finanças
IMF	International Monetary Fund
INE	Instituto Nacional de Estatística
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
MoF	Ministry of Finance
NPL	Non-Performing Loan
PAEL	Programa de Apoio à Economia Local
PPP	Public-Private Partnerships
POCP	Plano Oficial de Contabilidade Pública
ROSC	Report on Standards and Codes
SDDS	Special Data Dissemination Standard
SFA	Serviço e fundo autónomo
SI	Serviços integrados
SOE	State-Owned Enterprises
SS	Segurança Social
STA	Statistics Department of the IMF
UTAM	Unidade Técnica de Acompanhamento a Monitorização do Sector Público Empresarial
UTAP	Unidade Técnica de Acompanhamento de Projectos

## Preface

A mission from the Fiscal Affairs Department (FAD) of the International Monetary Fund visited Lisbon from April 29 through May 14 to undertake a Fiscal Transparency Evaluation (FTE) against the new Fiscal Transparency Code (FTC). The mission team consisted of Marco Cangiano (head), Jason Harris, Abdul Khan, Marcos Poplawski Ribeiro, and Anke Weber (all FAD staff), and Alberto Jimenez de Lucio (STA).

During its stay, the mission met with the Minister of Finance, Ms. Maria Luis Albuquerque; the Secretary of State for the Budget, Helder Reis; the Head of Conselho das Finanças Públicas (CFP), Teodora Cardoso; the Head of the Direção-Geral do Orçamento (DGO) Manuela Proença; and the Head of the Direção-Geral do Tesouro e Finanças (DGTF) Elsa Roncon.

At the Ministry of Finance, the mission also met with a number of officials from DGO, the Direção-Geral do Tesouro e Finanças (DGTF), the Gabinete de Planeamento, Estratégia, Avaliação e Relações Internacionais (GPEARI), the Agência de Gestão da Tesouraria e da Dívida Pública (IGCP), the Inspeção-Geral de Finanças (IGF), and the Unidade Técnica de Acompanhamento de Projetos (UTAP).

The mission also met with officials from the Direção-Geral Das Autarquias Locais (DGAL), the Instituto Nacional de Estatística (INE), the Banco de Portugal (BdP), the ministries of Economy, Health, and Education and Science, and the Court of Auditors (COA).

The mission would like to thank all of the above individuals and institutions for their warm hospitality and courtesy extended throughout its stay, and for the frank and candid discussions of all issues. A particular thank you goes to Ana Correia for her assistance in organizing the mission schedule and close cooperation throughout this mission, and Alexandra Antunes and Kathryn Watson for able interpretation.

## EXECUTIVE SUMMARY

**Portugal's practices meet most of the principles of the revised Fiscal Transparency Code at good or advanced levels.** A number of areas still present practices at a basic level, but in most of these cases this reflects reforms that have recently been launched and have not yet been fully implemented so as to affect current practices. Indeed, if measured against the practices observed prior to the recent financial crisis, there has been remarkable progress. The challenge is to press ahead with the reform agenda so that all fiscal transparency practices meet good or advanced levels, thus strengthening even further the management of public finances and the associated risks.

### **The key findings of the present Fiscal Transparency Evaluation are:**

- Fiscal reporting is in line with good or advanced practices, particularly in compliance with EU requirements and ESA 95 standards, but still lacks a sound conceptual accounting framework based on internationally accepted standards.
- Fiscal forecasting and budgeting have improved over the last three years, although investment evaluation only meets the basic standard of the Code.
- Reporting of fiscal risks is in its infancy and in spite of numerous initiatives undertaken in the last few years, such as the publication of a fiscal risk statement, remains fragmented.

**The large amount and good quality of information available allows a very preliminary and partial estimate of the public sector net worth and total risk exposure.** An estimated negative net worth position of 140 percent of GDP (including the liabilities of the main defined-benefits employment-related pension scheme) and a sizeable exposure to various contingent liabilities, although some of these have a low probability of crystallizing, are reminders of the still fragile status of Portugal's public finances.

**This evaluation identifies completing the ongoing reform agenda as the key priority to strengthen the management of public finances and improve transparency practices.** This requires bringing to fruition the ongoing efforts to develop and implement an accounting framework based on generally accepted accounting standards, and eventually publishing accrual-based consolidated financial statements, while progressively expanding the focus of fiscal reports from the general government to the public sector; revising the Budget Framework Law to reflect recent reforms and provide the basis for sound and prudent fiscal management; better coordinating, and preferably centralizing, risk management within a coherent framework under the responsibility of the Minister of Finance.

The key findings of the evaluation are presented in Table 1 below and ranked according to their relative importance for fiscal management.



**Table 1. Portugal: Summary Heat Map**

Level of Importance	Fiscal Reporting	Fiscal Forecasting & Budgets	Fiscal Risk Analysis and Management	Legend
High	Coverage of Institutions	Macroeconomic Forecasts	Specific Fiscal Risks	Not met
	Coverage of Stocks	Medium-term Budget Framework	Long-Term Fiscal Sustainability Analysis	Basic
	Coverage of Flows	Fiscal Legislation	Asset and Liability Management	Good
	External Audit		PPPs	Advanced
	Historical Revisions		Sub-National Governments	Not Assessed
			Financial Sector Exposure	
Medium	Tax Expenditures	Forecast Reconciliation	Public Corporations	
	Timeliness of Annual Financial Statements	Investment Projects	Macroeconomic Risks	
	Internal Consistency	Budget Unity	Budgetary Contingencies	
	Statistical Integrity	Public Participation	Guarantees	
		Independent Evaluation		
Low	Frequency of In-Year Reporting	Performance Information	Environmental Risks	
	Comparability of Fiscal Data	Timeliness of Budget Documents	Natural Resources	
	Classification	Fiscal Policy Objectives		
		Supplementary Budget		

## OVERVIEW AND BACKGROUND

**1. Portugal’s practices meet most of the principles and practices of the revised Fiscal Transparency Code (FTC) at good or advanced level.**<sup>1,2</sup> There are however a number of areas in which Portugal’s practices remain at the basic level, in spite of the numerous reforms initiated over the last three years, reflecting the fact that although seminal pieces of legislation have been passed practices are still in the process of being modified. Completing the reform agenda is thus the first order of priority to avoid repeating past and less successful attempts at improving Portugal’s capacity to manage prudently and transparently its public finances.

**2. The key findings of this Fiscal Transparency Evaluation (FTE) can be summarized as follows (Box 1 provides a methodological note to the FTE).**<sup>3</sup>

- Fiscal reporting meets good or advanced practices against most of the Code’s principles, although the underlying accounting framework is fragmented. Statistical reports are compiled in line with applicable international statistical standards by independent institutions, and provide a fairly comprehensive institutional coverage of the main stocks and flows in spite of the lack of a conceptual accounting framework based on internationally accepted standards. As a result, fiscal reports combine information emanating from different sources and significant revenues, expenses, assets, and liabilities remain outside the official accounting system. Further, the focus remains on the general government, in line with EU reporting requirements, thus masking risks that may emerge, as in the recent history, from liabilities incurred by public entities outside the general government or even by entities outside the public sector.
- This evaluation attempts for the first time to compile a balance sheet for the public sector (Table 0.1). Bearing in mind the preliminary nature of the exercise, the public sector is estimated to have presented a negative net worth of 140 percent of GDP in 2012, largely because of accrued pension liabilities.<sup>4</sup>

<sup>1</sup> The evaluation is based on the FTC that was approved by the IMF Board on July 11, 2014 available at <http://www.imf.org/external/np/pp/eng/2014/061614.pdf>. The evaluation is based on information available as of May 30, 2014. It also relies on technical assistance reports and documents produced in the context of the EC/ECB/IMF-supported adjustment program. The findings and recommendations represent the views of the IMF staff and do not necessarily reflect those of the government of Portugal. Unless otherwise specified, the data included in the text, figures, and tables in the report are IMF estimates and calculations.

<sup>2</sup> Fiscal transparency is defined in IMF (2012) as “the clarity, reliability, frequency, timeliness, and relevance of public fiscal reporting and the openness to the public of the government’s fiscal policy-making process.”

<sup>3</sup> The “importance” dimension attempts to capture principles that are more relevant in a given country. As such, the first criterion is a “size” factor, that is, whether the impact of a particular practice is sufficiently large to affect the key macro-fiscal aggregates. But there are other criteria more directly related to transparency and accountability, which remain more difficult to quantify.

<sup>4</sup> The details and assumptions behind these estimates are discussed in Chapter 1.

- The focus on the general government leaves aside about 10 percent of GDP of expenditure and revenue flows and about 130 percent of GDP in assets and liabilities accounted for by public financial and nonfinancial state-owned enterprises (SOEs), largely matched by assets and half of them related to Bank of Portugal's (BdP) balance sheet.
- Accrued general government expenses related to employee pensions, estimated at 7.1 percent of GDP in 2011 are not included in fiscal statistics.

**Table 0.1 Portugal: Public Sector Financial Overview, 2012**  
(Percent of GDP)

	State	Central Govt	Local Govt	General Govt	CG Non Fin Corps	LG Non Fin Corps	Public Fin Corps	Central Bank	Public Sector
<b>Total Transactions</b>									
Revenue	24.2	36.5	6.5	40.9	5.3	0.6	4.6	0.5	50.9
Expenditure	32.7	43.5	6.0	47.4	4.3	0.6	4.9	0.2	56.3
<b>Balance</b>	<b>-8.5</b>	<b>-7.0</b>	<b>0.5</b>	<b>-6.5</b>	<b>1.0</b>	<b>0.0</b>	<b>-0.2</b>	<b>0.3</b>	<b>-5.4</b>
<b>Total Assets</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>122.8</b>	<b>22.9</b>	<b>1.9</b>	<b>70.8</b>	<b>72.3</b>	<b>255.6</b>
Non-Financial Assets	na	na	na	72.6	17.9	na	1.6	0.1	92.2
Financial Assets	na	53.7	1.7	50.2	5.0	na	69.2	72.2	163.4
<b>Total Liabilities</b>	<b>na</b>	<b>259.3</b>	<b>8.4</b>	<b>262.5</b>	<b>21.4</b>	<b>1.4</b>	<b>66.4</b>	<b>71.6</b>	<b>395.2</b>
Other (reported liabilities)	na	125.4	8.4	128.6	21.4	1.4	66.4	71.6	261.4
Public Service Pension	na	133.9	na	133.9	na	na	na	na	133.9
<b>Net Financial Worth</b>	<b>na</b>	<b>-205.6</b>	<b>-6.7</b>	<b>-212.3</b>	<b>-16.4</b>	<b>na</b>	<b>2.8</b>	<b>0.6</b>	<b>-231.9</b>
<b>Net Worth</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>-139.7</b>	<b>1.5</b>	<b>0.5</b>	<b>4.4</b>	<b>0.7</b>	<b>-139.7</b>
<b>Memo</b>									
General Government Gross Debt at face value (EDP notification)				124.1					
Net Debt (gross debt minus central administration deposits)				114.0					
Additional PPP liabilities outside Public Sector					7.5				

Source: Staff estimates, INE, MoF, and BdP.

Notes: The figures for central government, general government, and public sector are consolidated.

The figures for general government and its subsectors are from the nonfinancial accounts (i.e., revenue and expenditure) and the financial accounts (i.e., financing). The figures for central government nonfinancial corporations are from the 2013 SEE Relatório prepared by DGTF, adjusted to exclude public corporations reclassified into central government.

The figures for local government corporations are from a 2011 study and include only corporations classified within the general government. The figures for public service pension liabilities are from the BdP, and exclude liabilities of the social security funds. The 2012 figure has been estimated using the 2011 figure and adjusting it by the percentage GDP increase of the liabilities during 2011.

The figure for nonfinancial assets of the general government is an estimate based on the stock of fixed assets used to calculate consumption of fixed capital. It is an underestimate as it does not include inventories, valuables, and non-produced assets.

### Box 1. Fiscal Transparency Evaluations: A Methodological Note

FTEs assess country practices against the standards set by the code. They provide quantified analyses of the comprehensiveness and quality of published fiscal data and key sources of fiscal risks; and an accessible summary of the strengths and weaknesses of country practices related to fiscal transparency and their relative importance, through a set of summary heat maps.

In quantifying the analysis, FTEs rely on data from different sources, at times not easily accessible or widely disseminated even if publicly available, as well as on prevailing accounting and reporting standards and generally accepted methodologies. As such, they rely on statistical reporting standards such as the UN System of National Accounts (SNA), its European version or ESA for all EU countries, and the IMF Government Finance Statistics Manual (*GFSM*). As these standards are evolving, reference is made to the relevant versions or announced new versions, such as ESA 10 or *GFSM 2014*. FTEs also rely on relevant national accounting standards and on the public sector accounting standards set by the International Public Sector Accounting Standards Board (IPSASB). FTEs disclose sources and methods for the data presented. As these estimates are often not routinely produced by countries, such as public sector net worth, international comparisons are sometimes provided using only countries where such estimates exist, including results from previous FTEs. While every effort is taken to align them on a conceptual basis, any major differences (such as coverage of federal versus general government) are disclosed.

In line with the revised FTC, FTEs assess a country's exposure to certain liabilities, contingent liabilities and other risks for which there may not be universally agreed accounting or statistical standards. In all such cases, FTEs emphasize recognition and/or disclosure as a prudent course of action. For instance, in assessing a government's exposure to employee pension benefits, FTEs follow the approaches adopted by the *GFSM 2001* and IPSAS 25, whereby these benefits are recognized as expenses and liabilities as the employees provide service, instead of the approach followed by ESA 95. Similarly, in the absence of generally accepted methodologies to ascertain the probability of a given risk factor, FTEs choose to disclose their potential impact at face value, even where their probability may be extremely low, such as the case with potential calls on deposit guarantee schemes.

For all of the above reasons, some of the estimates presented in the FTEs are not strictly comparable with data published in official documents, such as for instance the general government net lending/borrowing calculated on the basis of ESA 95 methodology. FTEs thus make clear all cases in which a different aggregate and/or methodology is applied.

- Fiscal forecasting and budgeting have improved substantially over the last three years, with most of the FTC principles met at good or advanced levels of practice.** A number of reforms initiated in the context of the adjustment program remain to be completed and fully implemented, such as the streamlining of budget appropriations and development of proper programs/objectives. Citizens' participation to the budget process is still in its early days—Portugal now produces a citizens' guide to the budget and there are a number of participatory initiatives at the municipal level.<sup>5</sup> Further strengthening of the medium-term budget process and policy orientation of the budget are required.

<sup>5</sup> These include, for instance, the city of Lisbon (<http://www.lisboaparticipa.pt/pages/orcamentoparticipativo.php>) and the municipalities of Oeiras, Cascais, and Guimarães, among others.

- The budget system remains somewhat fragmented, with an excessive number of appropriations and budget entities.<sup>6</sup> Although reported in line with advanced practices, own revenues represent 35 percent of total revenue.
- There has been an optimistic real GDP forecast bias (1.7 percent of GDP in the outer years) accompanied by considerable deficit drift (3.0 percent).
- There has been on average an overspending of 0.7 percent of expenditure in a budget year and on average downward revenue revisions of 3 percent of GDP over the medium term.
- **Fiscal risk management is fragmented in spite of numerous initiatives undertaken in the last few years, such as the compilation and publication of a fiscal risk statement.** While much of the information appears to be available, there are worrying gaps, mainly on risks faced by municipalities and regions, but also through central government's PPPs, concessions, and SOEs. A very preliminary assessment based on available information puts the government's overall exposure to contingent liabilities up to 122 percent of GDP between 2012 and 2013.<sup>7</sup>
  - A large share of PPPs and concessions (about 60 percent of their total investment value in 2012) are not centrally monitored; those related to municipalities and regions are not known.<sup>8</sup>
  - Other specific risks—local SOEs, and contingent liabilities from the financial sector—are either not reported or managed within a risk management framework.
  - There is no systematic focus on long-term sustainability analysis.
  - In spite of recently enacted legislation, coordination across different levels of government is still developing.

**3. The overall positive result of the evaluation marks a significant improvement over the situation observed at the start of the adjustment program (Box 2).** This progress is illustrated in Table 0.2, which shows for a selected set of principles how the various practices would have been assessed prior to these reforms; how they are assessed now; and the envisaged impact of the priorities identified in the FTE. In some areas, these reforms have already brought Portugal to an advanced level of practice, such as in reporting of tax expenditures. In others, this evaluation found that while the reforms have led to improvements, such as fiscal risk reporting, further efforts are required to reach an advanced level. Finally, in others, such as coverage of flows, there has been little movement as yet, but the evaluation has identified priority actions, required to bring Portugal to the advanced level.

<sup>6</sup> The fragmentation of Portugal's budget system is discussed, among others, in MoF (2012).

<sup>7</sup> The details and assumptions behind these estimates are discussed in Chapter 3.

<sup>8</sup> DGTF Q3 2012 Report on PPPs and Concessions.

### Box 2. Progress Under the Adjustment Program <sup>1/</sup>

Since the beginning of the adjustment program in mid-2011, there has been considerable progress in strengthening Portugal's budgetary framework and transparency practices. The key achievements are:

- The quality and comprehensiveness of information of fiscal developments has improved.
- New fiscal reports and documents, including on tax expenditures, fiscal risks, and PPPs have been developed and published.
- A commitment control system is now in place in all administrative units of the general government.
- A new governance framework for SOEs was approved in late 2012.
- A new legal and institutional framework for PPP was established in 2012, which included the creation of the Unidade Técnica de Acompanhamento de Projectos (UTAP) as well as a series of measures aiming at increasing the control over potential fiscal risks stemming from PPP.
- Progressive refinements of the Budget Framework Law (BFL) have been enacted, including the transposition of the EU Fiscal Compact provisions.
- The new legislation on the financial management of local governments (municipalities and regions) that was approved in September 2013 strengthens monitoring and reporting requirements as well as coordination across levels of government.

1/ A compendium of all measures undertaken under the adjustment program can be found in a document recently produced by the Government of Portugal *A Gestão do Programa de Ajustamento. 1,000 Dias, 450 Medida Cumpridas*, May 2014.

**4. The positive result is further supported by other transparency initiatives, such as the Open Budget Index compiled under the Open Budget Partnership initiative.**<sup>9,10</sup> It is also a clear improvement over the 2003 IMF fiscal transparency assessment undertaken as part of the Report on Standard and Codes (ROSC) initiative, the findings of which, like those of other international (e.g., OECD) as well as domestic institutions (chiefly those of the COA) remained unfortunately largely unheeded until the onset of the recent financial crisis.<sup>11</sup>

<sup>9</sup> Portugal's ranking has improved from 25 to 21 between 2010 and 2012, while its overall score increased from 58 to 62. The Open Budget Index assigns countries a transparency score on a 100-point scale using 95 out of the 125 questions that focus specifically on whether the government provides the public with timely access to comprehensive information contained in eight key budget documents. A more detailed description of the Open Budget Index as well as a full report is available at <http://internationalbudget.org/>.

<sup>10</sup> The 2011 IMF/EC diagnostic found that responsibilities were dispersed across many entities and levels of government enjoying administrative and financial autonomy, with weak controls on their spending. Past attempts at meeting the Stability and Growth Pact objectives had been pursued partly via fiscal stratagems and one-off measures that masked the country's true indebtedness, leading to loss of control of the fiscal aggregates. Compliance with public financial management legislation was weak, sanctions were rarely applied, and regulations easily bypassed, as witnessed by the accumulation of outstanding and overdue government's payment obligations (arrears).

<sup>11</sup> The key findings of the 2003 ROSC were the need to: (i) focus on the finances of public institutions outside of the general government, particularly those of SOEs and the rapidly proliferating PPPs; (ii) strengthen budget preparation to better integrate the medium-term framework with the annual budget process, and over time, develop a full-fledged medium-term budget; (iii) enhance the quality of budget projections, their external scrutiny, and the analysis of fiscal risks; and (iv) strengthen budget execution and reporting, along with internal and external controls, pointing to the lack of systematic accounting of expenditure arrears.

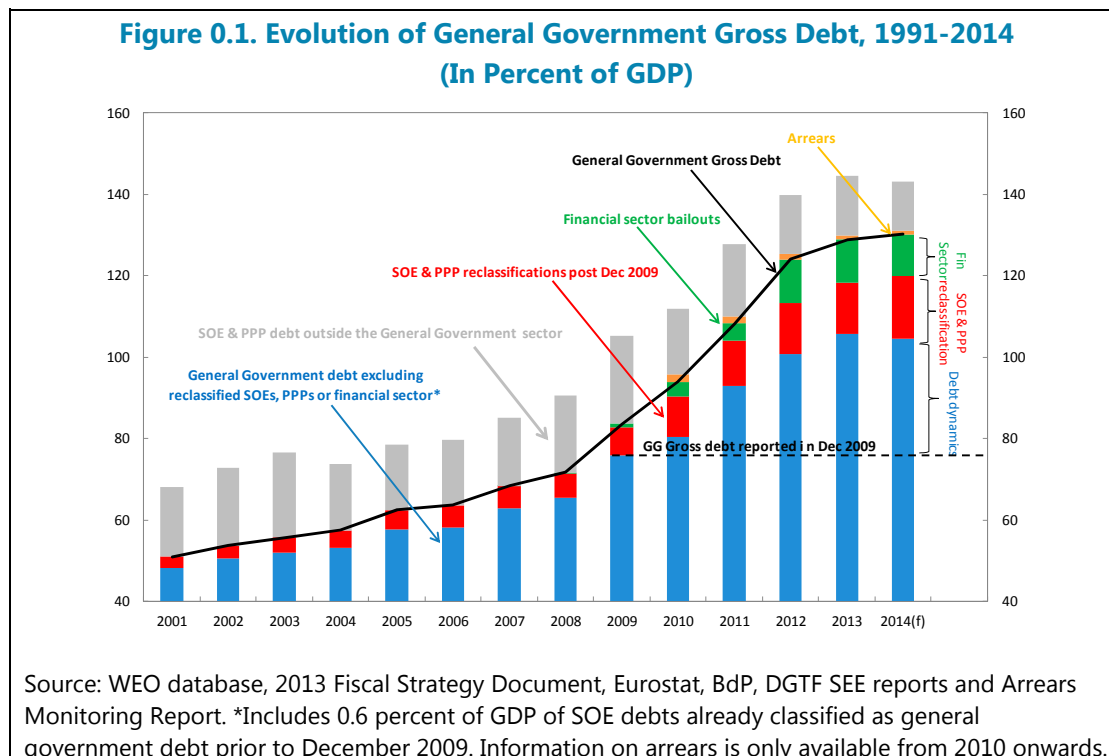
**Table 0.2. Portugal: Impact of Reforms on Selected Transparency Principles**

Principle	Before Program	Reforms Undertaken	Current Situation	FTE Priorities	End Point
Tax Expenditures	No reporting		Complete tax expenditure report		
Frequency of In-year Fiscal Reports	Weak reporting on state budget only		Complete general government monthly reports		
Budget Unity	State budget only		Full budget coverage		
Financial Sector Exposure	No discussion financial sector exposure		Reporting of explicit exposures		
Macroeconomic Risks	No risk analysis		Macro sensitivity analysis		
Guarantees	No reporting of guarantees		Guarantees are disclosed		
Public Participation	No citizen's budget		Citizen's budget published		
Medium-term Budget Framework (MTBF)	Nothing except for SGP forecasts		MTBF prepared weak track recording following		Credible and complete MTBF
Fiscal Legislation (Budget Frame Law)	Incomplete guide to budget process		More complete BFL with some weaknesses		Sound BFL
Specific Fiscal Risks	No fiscal risk reporting		Some fiscal risks discussed but incomplete		Comprehensive fiscal risk report
LT Fiscal Sustainability Analysis	No analysis		DSA's not produced on a regular basis		DSA and LT sectoral projections
Sub-National Governments	Limited reporting/weak coordination		Aggregate monthly report but not for individual municipalities		Summary annual reports
PPPs	Unrecognised risks		Reporting on 35 out of 110 PPPs and concessions		Complete coverage & summary reporting
External Audit			Audit in accordance with legal mandate but not fully with international standards		Audit opinion according to international standards
Coverage of Institutions			General government		Public sector
Coverage of Flows			Accrual statistics but cash accounts		Full accrual
Asset and Liability Management			Debt management strategy but not assets		Complete coverage and public strategies

**5. While not a root cause of the recent financial crisis, the above identified—and long unaddressed—fiscal transparency shortfalls amplified its effects.** This contributed to the increase of the public debt-to-GDP ratio from 83.7 percent in 2009 to 129 percent in 2013. Besides the underlying and general government flows, the increase reflected the fact that loss making and heavily indebted SOEs were re-classified inside the general government; government guarantees were called; large regional government and PPP contingent liabilities were realized; and expenditure arrears were uncovered, as illustrated in Box 3 and Figure 0.1.

### Box 3. Fiscal Transparency Shortfalls and the Financial Crisis

In Portugal, many of the problems experienced during the crisis derived from poor information on fiscal developments and reporting. In addition to a deterioration of the underlying deficits, debt increased rapidly as a result of the inclusion of sectors that were previously excluded from the general government under the ESA 95 framework, particularly from SOEs and PPPs. Figure 0.1 below illustrates how these problems were shifted onto the balance sheet of the government and supports the FTC's claim for focusing on the public sector for ex ante forecast and risk analysis and ex post reporting purposes.



- General government debt in Portugal has increased from the real-time reported 76 percent of GDP in 2009 to a forecast 130 percent of GDP in 2014.
- About half of that increase was due to fiscal deficits and normal debt dynamics.
- The other half of that increase was due to reclassifications of entities that were previously outside of the general government—mainly SOEs, primarily rail and transportation companies, as well as various PPPs—and interventions to sustain financial institutions.
- Prior to the crisis, the bulk of SOE debts were assessed as market activities, and therefore were not included in the general government debt statistics. At the time, this information was not collected as part of the government statistics, nor considered within the budget process, nor thought of as contingent liabilities to the budget. Indeed, most of the information was unavailable prior to 2001.
- Despite the reclassifications done to date, there is a further 12 percent of GDP worth of public corporation debt that remains outside the general government perimeter, even after accounting for the anticipated reclassifications expected to occur in late 2014.
- Finally, expenditure arrears, largely from outside the central government budget, add a further 1 percentage point to debt, down from 2 percent in 2010, but are not included in the Maastricht debt definition.



**6. As in the decade leading to the recent financial crisis, there is a risk that ongoing reforms may not be completed and fully implemented.**<sup>12</sup> This risk may become more acute as Portugal successfully graduates from the adjustment program and faces, similarly to other countries, reform fatigue. This is a risk Portugal must manage very carefully to avoid backsliding on the progress achieved. Accordingly, this evaluation identifies completing the ongoing reforms as the key priority to strengthen the overall management of public finances and improve transparency practices. The report's key findings are summarized below.

**7. Fiscal reporting**—Complete ongoing efforts to develop and implement an accounting framework for the whole of government that is based on generally accepted accounting standards and expand the focus on the entire public sector.

- The Instituto Nacional de Estatística (INE), The Banco de Portugal (BdP), and the Ministry of Finance (MoF) should compile and disseminate complete fiscal reports covering all institutional units of the public sector and its subsectors, in addition to reporting on the general government as per ESA 95/ESA 10.
- MoF should develop a government accounting function for maintaining adequate books of account and adopt an integrated accounting system that provides complete information for the preparation of financial statements in accordance with IPSAS.
- The COA should provide, within six months after the year end, an opinion on whether the audited financial statements provide a true and fair view in accordance with internationally accepted auditing standards.

**8. Fiscal forecast and budgeting**—Complete the revision of the BFL, for which a firm timetable and a working group tasked with resolving some outstanding issues and drafting the legislation have already been set in motion.<sup>13</sup>

- MoF should continue the current process of reforming the budget framework law in order to reduce fragmentation and improve transparency through streamlining the appropriation structure and reducing the number of budgetary entities.
- MoF should strengthen the medium-term budget framework by broadening the coverage to all state budget expenditure and provide a reconciliation table across previous vintages.
- MoF and the Ministry of the Economy (MoE) should report analysis of major investment projects irrespective of their financing sources.

<sup>12</sup> On past attempts at reforming Portugal's public administration and financial management, see for instance, Corte-Real (2008), Magone (2011), and Melo (in Rohdes et al., 2012). See also IMF (2003) and OECD (2008)

<sup>13</sup> The BFL is being amended to transpose the remaining relevant EU Fiscal Compact provisions.

**9. Fiscal risk management**—Coordinate, and preferably centralize, a number of activities currently carried out by various ministries, units, and agencies under a general umbrella which should be located under the responsibility of the ministry of finance.

- MoF should expand the fiscal risk statement by centralizing information provided by various ministries and agencies, and analyzing how different risks could interact.
- It should also carry out on a regular basis long-term sustainability analysis including an assessment of sensitivity to macroeconomic shocks and the impact of aging.
- MoF should develop a comprehensive asset management strategy and disclose risks around major assets, including the opportunity cost of idle cash holdings.
- The relatively narrow mandate of UTAP should be extended to monitor potential risks from central government concessions currently outside of its scope.
- The ongoing transparency initiative should be expanded to provide an annual report of individual municipal and regional finances<sup>14</sup> against the new finance limits, and start systematically monitoring and reporting sub-national activities that fall outside the perimeter of the general government, particularly around SOEs and PPPs.

## FISCAL REPORTING

### A. Overview

**10. This chapter assesses the quality of Portugal’s fiscal reporting practices against those set out in IMF’s FTC.** In doing so, it separately considers the following dimensions of fiscal disclosure:

- a. coverage of institutions, stocks, and flows;
- b. frequency and timeliness of reporting;
- c. quality—including internal consistency—of fiscal reporting; and
- d. integrity of fiscal reports.

**11. Fiscal reports should provide a comprehensive, timely, reliable, comparable, and accessible summary of the government’s financial performance and position.** To do so, fiscal

<sup>14</sup> Regarding the Madeira’s finances, the information has improved in the last years and it is now publicly available at: <http://srpf.gov-madeira.pt/>

reports, which comprise budget execution reports, fiscal statistics, and government accounts, should:

- cover all institutional units engaged in fiscal activity;
- capture all assets, liabilities, revenue, expenditure, financing, and other flows;
- be published in a frequent and timely manner;
- be classified according to an internationally recognized classification system;
- reconcile any unexplained discrepancies within or between fiscal reports; and
- be prepared by an independent agency (in the case of statistics) or scrutinized by an independent national audit institution (in the case of accounts).

**12. Portugal’s fiscal reporting framework has many good features, but it is fragmented and lacks a strategic perspective.** The FTE confirmed that fiscal reports are produced frequently; statistical reports covering the general government and many assets and liabilities are prepared by independent agencies. The MoF report on tax expenditures meets advanced standards. However, the lack of a sound conceptual framework based on accrual accounting and internationally accepted standards, a central government accounting function to, among other things, account for and report items such as tax revenues, government bank accounts, and debt, and adequate accounting records constitute major deficiencies of the existing framework. This has led to significant revenues, expenses, assets, and liabilities remaining outside the official accounting system, with fiscal reports relying on combining information emanating from different sources. The adoption of a sound framework and the regular preparation and publication of audited consolidated financial statements in accordance with IPSAS would also help address many of the specific shortcomings, including the lack of comprehensive coverage of stocks and flows in existing fiscal reports, discussed in this report. The MoF and the standard setting body are developing an IPSAS based framework, while also keeping abreast of the project on European Public Sector Accounting Standards (EPSAS).

## B. Coverage of Fiscal Reports

### 1.1.1 Coverage of public sector institutions (Good)

**13. Fiscal reports cover the consolidated general government in line with EU reporting requirements.** The INE’s and BdP’s quarterly and annual fiscal statistics for the general government account for about 85 percent of public sector expenditure. The public corporations account for the other 15 percent of public sector expenditure, and are dominated by corporations from the infrastructure sector and Caixa Geral de Depositos (CGD). The main fiscal reports are summarized in Table 1.1.

Table 1.1. Portugal: List of Reports

REPORT	COVERAGE			ACCOUNTING		PUBLICATION	
	Institutions	Flows	Stocks	Basis	Class	Freq	Date
<b>IN-YEAR REPORTS</b>							
<b>Monthly Budget Execution (DGO)</b>	GG	Rev, Exp, trans. in fin assets & liab	Non-fin. Liab – accounts payable	Cash	National	Mo	23-25 day lag
<b>Quarterly Accounts (DGO)</b>	SI, SFA (incl. reclassified SOEs), SS, (same as Budget)	Rev. Exp Loans/debt	Cash, bank	Cash	National	Qtr	90 days
<b>Quarterly nonfinancial accounts (INE)</b>	GG	Rev, Exp, Bal	-	Part Accrual	ESA 95	Qtr	90 days
<b>National Financial Accounts (BdP)</b>	GG	Trans. In Fin Assets, liabilities	Fin Assets, liabilities	Part Accrual	ESA 95	Qtr	90 days
<b>General Government Debt (BdP)</b>	GG	N/A	Debt	Part Accrual	ESA 95	Mo	1 month
<b>Debt of Non-Financial Public Corporations (BdP)</b>	NFPC (both in an out of GG)	N/A	Debt	Part Accrual	ESA 95	Mo	7 weeks
<b>Financing of General Government (BdP)</b>	GG	Trans. In Fin Assets, liabilities	N/A	Part Accrual	ESA 95	Mo	7 weeks
<b>YEAR-END REPORTS</b>							
<b>General State Accounts (DGO)</b>	IS, SFA (incl. reclassified SOEs) and SS, incl.; GG (sup information)	Rev, Exp, Fin, Budget Vs. Actual	Debt, Guarantees	Cash, SS also accrual, (+ high level Nat. Acc)	Nat	Ann	June
<b>EDP Notifications (INE, BdP) (take to year end)</b>	GG	Reconciliation between Working Bal (rev-exp) at Net lending, deficit and debt reconciliation	Debt	Part Acc	ESA 95	6 Mo (multiannual data)	March 2014: 2010- 13, and 2014 forecast; September 2014: same years updated
<b>Annual nonfinancial accounts (Statistics – INE)</b>	GG	Rev, Exp, Net lending,	-	Part Acc	ESA 95	Ann	6 months (same as EDP notifications)

GG = General government; Mo = Monthly; Qtr = Quarterly; Rev. = Revenue; Exp = Expense; trans. = Transactions; Fin = Financial; NFPC= Nonfinancial Public Corporations; SS = Social security; Ann = Annual

**14. INE is responsible for officially determining the institutional units that comprise the general government and its subsectors, as well as the public sector.** The list of institutional units of the general government and its subsectors, compiled following ESA 95 methodological guidelines, is published on INE and BdP's websites. INE also has a list of public corporations, but it does not publish it; however, BdP publishes the list on its website. Compilation of the list includes, among other ESA 95 rules, the yearly application of a 50 percent market test to determine whether a corporation, controlled by the central or local (including regional) government, should be reclassified into the general government subsector.

**15. In 2012, the public sector comprised a total of 6,095 separate institutional units.** Table 1.2 lists the number of institutional units in each subsector of the public sector and shows that the general government includes 5,395 units, while public corporations account for 700 units (of which 58 are financial corporations). A further breakdown shows that the general government comprises 331 central government units and the local governments (including the regional governments) comprise 5,064 units.

**16. Three entities compile a majority of fiscal reports in Portugal, INE, BdP, and DGO.** These entities have reached an agreement on the allocation of responsibilities, where INE compiles the nonfinancial accounts, while BdP compiles the financial accounts and debt of the general government and its subsectors. The statistics are compiled on a partial accrual basis.<sup>15</sup> DGO compiles budget execution reports for central government and social security on a cash basis, but also incorporates data on the local government sector in its monthly and annual accounts to achieve general government coverage. All the three entities prepare their fiscal reports on a consolidated basis. DGTF prepares reports for SOEs owned directly by the Treasury on an accrual basis; quarterly reports present non-consolidated figures, while the annual report presents consolidated figures. There are no fiscal reports for the other central government and local government controlled SOEs.

**17. The institutional coverage of the fiscal reports prepared by INE, BdP, and DGO for the general government and its subsectors is broadly similar.** The three entities prepare reports for the general government and its subsectors. A minor difference concerns local government entities other than municipalities, where DGO covers only the two regions and the municipalities, while INE and BdP reports on all local governments, although INE uses estimates for the quarterly reports for the local government entities not covered by DGO, as only annual figures are available. None of these three entities compile statistics for the public corporations classified outside the general government, quarterly and annual reports for the corporations controlled by central government are prepared by DGTF. No entity consolidates the separate information on general government and public corporations to obtain a comprehensive view of the public sector.

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<sup>15</sup> The term partial accrual has been used to indicate departures from accrual concepts used in IPSAS, e.g. non-recognition of employee pensions on an accrual basis.

**Table 1.2. Portugal: Public Sector Institutional Composition and Finances, 2012  
(Percent of GDP)**

	Number of Entities	Gross Revenue	Intra-PS Receipts	Net Revenue	Net Expenditure	Net Balance
<b>Central Government</b>	<b>331</b>	<b>50.1</b>	<b>13.5</b>	<b>36.5</b>	<b>43.5</b>	<b>-7.0</b>
Integrated Services (SIs)	20	24.2	na	24.2	32.7	-8.5
Autonomous Funds and Services (SFAs)	298	11.9	na	11.9	10.6	1.3
Reclassified public corporations*	32	1.3	na	1.3	2.6	-1.3
of which: Estradas de Portugal SA		1.0	na	1.0	1.0	0.0
Rede Ferroviaria Nacional-REFER		0.1	na	0.1	0.1	-0.1
Metropolitano de Lisboa		0.1	na	0.1	0.1	0.0
Metro do Porto		0.1	na	0.1	0.3	-0.2
Social Security Funds	13	13.9	na	13.9	13.7	0.2
<b>Local and Regional Governments</b>						
Local Governments	5,064	6.5	2.1	6.5	6.0	<b>0.5</b>
Reclassified public corporations*	109	0.2	na	0.2	0.2	<b>0.0</b>
<b>General Government</b>	<b>5,395</b>	<b>56.6</b>	<b>15.6</b>	<b>40.9</b>	<b>47.4</b>	<b>-6.5</b>
<b>Public Corporations</b>	<b>700</b>	<b>11.0</b>	<b>1.1</b>	<b>11.6</b>	<b>10.5</b>	<b>1.1</b>
Non-Financial Public Corporations (Central)	254	5.3	0	5.3	4.3	1.0
of which: Parpublica SGPS	1	3.1	na	3.1	2.8	0.3
Camboios de Portugal	1	0.2	na	0.2	0.3	-0.1
Sociedade de Transporte Colectivo de Carris	1	0.0	na	0.0	0.1	0.0
Carris	1	0.1	na	0.1	0.1	0.0
Non-financial public corporations (Local)	306	0.6	0.1	0.6	0.6	0.0
Financial PC	58	5.1	0.6	5.7	5.7	0.0
Central Bank	1	0.5	0.1	1.1	0.8	0.3
CGD	1	4.6	0.5	4.6	4.9	-0.2
Other	56	na	na	na	na	na
Other Central and Local Government Entities	82	na	na	na	na	na
<b>Public Sector</b>	<b>6,095</b>	<b>67.6</b>	<b>16.7</b>	<b>51.5</b>	<b>56.9</b>	<b>-5.4</b>
Non-Financial Public Sector	6,037	61.9	16.1	45.8	51.2	-5.4

Sources: DGO, INE, and BdP.

Notes: The number of entities for general government are as reported by DGO for the GFS Yearbook, the number of reclassified corporations comes from INE and correspond to March 2014, while the number of public corporations comes from INE lists published by BdP (March 2014 update).

The figures for central government, general government, and public sector are consolidated. The figures for the other subsectors are not consolidated. The gross revenue figures are not consolidated, while the net revenue and net expenditure figures are consolidated.

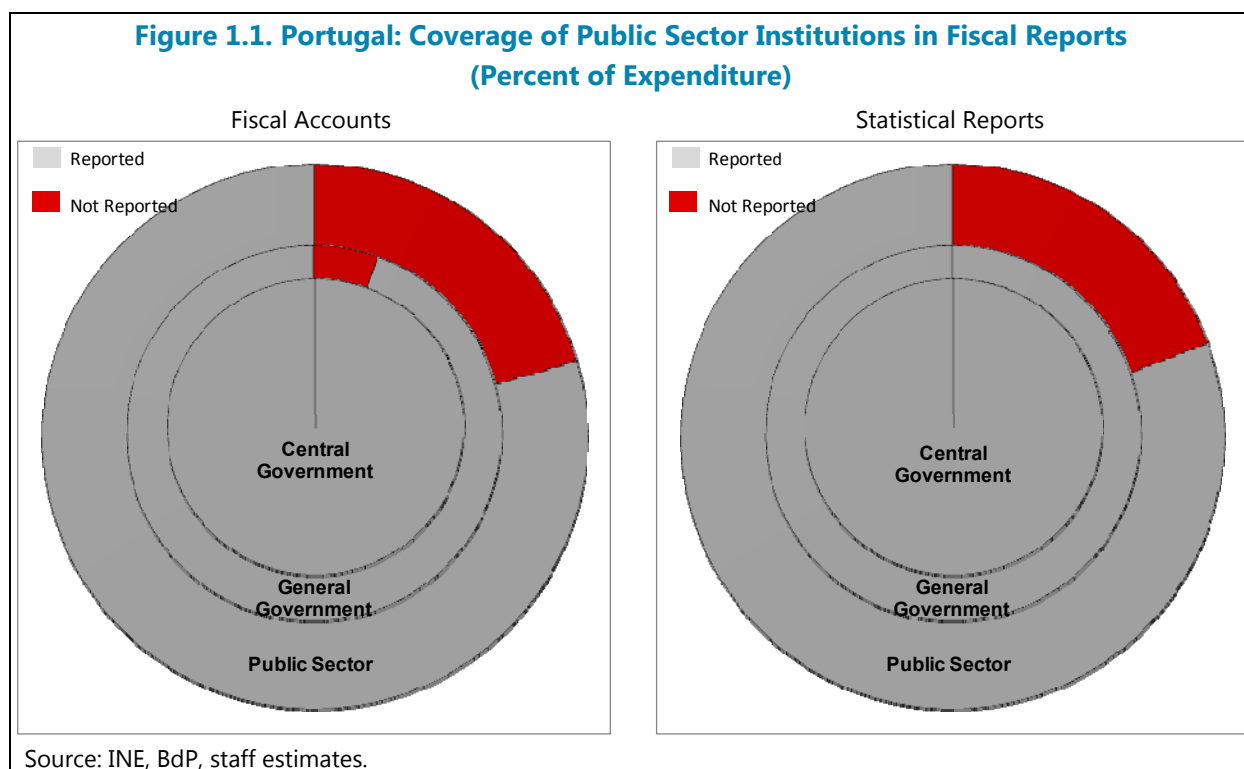
The figures for subsectors and sectors come from Table 1. The figures for individual public corporations come from their financial statements.

The general government figure for net balance of -6.5 percent of GDP is the ESA 95 balance, the EDP notification balance is -6.4 percent of GDP.

Reclassified public corporations are entities constituted as corporations that have been reclassified into central government in accordance with ESA 95 guidelines.

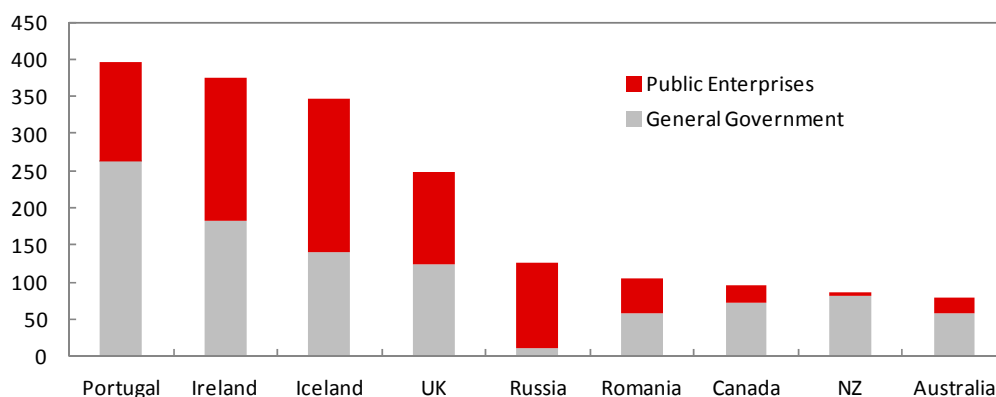
**18. The public sector accounted for around 57 percent of GDP by expenditure in 2012.**

Figure 1.1 summarizes the distribution of public resources across the different sub-sectors of the public sector.



**19. Expanding the institutional coverage of Portugal’s fiscal reports from the general government to encompass the entire public sector, results in a modest improvement in the overall balance in 2012.** Public corporations add an additional 10.5 percent of GDP to expenditure and 11.6 percent to revenue, reducing the overall balance from a negative 6.5 percent of GDP (ESA 95) to a negative 5.4 percent of GDP. This is due in large part to the operating profits made by SOEs. However, as discussed in the next section, while the revenues and expenditures of public corporations make a modest contribution to public sector flows, their assets and liabilities are large relative to the public corporations sector of other advanced and emerging economies other than those, such as Iceland and Ireland, that have undertaken considerable financial sector interventions (Figure 1.2).

**Figure 1.2. Public Sector Gross Liabilities  
(Percent of GDP)**



Source: Staff estimates for Portugal, Ireland, Russia, and Romania; National Financial Statements for others.

### 1.1.2 Coverage of stocks (Good)

**20. The BdP prepares the financial accounts of the general government and its subsectors, but INE does not compile statistics on nonfinancial assets for these sectors.** As shown in Figure 1.3, Portugal's public sector financial asset holdings are estimated to be around 163.4 percent of GDP and its liabilities are estimated around 395.2 percent of GDP in 2012. Within this:

- general government has financial assets of 50.2 percent of GDP and recognized liabilities of 128.6 percent of GDP, the bulk of which is central government debt;
- general government has additional liabilities of 134 percent of GDP in unfunded public service pensions that are not recognized in the consolidated fiscal reports; and
- financial and nonfinancial public corporations, excluding BdP, have unreported financial assets of 72 percent of GDP and nonfinancial assets of 19.5 percent of GDP, while their total liabilities amount to 89.2 percent of GDP.

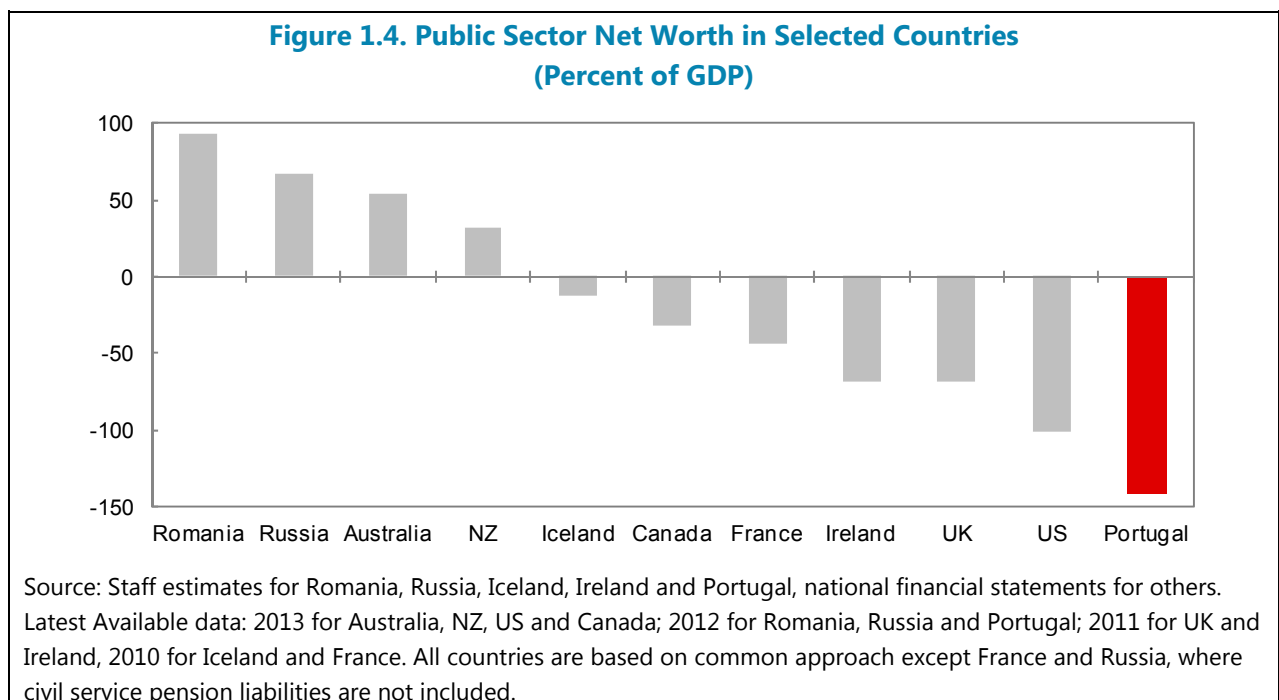
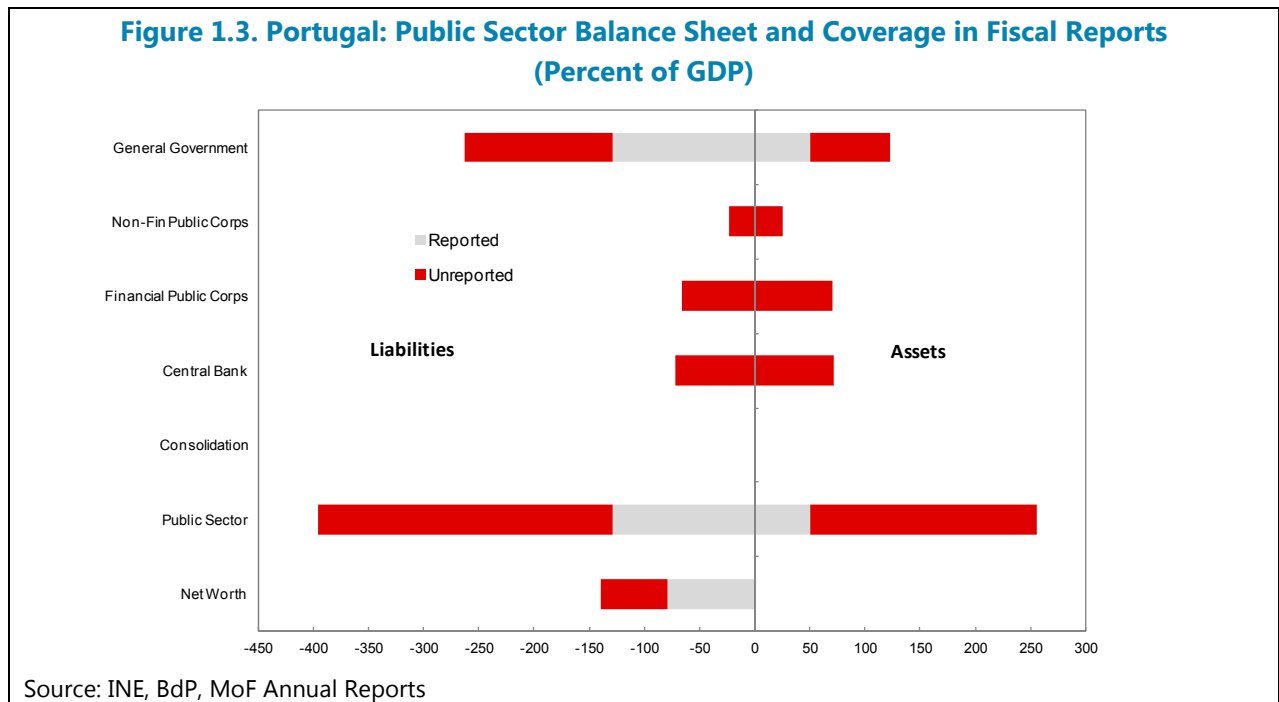
**21. The absence of figures for nonfinancial assets of the general government and its subsectors is a significant gap in fiscal reports.** The stock of fixed assets implicit in the figures for the calculation of consumption of fixed capital by the general government, estimated using the perpetual inventory method, amounts to 72.6 percent of GDP.<sup>16</sup>

**22. The estimated public sector negative net worth was 139.7 percent of GDP in 2012, high by the standards of the few advanced countries for which data are available.** As shown in Figures 1.4 and 1.5, Portugal appears to have net liabilities higher than the UK public sector and the

<sup>16</sup> This figure does not include PPP assets classified outside the general government.



US Federal Government in percent of GDP, partly due to large public sector pension liabilities, which are discussed later in this chapter.



**Figure 1.5. Gross Public Sector Employee Pension Liabilities in Selected Countries (Percent of GDP)**



Source: Almeida et al. (2013); BdP estimates; and various national financial statements.

Note: \*Does not include local government pension liabilities.

Latest available data: 2013 for Australia, NZ, US, UK and Canada, 2011 for Portugal and France, 2009 for Ireland.

### 1.1.3 Coverage of flows (Basic)

**23. Fiscal reports range from cash based financial statements to mainly accrual based statistical reports.** While accounts are cash based, statistical reports include some accrual flows. However, significant accrual flows remain outside fiscal reports.

**24. DGO's annual, monthly, and quarterly budget execution accounts are cash-based, supplemented by some information such as accounts payable and guarantees.** The annual accounts cover integrated services, autonomous bodies (including reclassified SOEs) and social security,<sup>17</sup> include preliminary figures for regional governments and municipalities, and provide a comparison of actual and budgeted amounts of revenues, expenditures, and balances. The annual accounts also include, as supplementary information, summary reports on general government produced by INE on an ESA 95 basis. However, the general government information is limited to outturn data, without any comparison to ex ante estimates and budgets, where available. Local government financial statements are accrual based, although the coverage of stocks and flows may not be comprehensive in all cases.

**25. Fiscal statistics are based on ESA 95 and incorporate accrual principles.** The INE's quarterly and annual statistical reports (nonfinancial accounts) and the semi-annual EDP notifications, jointly produced by INE and BdP, include information about payables, receivables, debt, gross capital formation and consumption of fixed capital in line with ESA 95 requirements. The net impact of these accrual adjustments in 2011 was to add a further 1.6 percent of GDP to

<sup>17</sup> The annual social security accounts are cash and accrual based.

revenue,<sup>18</sup> take away 3.7 percent of GDP from expenditure,<sup>19</sup> and reduce net borrowing by 5.3 percent of GDP (Table 1.3). Adding the government employee pension liabilities, however, increases general government net borrowing by an estimated 7.1 percent of GDP, raising it to 11.4 percent of GDP.<sup>20</sup>

**Table 1.3. Portugal: Cash to Accrual Adjustments<sup>1/</sup>**  
(Percent of GDP)

	2011	2012	2013
<b>Cash based accounts balance (a)</b>	<b>-9.6</b>	<b>-11.3</b>	<b>-7.6</b>
Accrual adjustments recognized in ESA 95 Net lending calculation (b)	5.3	4.9	2.7
<b>ESA 95 Net Lending (c)=(a)+(b)</b>	<b>-4.3</b>	<b>-6.4</b>	<b>-4.9</b>
Unreported net increase in government employee pension liabilities (d)	-7.1	-7.1	-7.1
<b>GFS Net Lending (e)=(c)+(d)</b>	<b>-11.4</b>	<b>-13.5</b>	<b>-12.0</b>
<b>Accrual adjustments recognized in other fiscal reports</b>			
Valuation changes in financial assets and liabilities (f)	9.1	15.3	-15.3
Net acquisition of nonfinancial assets - reversal (g)	0.4	-0.9	-0.9
<b>Change in net worth (h)=(e)+(f)+(g)</b>	<b>-2.0</b>	<b>0.9</b>	<b>-28.2</b>
Recognized in fiscal reports	5.1	8.0	-21.1
Not recognized in fiscal reports	-7.1	-7.1	-7.1

Source: INE Table B.4.2.2 - Provision of the data which explain the transition between the public accounts budget balance and the central government deficit/surplus and Table B.4.1.1 - Annual economic accounts of general government (S.13); BdP, and staff estimates.

Note: Adjustments for pension accruals less pension payments for 2011 were estimated by BdP at 7.1 percent of GDP. In the absence of information about 2012 and 2013, it has been assumed that the annual adjustments for those years would also approximate 7.1 percent of GDP.

1/ The table shows fiscal indicators (cash balance, net lending) related to general government and the impact of unrecorded flows on them. It has been assumed that the unrecorded flows for general government and public sector will be the same, as entities outside the general government follow accrual accounting and therefore record all flows.

**26. However, significant accrual based flows that have an impact on net worth remain outside the existing fiscal reports and indicators.** This is because:

- the ESA 95 framework is based on rules under which specific expenses, provisions, or liabilities are not recognized. Thus accrued pension obligations for government employees are not

<sup>18</sup> Related mainly to earlier recognition (in 2011) for net lending purposes of cash received from bank pension fund.

<sup>19</sup> Related mainly to reclassification of loans to SoEs— treated as expenditure in cash based accounts— as financial transactions for the purposes of calculating net lending.

<sup>20</sup> The magnitude and impact of the unrecorded accrual flows can vary significantly from year to year; available information is limited and not always audited or otherwise verifiable, and therefore Table 1.3 should be interpreted with caution.

recognized either as an expense or a liability. Instead, the cash payments to retirees less contributions received are recognized as expenditure. These accrual based stocks and flows should be recognized in audited financial statements planned to be prepared according to IPSAS;<sup>21</sup> and

- conceptually, the ESA 95 net lending/borrowing measure is not designed to estimate directly the change in net worth. Instead it is designed to report the financial impact of government activities on the rest of the economy.<sup>22</sup>

**27. Other significant adjustments—ranging from a reduction of 7.1 percentage points of GDP to an increase of 15.1 percentage points of GDP—are not taken into account in determining net borrowing.** The reasons for their exclusions are discussed below.

- Accrued pension entitlements of government employees accumulated under defined benefit schemes are not recognized; only the cash payments to retirees net of contributions received are recognized as expenditure. The effect of this accounting policy is to understate the deficit by €12.1 billion (7.1 percent of GDP) in 2011, as estimated by BdP.<sup>23</sup> The accumulated liability of the government for these pension entitlements at the end of 2011 was estimated at €209.3 billion (122 percent of GDP).<sup>24</sup> While government employee pension liability is high in several countries, as shown in Figure 1.5, Portugal appears to have the highest liability of the sample countries when measured as a percent of GDP. In the absence of data, it has been assumed that the net impact of these adjustments in 2012 and 2013 will remain unchanged at 7.1 percent of GDP.<sup>25</sup> Box 4 explains why employee pension benefits such as those provided under the CGA are a defined benefit plan and should be recognized as liability and expenses.

<sup>21</sup> Similarly, provisions for amounts considered likely to be payable (more than 50 percent probable) in future years for existing guarantees and other contingent liabilities are required to be made under IPSAS, but not ESA 95. Provisions for doubtful debts is another example of amounts that need to be recognized under IPSAS, but not allowed to be recognized under ESA 95.

<sup>22</sup> Thus, although the ESA 95 framework recognizes the consumption of fixed capital (or depreciation) as an expense that affects net worth, this expense is excluded from the ESA 95 measure of net lending/borrowing. Instead, net lending/borrowing treats acquisitions (less disposal) of nonfinancial assets, as expenditure, although this does not affect net worth. Similarly, although the ESA 95 framework recognizes changes in volume and value of assets and liabilities as other economic flows that affect net worth, these are not taken into account in determining the ESA 95 net lending/borrowing.

<sup>23</sup> Some of this amount could be related to changes in actuarial valuation of the liability and therefore would be included as part of other economic flows. However, this information was not available.

<sup>24</sup> Almeida, Branco, and Falcão, BdP (2013), *Pension Liabilities in a Context of an Ageing Population: the Portuguese Case*; and BdP staff estimates. The estimates are of liabilities as of end of 2011 and do not take into account reform measures since 2011.

<sup>25</sup> An alternative estimate by Conta Geral do Estado (CGE) suggests that the liability at the end of 2013 will be slightly reduced at €207.7 (125.4 percent of GDP). Details of the movements including accruals and payments were not available.

#### Box 4. Treatment of Employee Pension Benefits

Portugal has two main government managed pension schemes: a pension scheme for civil servants, the Caixa Geral de Aposentações (CGA); and the regime geral da Segurança Social (SS). The CGA was available to government employees appointed before January 1 2006. These employees retain their membership of the CGA as long as they do not leave the civil service. The civil servants appointed after December 31, 2005 are no longer eligible to join the CGA pension scheme.

The treatment of expenses and liabilities related to pension schemes depends on the nature of the pension schemes and the accounting or statistical standards followed.

- Under ESA 95 accrued employee pensions are not recognized as expenses or liabilities. Instead, the cash payments of pensions less any contributions are recognized as expenditures. Portugal follows ESA 95 in its statistical reports. The annual general state accounts are cash based and therefore also do not recognize accrued expenses and liabilities related to pensions. Under ESA 2010 government sponsored pension schemes remain unrecognized in core accounts, but a new supplementary pension table is required to disclose all accrued-to-date pension entitlements (funded and unfunded).
- Under IPSAS pensions and other retirement benefits provided in exchange for services rendered by employees under formal or informal arrangements and legislative requirements are recognized on an accrual basis. This involves the recognition of a liability and expense when the employee has provided the service in exchange for retirement benefits to be paid in the future. Cash payments to retirees reduce the liability.
- Similarly under GFSM 2001, unfunded employer retirement schemes are considered to involve a contractual liability for a government to its employee. The recognition of the expense and liability under IPSAS and GFSM 2011 ensures that the full cost of employment is reflected in the fiscal reports.

Applying these principles, the benefits under CGA, being available to qualified retired and current government employees as part of their employment conditions, should be recognized on an accrual basis under both IPSAS and GFSM 2001.

The amount of liabilities to be recognized also depends on whether the pension schemes are defined benefit or defined contribution plans. Put simply, defined benefit plans give rise to liabilities, while defined contribution plans do not. IPSAS 25 (paragraph 10) provides the following definitions of defined benefit plans and defined contribution plans:

- “Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund), and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.”
- “Defined benefit plans are post-employment benefit plans other than defined contribution plans.”

IPSAS 25 (paragraph 29) provides the following further guidance on when the employer’s obligation may not be as limited as in a defined contribution plan:

- “Examples of cases where an entity’s obligation is not limited to the amount that it agrees to contribute to the fund are when the entity has a legal or constructive obligation through: . . . a plan benefit formula that is not linked solely to the amount of contributions.”

Based on the above definitions and explanations, the CGA is a defined benefit plan because:<sup>1/</sup>

- i. the government does have “legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets. . . .” The CGA does not accumulate assets from which to pay benefits. It relies on transfers from the government to pay out the benefits.
- ii. the CGA benefits are based on formulae “not linked solely to the amount of contributions”. CGA benefits are based on formulae that take into account factors such as salaries and length of service.

Applying these principles, the FTE concluded that the benefits payable under the CGA should be recognized as a liability and benefits earned by employees recognized as an expense.

1/ Furthermore, the CGA is categorized as a defined benefit scheme in the following documents: (i) *Pension Statistics for the New ESA: Compilation Issues and Some Results for Portugal (BdP)*; (ii) *The Public Sector Pension Scheme of CGA (Country Portugal)* (European Association of Public Sector Pension Institutions), (iii) *Rethinking the State – Selected Expenditure Reform Options* (FAD TA Report, January 2013).

- The above defined benefits scheme is now closed to new entrants. New employees make contributions to the general social security scheme and would be entitled to pension from this scheme in the future. Although a case could be made to provide for the pensions entitlements under this arrangement on the ground that these are imputed costs of employment,<sup>26</sup> it could also be argued that the general social security scheme (SS) would fall under the scope of social benefits. These are non-exchange transactions and currently not recognized as liabilities under IPSAS, except to the extent that they are due and payable.<sup>27</sup> Accordingly the obligations under the general social security scheme (SS), including for any government employees, have not been included as an accrual adjustment in Table 1.3 above.<sup>28</sup> The total of such obligations at the end of 2011 amounted to €348.2 billion (203.5 percent of GDP).<sup>29</sup>
- General social security obligation should be reported as part of long term sustainability reporting (see also Section 3.1.3).<sup>30</sup> IPSASB is working on a project with a view to issuing a standard on this issue. In the meantime IPSASB recommends that government should publish long term fiscal sustainability reports showing, among other things projections for these social benefits to facilitate the assessment of the sustainability of policies and evaluate the fiscal gap. The US federal government publishes such long term projections as part of its audited financial statements and provides additional information and explanations as supplementary information.
- Provisions for amounts payable against guarantees and other contingent liabilities and provisions against any doubtful receivables are not recognized in the fiscal reports. No estimate for such amounts is available.
- Depreciation is not recognized as an expense and acquisition of nonfinancial asset is treated as expenditure in calculating net lending/borrowing. For the purposes of estimating the change in net worth this treatment has to be reversed. In the absence of accounting information about depreciation and net additions to nonfinancial assets, statistical information based on a perpetual inventory system for consumption of fixed capital and net acquisition of nonfinancial

<sup>26</sup> Under the pre-publication draft GFSM 2014 this element should be recognized as an expense and liability (paragraph 6.25).

<sup>27</sup> *GFSM 2014* requires an estimate of the net implicit obligations under social security benefits to be presented as a memorandum item to the balance sheet, with the details being included in a supplementary statement.

<sup>28</sup> Under IPSAS, it is unclear at this stage whether pensions payable to government employees appointed after December 31, 2005, who are not eligible to join CGA and are only entitled to benefits under SS, will be treated as exchange or non-exchange transactions. For this reason the FTE has not taken these into consideration in assessing any unrecorded flows or stocks.

<sup>29</sup> Pension entitlements were estimated using an actuarial cross section country model based on the following assumptions and methodology: the accrued to date gross liabilities approach was used; the GDP growth rate was assumed to be 1.7 percent; wages were expected to grow at a rate of 1.5 percent; the discount rate used was 3 percent, which corresponded to the ten year average of Euro area ten-year government bond yields; the employment rate was assumed to be constant; the demographic assumptions relied on the EUROPOP2008 figures for mortality and fertility rates (migration was ignored). (Source: Almeida, Branco, and Falcão, BdP, (2013); and BdP staff estimates).

<sup>30</sup> This reporting should be undertaken by the MoF in addition to the sustainability reporting done by the EC.

assets have been used to arrive at this adjustment. This led to an increase in net worth by 0.4 percent of GDP in 2011 and reduction in net worth of 0.9 percent of GDP in each of 2012 and 2013.

- Other significant economic flows representing volume and value changes on financial assets and liabilities are not reflected in net lending, but are taken into account in other statistical reports. Substantial gains—€10.6 billion (6.2 percent of GDP)—were reported in 2011 in relation to financial liabilities. These gains arose due to the loss of value of Portuguese debt during the crisis, reducing the government's liability.<sup>31</sup> The value of debt dropped further in 2012 leading to more significant gains €24.1 billion (14.6 percent of GDP). However these gains were substantially reversed in 2013, by €29.6 billion (17.9 percent of GDP), as the Portuguese debt value started recovering thereby increasing the government's liability. The gains in financial assets of €4.9 billion (2.9 percent of GDP) in 2011 reflected mainly a rise in the value of BdP due to a rise in the value of its gold reserves. Similar gains were made in the next two year—€1.1 billion (0.7 percent of GDP) in 2012, and €4.2 billion (2.5 percent of GDP) in 2013. The net impact of these other economic flows was to increase net worth by 9.0 and 15.3 percent of GDP in 2011 and 2012 and reduce net worth by 15.3 percent in 2013.
- Other economic flows, if any, arising from nonfinancial assets are not reported. Adequate records of value and volume of government assets including land and significant infrastructure assets such as roads, bridges, and buildings are not kept. Neither statistical nor accounting reports report any changes in such value or volume.

### 1.1.4 Coverage of tax expenditures (Advanced)

**28. MoF commenced publishing an annual report on the estimated revenue foregone from tax expenditures with the *Relatorio Despesa Fiscal 2013*.** The 2014 version incorporated several improvements in presentation and content. The report covers central, regional and local governments, and provides detailed information about tax expenditures, including principles, methodology for estimating tax expenditure, evolution of tax expenditure, and some international comparison. The report also provides analysis of tax expenditure by function (e.g., economic affairs, social protection) type of tax that is subject to tax expenditure (e.g., taxes on income/wealth, taxes on production and imports etc.), and the type of tax expenditure (e.g., exemptions, deductions, preferential rates, credits). Total tax expenditure in 2013 is estimated to be around 5 percent of GDP or 25 percent of the total net revenues in 2013. This revenue loss is compared with a sample of other OECD countries in Figure 1.6.

**29. Tax expenditure information disclosed in published documents is not consistent.**

In addition to the tax expenditure report mentioned above, the general state accounts also publish information about tax expenditure. However, the amounts in these two reports differ significantly,

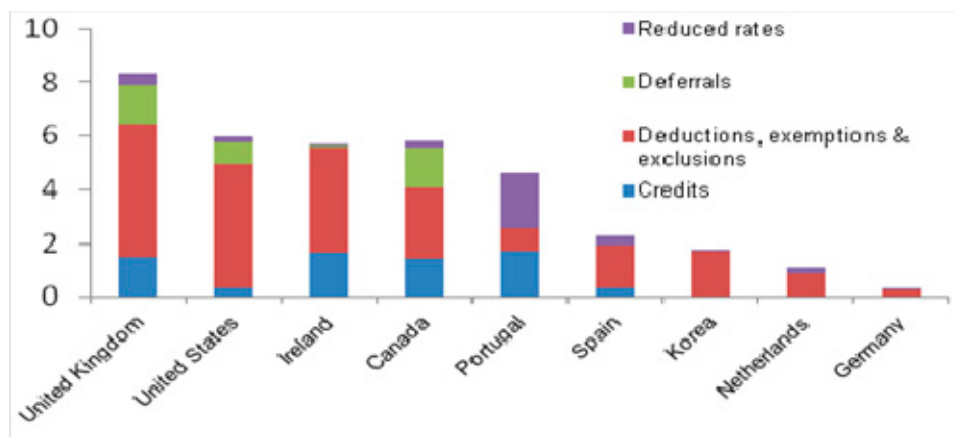
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<sup>31</sup> A paradoxical effect of measuring debt on market value is that reported net worth rises as Portugal's credit deteriorates.

even though they are estimated by the Tax Authority that is part of the MoF. The difference arises because these two reports apply different definitions of tax expenditures. While the tax expenditure reports use a broad definition, the general state accounts defined tax expenditures with a narrower scope. The COA, in its opinion on the General State Accounts of 2012, issues a reservation in regard of the amounts shown in the accounts. Moreover the COA makes a reference to the tax expenditure report but cites a lack of adequate information and records, among other things, as a scope limitation on the audit of tax expenditure. This issue should be resolved and a single definition of tax expenditures should be applied in the fiscal reports.

**30. There are controls on the size of tax expenditures.** Budget documents provide targets and ceilings for tax expenditures. Under the Program, between 2011 and 2014 tax expenditures were set to be reduced by €4.8 billion or 35 percent. Of this total saving, fiscal year 2014, in particular, provides for a reduction €640 million, which represents a decrease of 6.7 percent compared to 2013.

**Figure 1.6. Revenue Loss from Tax Expenditures  
(Percent of GDP)**



Source: OECD (2010); Collins and Walsh (2010); and MoF (2013).

## C. Frequency and Timeliness of Fiscal Reporting

### 1.2.1 Frequency of in-year reporting (Advanced)

**31.** Portugal produces in-year fiscal reports with a high degree of frequency. Monthly, quarterly, and annual reports are published. Monthly cash based budget execution reports covering the general government sector are produced within 23-25 days of the end of the month.<sup>32</sup> This is not required by law, but produced to enhance transparency. The BdP produces quarterly reports of the debt of general government, financing of the general government, and the debt of nonfinancial corporations with a time lag ranging from one month to about seven weeks. All BdP reports are

<sup>32</sup> Excludes parishes, local government enterprise reclassified, and local government autonomous services.



included in the monthly Statistical Bulletin. Quarterly (budget execution) accounts covering the integrated services, autonomous services, and social security (same scope as the Budget) are published with a time lag of a quarter. INE produces quarterly fiscal statistics (known as nonfinancial accounts) and the BdP produces quarterly financial accounts for the general government sector, also with a quarterly lag.

### 1.2.2 Timeliness of annual financial statements (Basic)

#### 32. Audited annual financial statements are available twelve months after the year-end.

This is somewhat slow by international standards and limits the usefulness of the statements. Unaudited General State Accounts are produced and presented to the Parliament and the COA within six months of the end of the financial year and their audit requires a further six months. This lengthy timetable means that the audited accounts are not very useful for their primary intended purpose—accountability and decision making. Annual financial statements should be prepared by March 31 and a standard audit opinion should be issued by June 30. Local government accounts are audited by private sector auditors and completed by April. The accounts are submitted to the Direção-Geral Das Autarquias Locais (DGAL), which aggregates reports of all local governments.

## D. Quality of Fiscal Reports

### 1.3.1 Classification (Good)

33. **Statistical reports follow international classifications standards.** Accounting reports are broadly consistent with such standards at the highest level, with some exceptions. Fiscal statistics comply with ESA 95 classifications. The statistics produced by the INE and BdP under the EDP procedure, e.g., the Maastricht Returns, meet the ESA 95 classification requirements for reporting of fiscal aggregates such as general government net lending/borrowing and debt. On an annual basis, the INE also produces data for inclusion in the IMF's Government Finance Statistics Year Book that, while in large parts, are consistent with *GFSM 2001* economic classification, contain a significant departure from GFSM methodology. This departure relates to the treatment of unfunded public sector pensions which is recognized in *GFSM 2001* but not in ESA 95. No data on nonfinancial assets are reported.

34. **Financial statements follow national classification.** The General State Accounts use cash accounting based economic classification<sup>33</sup> that, although not fully consistent with *GFSM 2001*/ESA 95, is capable of providing the information required by these standards at the highest level, with some exceptions.<sup>34</sup> The functional classification used is also broadly consistent with COFOG at the

<sup>33</sup> Revenue and expenditure classifications are in fact classifications of receipts and payments. For example receipts and payments include, in addition to revenues and expenditures, transactions in financial assets and liabilities, including borrowing and repayments of debt. However, the financial statements make appropriate distinction between revenues, expenditures, and financing items.

<sup>34</sup> For example, the expenditure classification does not separately show subsidies, grants, and social benefits as required by *GFSM 2001*.

highest level, with some exceptions. In particular, Environmental Protection is not shown separately as a highest level function, but is included as part of Housing and Community Services.<sup>35</sup>

**Table 1.4. National Classification vs. International Standards**

Classification	Purpose	International Standard	Portugal Central Government
<b>Administrative</b>	Accountability and budget administration  Example: Ministries, departments, agencies, cost centers, budget funded entities	None	13 ministries, including the Presidency of the Council of Ministers, and a unit called state general charges
<b>Economic</b>	Accountability and budget administration, Control and monitoring of fiscal aggregates, macroeconomic analysis, and financial and statistical reporting	GFSM 2001/ESA 95 IPSAS/IFRS	Revenue and expenditure in accounts according to GFSM 2001/ESA 95 at high level with some exceptions. Statistical reports follow ESA 95 classification.
<b>Functional (and/or Program)</b>	Historic analysis, policy analysis and comparisons, and policy formulation and performance accountability	Classification of Functions of Government (COFOG)	Current and capital expenditure are classified according to functional classification that is broadly consistent with COFOG at the highest level, with some exceptions. All payments including financing transactions are analyzed by functions/organizations and functions/economic.  Program classification corresponds to ministries, other than two miniseries that each has two programs. Each program can perform several COFOG functions or sub functions.
<b>Financial assets and liabilities</b>	Control, accountability, policy and sustainability analysis, fiscal aggregates	GFSM 2001/ESA 95 IPSAS/IFRS	Financial assets and liabilities are classified according to GFSM/ESA 95.
<b>Fund</b>	To identify source of funding, facilitate consolidation, and separately report on all public funds	Specific to each country	Separate accounting is done for each fund, including general revenue, own revenue, revenue from EU, other receipts from borrowing.

Source: IMF.

**35. The existing central government classification is being replaced by the progressive implementation of a new accounting framework defined in the Plano Oficial de Contabilidade Pública (POCP), which incorporates an accrual-based classification.** The POCP classification,

<sup>35</sup> In addition, some sub functions (Fuel and Energy, and Mining, Manufacturing, and Construction) under the COFOG highest level function Economic Affairs are missing. Administrative classification at the highest level represents 12 ministries and a notional organizational unit called State General Expenditure. The program classification is similar to the administrative classification with each ministry being responsible for a program, the exceptions being the MoF and the Ministry of Education and Science, each of which is responsible for two programs.

although broadly consistent with *GFSM 2001/ESA 95*, is designed to enable the preparation of “true and fair view” financial statements and thus would recognize items such as bad debts and losses on sale of fixed assets as expenses. In statistical reports, some of these items would be classified as other economic flows, while others such as provision for doubtful debts may not be recognized.

**36. There is a multiplicity of classification systems.** Municipalities follow a different economic classification based on accrual accounting.<sup>36</sup> These classifications are broadly comparable to the POCB, but have specific accounts to meet the needs of each sector. Public corporations have their own charts of accounts which do not map directly to those used by either central or local government.

**37. The planned introduction of IPSAS provides an opportunity to rationalize the existing classifications and make them consistent with international standards.**<sup>37</sup> In particular, the various classifications mentioned above should be replaced by one standard classification system for the general government sector. Accounts required to meet the specific needs of particular sectors can be accommodated within such a standard system. Furthermore, the new standard classification should be designed to enable the generation of IPSAS based financial statements and be as consistent as possible with the *GFSM2001/ESA 95* classification system. A mapping table to convert public corporations’ financial statements as necessary to enable the production of consolidated financial reports for the public sector as a whole should also be prepared. It is understood that the CNCP (Comissão de Normalização Contabilística Público) is developing a standard classification system for the general government sector.

### 1.3.2 Internal consistency (Advanced)

**38. Fiscal reports are internally consistent as the three internal consistency checks called for under the FTC are regularly verified and published.** The net lending/borrowing quarterly and annual figures derived from the compilation of the non-financial accounts and the financial accounts for the general government and its subsectors, are regularly discussed in the working group of data-producing agencies prior to publication. The discrepancy is often compensated between quarters. The remaining discrepancy is included under accounts payable in the financial accounts, as BdP considers the data sources for this figure not as solid as for the other financial instruments. Thus, the published figures show no discrepancy between the nonfinancial accounts and the financial accounts in terms of net lending/borrowing. This practice should however be discontinued, as it is

<sup>36</sup> These include Plano Oficial de Contabilidade para as Autarquias Locais (POCAL) for the local government sector, Plano Oficial de Contabilidade para o Sector da Educação (POC-Education) for the education sector, Plano Oficial de Contabilidade do Ministério da Saúde (POCMS) for the health sector, and Plano Oficial de Contabilidade das Instituições do Sistema de Solidariedade e da Segurança Social (POCISSSS) for the social security sector.

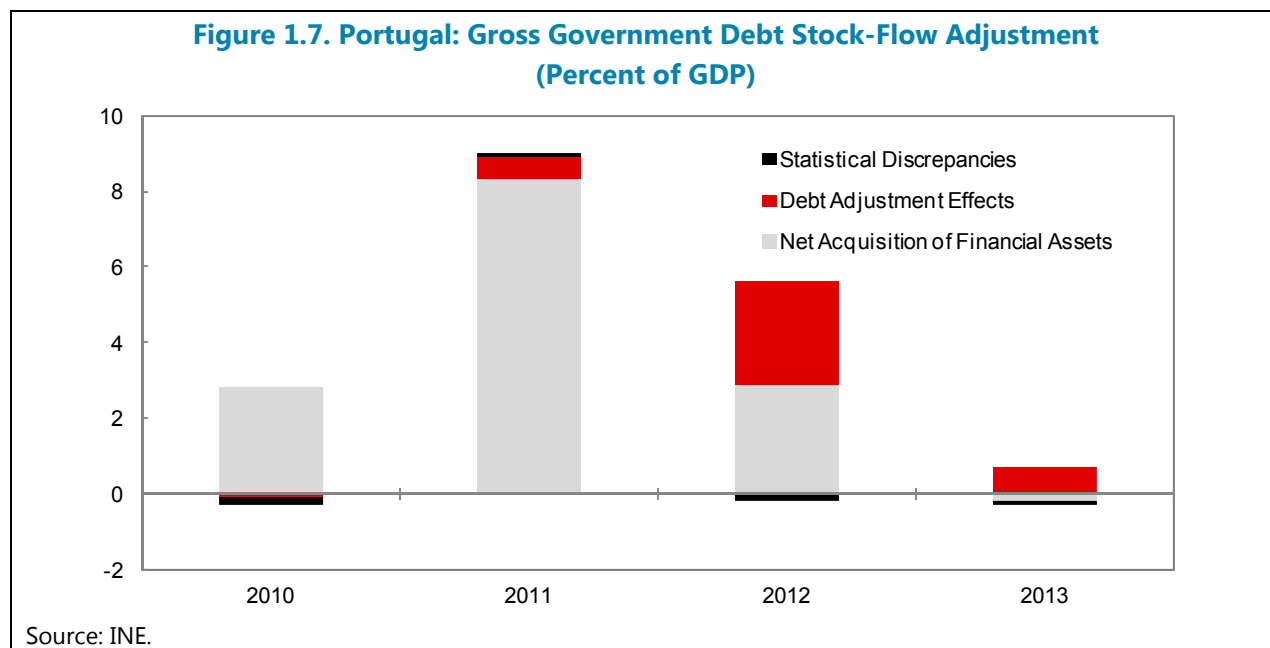
<sup>37</sup> All entities of the general government sector will follow IPSAS. IPSAS based financial statements for entities are expected to be prepared from 2017, while consolidated financial statements for public sector entities are planned to commence from 2019.

preferable to show the remaining statistical discrepancy between the nonfinancial accounts and the financial accounts on a separate line.

**39. General government debt issues and debt holdings are reconciled on a monthly basis.**

Government securities are issued by the IGCP and BdP records all issues in a database. Monthly a direct inquiry in the form of a specific report is sent to banks and selected entities (resident foundations and corporations, and non-resident clearing houses that manage portfolios) that provide 99 percent coverage of debt holdings. Any difference between the issuance of securities and its holdings is attributed to nonresident holdings. The reconciliation of total debt is published in BdP's monthly Statistical Bulletin. The financing of the general government and its subsectors and the resulting changes in the debt stock are reconciled on a quarterly basis for the general government, and on an annual basis for all subsectors. The reconciliation is published in BdP's monthly Statistical Bulletin.

**40. Other internal consistency indicators of the fiscal reports also show a high degree of consistency in the various fiscal reports.** The components of major aggregates add up to the total of the corresponding aggregates, and the balances match the difference between the corresponding aggregates. Furthermore, quarterly figures add up to annual figures, as quarterly reports are adjusted, if needed, to match the annual figures.



**41. Portugal's stock-flow adjustments have been large, mainly because of acquisitions of financial assets.** The stock-flow adjustment is the difference between the change in government debt and the government deficit/surplus, which generally has legitimate explanations, and that provides a useful check of data quality. The stock-flow adjustment can be viewed as composed of three elements: acquisition of financial assets, debt adjustment effects, and statistical discrepancies. Figure 1.7 shows that Portugal had an average adjustment during the 2010-13 period of 4.3 percent

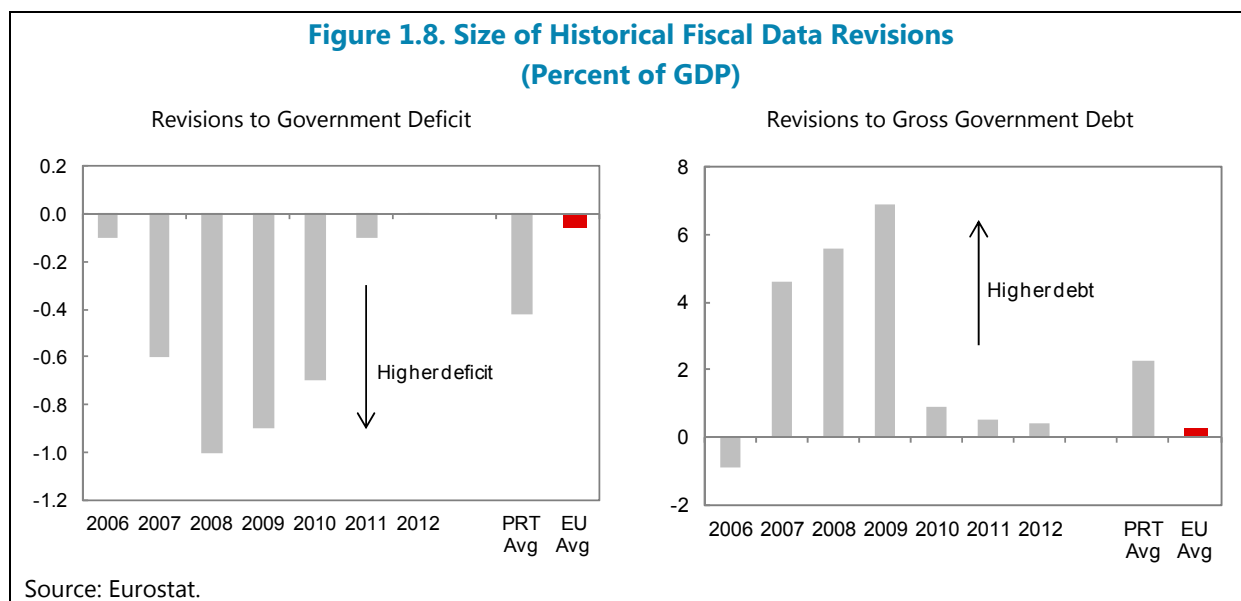
of GDP, compared to an EU average of 1.0 percent of GDP. The figure also shows that the main element responsible for the difference is large net acquisitions of financial assets, which increase debt without affecting the deficit.

### 1.3.3 Historical Revisions (Good)

**42. Portugal discloses revisions to fiscal aggregates in later vintages of published data, and revisions to general government deficit and debt have usually exceeded the EU average, by large margins during certain periods.** Portugal is required to report EDP-related data to Eurostat twice a year (in April and October). The revision policy for annual figures operates as the following example illustrates. The April 2014 EDP notification contains preliminary figures for 2013, provisional figures for 2012, and final figures for 2010 and 2011. The October 2014 EDP notification will contain provisional figures for 2013 and final figures for 2010-12. When each successive quarter within a given year is compiled, the figures for previous quarters are revised, otherwise quarterly figures are revised at the time of the EDP notification (to ensure consistency with annual figures). Changes are explained in press releases whenever significant. The revision policy for nonfinancial accounts is presented and explained in DGO's website.

**43. Portugal's general government deficit and debt figures have been revised up significantly over recent years, mainly as a result of statistical reclassifications.** Over the period 2005–12, the initial deficit estimate has been revised up by an average of 0.4 percent of GDP, and as much as 1 percent of GDP in 2008. The revisions to gross debt have been even larger, with the initial estimate revised up by 2.2 percent on average, and 7 percent in 2009 (Figure 1.8). This is far larger than the EU average, and represents some of the largest revisions in Europe. The bulk of these revisions relate to reclassifications of state owned enterprises and PPPs within the general government perimeter, but also reflect previously unreported figures from Madeira. In reporting to Eurostat on revisions to historical fiscal data, INE and BdP provide a supplementary table with an item wise breakdown of changes between the old and new time series. This supplementary table is not published either domestically or by Eurostat.

**44. Other significant changes that affect historical fiscal data are published and explained.** When a new base year for the national accounts is introduced every five years it is explained in detail to the public, though no bridge table is currently prepared. However, the introduction of such a table is planned. Changes in the composition of the general government and its subsectors, for example the reclassification of public corporations, are communicated and explained to the public in press releases.



## E. Integrity of Fiscal Reports

### 1.4.1 Statistical integrity (Advanced)

**45. Fiscal statistics are compiled and disseminated by the INE and the BdP, which apply methodology and standards that are harmonized at EU level, and comply with IMF's Special Data Dissemination Standard (SDDS) requirements.** The statistical methodology used by BdP and INE for the compilation of the nonfinancial accounts and the financial accounts is the same—ESA 95. This methodology is available on the websites of INE and BdP. The fiscal statistics compiled and disseminated meet the various guidelines established by Eurostat for data reporting by EU member countries, and are subject to review by this institution.

**46. The legal and regulatory environment for the compilation and dissemination of fiscal statistics clearly allocate responsibilities among data-producing agencies and support the impartial undertaking of the associated tasks.** The main laws that specify the collection of fiscal data are the Budget Framework Law, the Decree law of budget execution, and MoF organizational internal rules. These laws specify the information to be collected and the obligation of public entities to supply the information to DGO.<sup>38</sup> The division of tasks and the cooperation framework for the compilation of national accounts are defined by a protocol signed in 1998 by BdP and the INE. For general government accounts, a specific institutional framework has existed since 2006, when the Institutional Cooperation Agreement in the Field of Government Finance Statistics was signed between BdP, INE, and DGO.

<sup>38</sup> The main national laws that specify the compilation of GFS by INE are Law No. 22/2008 of 13 May, approving the general basis of the National Statistical System, and Decree – Law No. 136/2012 of 2 July, approving the organization of INE. The main national laws that specify the compilation of GFS by BdP are its Organic Law (Law No. 5/98 of 31 January, and amendments) and the previously mentioned law on the National Statistical System.

### 1.4.2 External audit (Good)

**47. The COA is independent of the executive and provides an audit opinion on the General State Accounts.** The General State Accounts, including the accounts of the Social Security, are audited by the COA. The COA issues a report entitled “opinion on the General State Accounts.”

Currently the COA opinion focuses on the legality of budget execution, but also expresses reservations on the reliability of the accounts. The COA does not express an opinion on whether the financial statements present a true and fair view. The adoption of full accrual accounting in accordance with international accounting standards by the Portuguese authorities will facilitate the auditing in accordance with international standards and the provision of an opinion on whether the financial statements present a true and fair view. The financial statements of local governments are audited by certified auditors and audit opinions are provided. The COA also reviews these financial statements on a sample basis.

**48. Regarding reliability, the COA expresses an opinion that may be open to alternative interpretations.** Although not expressed fully in the manner set out in International Standards on Auditing or the corresponding International Standards for Supreme Audit Institutions (ISSAI), the COA uses language that could suggest that the COA is issuing a disclaimer of opinion on the accounts of the central government. However, the COA confirmed that this is a scope limitation and concerns legality issues and is not, by itself, a conclusion regarding the overall reliability of the accounts. Regarding the Central Government as well as the Social Security accounts, various reservations are expressed regarding the reliability, without a disclaimer of opinion.

**49. Regarding legality, the COA gives a favorable or unqualified opinion on the General State Accounts, but a qualified opinion on the social security accounts.** The opinion on the central government is accompanied by certain “emphasis of matter” without a modification of the opinion. The COA expresses reservations (qualifications) on the Social Security accounts regarding certain cases of noncompliance with legal provisions.

**50. Fiscal transparency would be further strengthened if the COA adopted ISSAI, and expressed a standard opinion.**<sup>39</sup> The COA should move progressively to full adoption of ISSAI and provide an opinion on whether the financial statements present a true and fair view. As noted earlier, the adoption of an IPSAS based (fair presentation, rather than compliance) framework would facilitate the COA to provide such an opinion.

**51. Fiscal transparency would also be enhanced through a clearer identification of the accounts that are covered by the audit opinion.** It is good practice for audit opinion to define the scope of the audit by defining the financial statements that have been audited and carefully indicating any information published along with audited financial statements that have not been audited. In Portugal the document referred to as General State Accounts includes information that is

<sup>39</sup> In particular, see ISSAI 1700 – *Forming an Opinion and Reporting on Financial Statements*.

subject to audit and also some that is not. For example, the information related to the general government is not covered by the opinion. It would be more transparent if the scope of the audit opinion is disclosed clearly.

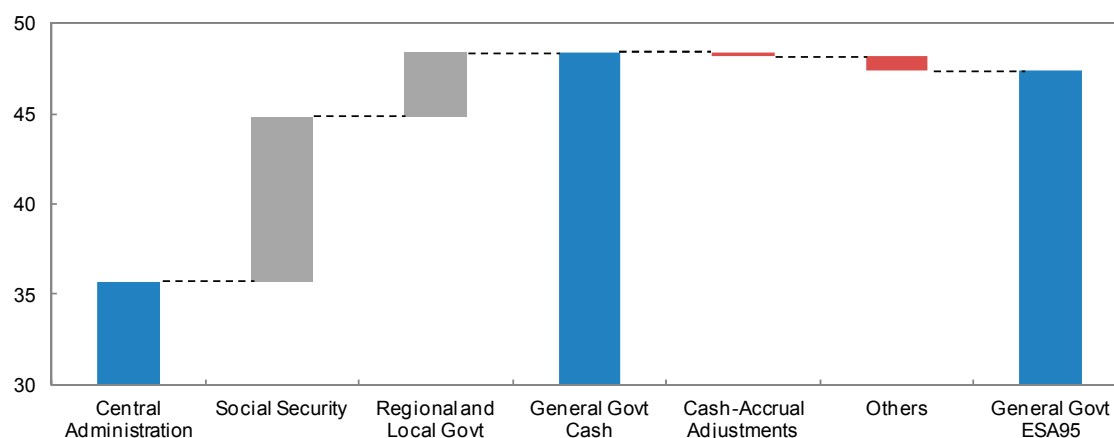
### 1.4.3 Comparability of fiscal data (Good)

**52. Fiscal reports have a good degree of comparability.** DGO prepares the budget execution reports, INE compiles the nonfinancial accounts, and BdP compiles the financial accounts for the general government. The final accounts are also prepared by DGO. As noted, the three institutions use the same institutional coverage of the general government and its subsectors. DGO prepares its reports on a cash basis, while INE and BdP prepare fiscal statistics on an accrual basis. The DGO report presents mainly data on revenues and expenditures, with a single line for assets and liabilities flows. INE uses the DGO reports as a key input to compile fiscal statistics. It makes adjustments to convert the revenue and expenditure data in DGO reports from cash to accrual basis. The budget execution data and fiscal statistics are on a different time of recording, though, which is an issue. This is addressed by reconciling in a table the deficit/surplus in DGO's fiscal reports with the net lending/borrowing balances in INE's fiscal statistics. INE and BdP coordinate closely the net lending/borrowing balance figure in their statistics to ensure consistency of the reports. INE sends to Eurostat the data required under the EDP notification. Thus, the reports prepared by the three institutions are well comparable.

**53. Budget forecasts and budget outturns are also comparable.** In their monthly fiscal outturns reports, DGO presents and compares the outturn of the fiscal items (revenue and spending categories) with their fiscal forecasts (budget or supplementary budgets), using the same statistical concept. The differences between the outturn balance and national debt, on the one hand, and the deficit and debt of general government, on the other, are further explained. The differences between the two main sets of indicators of the deficit and debt are reconciled. While the same reconciliation is not provided for expenditure or revenue, it can be put together based on publicly available information, by bridging both the coverage and cash accrual adjustment (Figure 1.9). Such cash-accrual adjustment is disclosed monthly by DGO in the budget execution report.



**Figure 1.9. Portugal: Total Expenditure - Reconciliation of Budget to General Government (Percent of GDP)**



Source: DGO and INE.

## F. Priorities

**54. The summary of the above evaluation is presented in Table 1.5.** The priority areas that require attention are as follows.

- INE, BdP, and MoF should compile and disseminate more comprehensive fiscal statistics, covering all institutional units of the public sector and its subsectors and all flows and stocks associated with these units.
- MoF should implement a central government accounting function responsible for maintaining adequate books of account for items such as tax revenue and government bank accounts and implement a conceptual framework and an integrated accounting system that provide complete information for the preparation of financial statements in accordance with IPSAS. The minister of finance should be legally responsible to prepare and submit, within three months after the year end, financial statements that certify that these provide a true and fair view.
- COA should provide, within six months after the year end, an opinion on whether the audited financial statements provide a true and fair view in accordance with internationally accepted auditing standards.

Table 1.5. Portugal: Summary Assessment of Fiscal Reporting

Principle		Assessment	Importance	Priority
1.1.1	Coverage of Institutions	<b>Good:</b> Fiscal statistics consolidate all general government institutional units	<b>High:</b> Public corporations with net expenditures of 10 percent of GDP are outside fiscal statistics	Y
1.1.2	Coverage of Stocks	<b>Good:</b> Fiscal reports cover most financial assets and liabilities	<b>High:</b> Central government liabilities of 134 percent of GDP are outside fiscal statistics. No data on general government non-financial assets	Y
1.1.3	Coverage of Flows	<b>Basic:</b> Fiscal reports cover all cash and some accrual revenues and expenditures	<b>High:</b> Accrued general government pension expenses of 7.1 percent of GDP outside fiscal statistics	Y
1.1.4	Coverage of Tax Expenditures	<b>Advanced:</b> Tax Expenditure is estimated by sector or policy area, published annually, and there is control on, or budgetary objectives for, the size of tax expenditure.	<b>Medium:</b> Tax expenditure around 5 percent of GDP is high by international standards, and amounts are reported inconsistently in different reports.	
1.2.1	Frequency of In-year Reporting	<b>Advanced:</b> In-year fiscal reports are published on a monthly basis	<b>Low:</b> Fiscal reports are published within 25 days	
1.2.2	Timeliness of Annual Financial Statements	<b>Basic:</b> Unaudited financial statements are presented to parliament within six months and audited statements are published within 12 months of the end of the financial year.	<b>Medium:</b> Audited financial statements for the previous year published too late to inform the preparation of the next year's budget	Y
1.3.1	Classification	<b>Good:</b> Fiscal reports include an administrative, economic, and functional classification consistent with international standards, with some exceptions	<b>Low:</b> Discrepancies with international standards are expected to be addressed as part of the planned accounting reforms.	
1.3.2	Internal Consistency	<b>Advanced:</b> Fiscal reports include the three key flow and stock reconciliations	<b>Medium:</b> The reconciliation of fiscal balance and financing is not published	
1.3.3	Historical Revisions	<b>Good:</b> Revisions to historical data are regularly reported	<b>High:</b> Revisions to general government deficit and debt exceed EU average revisions	
1.4.1	Statistical Integrity	<b>Advanced:</b> Statistics are prepared by independent agencies, which observe international standards	<b>Medium:</b> INE and BdP are subject to Eurostat governance principles and statistical standards	
1.4.2	External Audit	<b>Good:</b> Government accounts are audited by an independent supreme audit institution in accordance with its legal mandate, but not fully in accordance with international standards.	<b>High:</b> Annual accounts, audited independently, are the principal accountability document in Portugal.	Y
1.4.3	Comparability of Fiscal Data	<b>Good:</b> Balances of fiscal reports can be reconciled and budget forecasts and outturn are comparable	<b>Low:</b> Budgets and reports are subject to reconciliation processes required by Eurostat.	

## FISCAL FORECASTING AND BUDGETING

### A. Overview

**55. This chapter assesses the quality of current fiscal forecasting and budgeting practices relative to standards set by the IMF's Code.** It focuses on four main areas:

- a. the comprehensiveness of the budget and associated documentation;
- b. the orderliness of the budget process and its passage;
- c. the policy orientation of budget documentation; and
- d. the credibility of the fiscal forecasts and budget proposals.

**56. Portugal's budget and fiscal forecasting practices have improved over recent years, meeting good or advanced standards in most areas.** The broadening of budget coverage to all entities within the general government, and introduction of a medium-term budget framework have improved the comprehensiveness of budget documentation, although weaknesses in the reporting of major investment projects remain. The orderliness of the budget process is well established in both law and practice, though anticipated improvements in the budget framework law remain a priority.

**57. There remains scope for improvements around the policy orientation of the budget and credibility of the fiscal forecasts and budget proposals.** While the fiscal policy objectives have been adjusted to meet European requirements, the budget remains input focused, rather than focusing on outcomes and outputs. The introduction of a citizen's budget is a welcome initiative, though community participation could be improved. Apart from some high profile deviations, the annual budget has been largely delivered as announced, however there has been a well documented optimistic bias in the medium-term forecasts and plans over the past decade. The introduction of the public finance council and medium-term expenditure limits will go some way to preventing this from continuing, though clearly laying out any variations in fiscal forecasts through a reconciliation table would improve the credibility of medium-term forecasts.

**Table 2.1. Portugal: Fiscal Forecasting and Budget Documents**

Document	Purpose	2013 Timing
Stability Program Update/ Fiscal Strategy Report	Updates macroeconomic and fiscal forecasts; sets out fiscal objectives; meets European requirements.	Late April
Main Budget Report	Provides macroeconomic and fiscal forecasts; detailed expenditure allocations and measures	Mid-October
Supporting Tables	Detailed information on spending by economic program classification	Mid-October
Portuguese Public Finance Council Reports	Evaluation of fiscal forecasts and compliance fiscal rules	May and October
Economic and Social Council	Expresses the council's opinion on programs and policies for social and economic development	
General State Accounts	Provides audited outturn information and some performance indicators	December

Source: MoF.

## B. Comprehensiveness of Budget Documentation

### 2.1.1 Budget unity (Advanced)

**58. Portugal's annual budget documentation incorporates all general government revenue, expenditure, and financing activities.** These include all of the Integrated Services (SIs), the Autonomous Funds and Agencies (SFAs), and social security, as well as summaries of regional and local government sectors. Beginning in 2012, in line with the BFL, which required the government to include all general government entities within the state budget, all public corporations that are classified within the general government perimeter are also included within the budget documentation.

**59. The budget presents all expenditures and revenues on a gross basis, an important feature given the importance of own source revenues in Portugal.** The budget tables provide a clear distinction between expenditures funded through general revenues and those funded through own source revenues, the latter of which make up a substantial proportion of expenditure. Own source revenues of public administration bodies in Portugal—including those of reclassified public corporations—account for 17 percent of expenditures, one of the largest shares in the measured countries, which increases to 35 percent of the central government once the contributions of the social security sector are included (Figure 2.1).

**60. In line with EU requirements, the budget documentation that accompanies the annual estimates includes forecasts of the general government fiscal aggregates.** In addition to figures for gross general government revenue and expenditure, the Budget Strategy Document and Budget documentation include a reconciliation (or "walk") from the State Budget balance to the general government balance. However, there is no information provided on how state budget revenue and

expenditure aggregates relate to the ESA 95 general government expenditure and revenue aggregates which form the basis of Portugal's new EU and domestic fiscal rules described in Section 2.3.1 below.

**Figure 2.1. Own Source Revenues  
(Percent of Gross Expenditure)**



Source: 2014 Budget Report, staff estimates, national budgets.

## 2.1.2 Macroeconomic forecasts (Good)

### 61. Portugal's budget and fiscal strategy documents disclose the assumptions underlying their fiscal forecasts and key macroeconomic variables in a clear and comprehensive fashion.

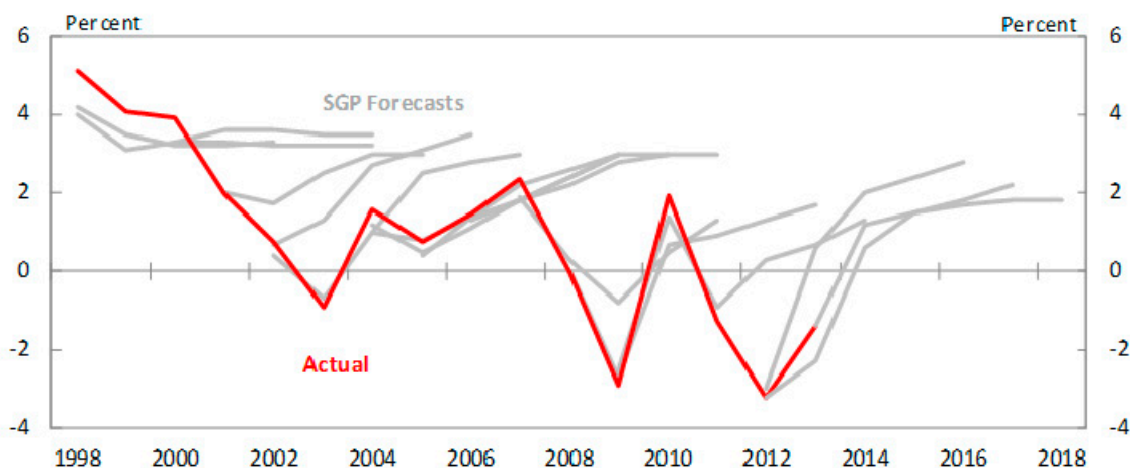
The forecasts are presented in their most comprehensive form in the fiscal strategy document (Documento de Estratégia Orçamental–DEO), with the recent outturn (sometimes in a quarterly frequency) and four year-ahead forecasts of key macroeconomic aggregates such as real GDP, inflation, the unemployment rate, exports and imports, and the current and capital account balances. There is a discussion of the forecasts and underlying drivers of each of the components of GDP as well as a discussion of the international investment position and government financing needs. The forecasts are then updated in the Budget Report in October along with the quarterly outturn of the main macroeconomic variables.

**62. However, while Portugal's year-ahead forecasts are relatively accurate, over the medium-term horizon they present a large optimistic bias.** For most of the past decade, budget macroeconomic forecasts envisaged a return to 3 percent real GDP growth in the medium term, a relic of the strong growth recorded over the 1990s (Figure 2.2). However, when this failed to materialize, forecasts did not adjust until the advent of the crisis. This resulted in a large optimistic bias—the third largest in Western Europe, which has been further exacerbated by the large unforecasted output falls over the course of the program (Figure 2.2).

**63. Since the financial crisis, the MoF's medium-term macroeconomic forecasts have become more prudent.** Expectations have been lowered considerably, with medium-term growth

forecasts now based on anticipated potential real GDP growth rates of 1 percent, due largely to demographic factors.<sup>40</sup> Other entities within the government (e.g., tax administration and social security institutions) are not obliged to use the MoF economic assumptions to prepare their revenue and expenditure forecasts. Although in practice most of them have been doing so for some time, there is no framework to ensure that all entities are using the same assumptions.

**Figure 2.2. Portugal: Real GDP Forecast History  
(Percent)**



Source: Staff estimates, European Commission, Ministry of Finance.

### 2.1.3 Medium-term budget framework (Good)

**64. Portugal introduced a basic medium-term budget framework in 2012, which combined with the medium-term fiscal forecasts in the Budget Strategy Document, provide a reasonable basis for medium-term budgeting.** Together, these documents provide a guide to expenditure, revenue and financing over the next four years on an economic basis, and present some details of expenditure on the same administrative basis as the budget beyond the budget year.

**65. The medium-term budget framework is published twice a year, presenting detailed expenditure allocations for the upcoming budget year and higher level aggregates for the following three years.** The allocations for the budget year are for the 15 high level programs, and intended to be fixed at the amounts laid out in the budget strategy document in April of each year. Expenditure allocations for higher “spending area” levels (combining three or four of the programs) are provided for budget year plus one, and are also intended to be fixed. A binding overall spending

<sup>40</sup> The MoF uses a macroeconomic model to prepare its forecasts. The model contains 5 blocks: a fiscal block, a price block, and demand component block, a potential output block, and a labor market block. In the long-term the model is neo-classical, but in the short- to medium-term, the model allows for Keynesian effects. One of the main issues for the MT forecast is how to forecast productivity effects and going forward how to account for the effects of the structural reforms recently implemented by the government in the context of the program.

limit is provided for budget years plus two and three (Table 2.2). When the budget is published, the expenditure allocations are updated for any budget decisions, and a revised table is provided.

**Table 2.2. Example of MTBF 2013 Budget**  
(€ millions)

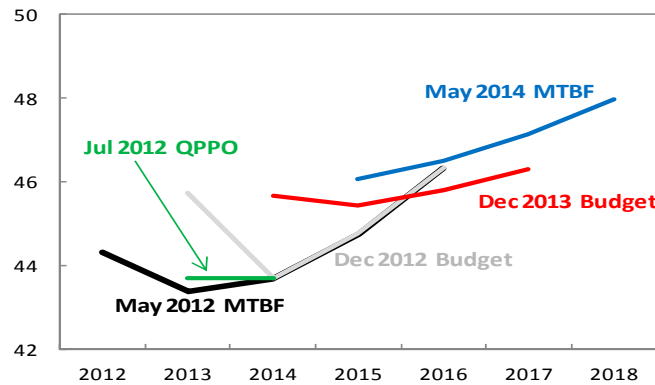
Unidade: milhões de euros

Despesa coberta por receitas gerais		2013	2014	2015	2016
<b>Soberania</b>	P001 - Órgãos de soberania	2.868			
	P002 - Governação e Cultura	222			
	P005 - Representação Externa	319			
	P008 - Justiça	679			
<b>Subtotal agrupamento</b>		<b>4.087</b>	<b>3.676</b>		
<b>Segurança</b>	P006 - Defesa	1.843			
	P007 - Segurança Interna	1.827			
<b>Subtotal agrupamento</b>		<b>3.669</b>	<b>3.497</b>		
<b>Social</b>	P011 - Saúde	7.841			
	P012 - Ensino Básico e Secundário e Administração Escolar	5.232			
	P013 - Ciência e Ensino Superior	1.305			
	P014 - Solidariedade e Segurança Social	8.871			
<b>Subtotal agrupamento</b>		<b>23.249</b>	<b>20.139</b>		
<b>Económica</b>	P003 - Finanças e Administração Pública	6.874			
	P004 - Gestão da Dívida Pública	7.276			
	P009 - Economia e Emprego	160			
	P010 - Agricultura, Mar e Ambiente	422			
<b>Subtotal agrupamento</b>		<b>14.732</b>	<b>16.379</b>		
<b>Agrupamentos de programas</b>		<b>45.737</b>	<b>43.691</b>	<b>44.761</b>	<b>46.320</b>

Source: Various Fiscal Strategy and Budget reports.

**66. The intended approach of setting binding expenditure allocations has been disrupted by unexpected developments, such as rulings of the constitutional court.** This has resulted in the annual budget needing to be updated almost immediately on a number of occasions due to budget measures being found to be unconstitutional. Such problems resulted in the MT budget framework (Fiscal Strategy Document) for 2014-18 not being published in 2013, and the intended binding expenditure constraints in the MT budget framework not being respected (Figure 2.3). A further issue relates to the fact that the budget framework covers only expenditure financed by general revenues (approximately €45.8 billion in 2014), rather than total budget expenditure of €79.5 billion. In addition to leaving more than a third of expenditure outside of its coverage, it also makes it difficult to reconcile the outturns back to the limits, as the general revenue financed expenditure is not reported in most other documents.

**Figure 2.3. Successive Spending Limits  
(€ Billions)**

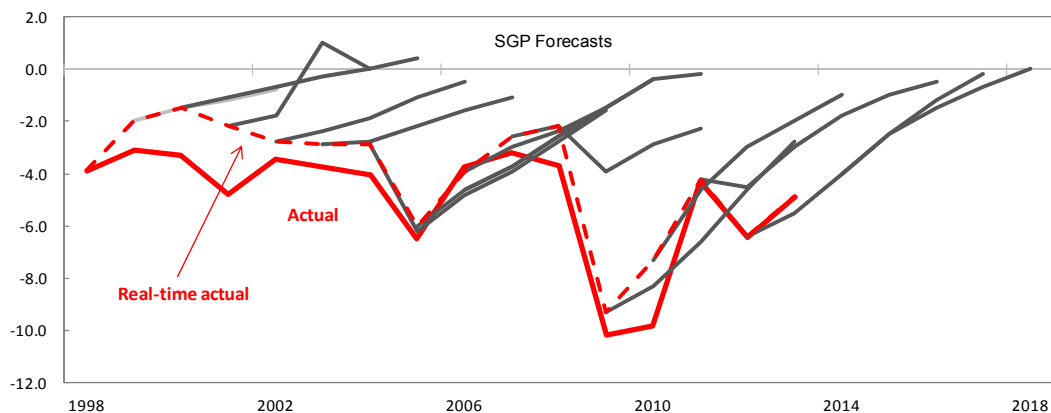


Source: Various Fiscal Strategy and Budget Reports.

\*Quadro Plurianual de Programação Orçamental.

**67. Nevertheless, the introduction of the medium-term budget framework has been a useful innovation, and greater commitment to it will assist with future adjustments.** The integration of top-down and bottom-up expenditure forecasting has resulted in a more consistent budget, and greater focus on the medium-term impact of budget measures. In the pre-crisis years, the fiscal forecasts bore little relation to actual budget outcomes (Figure 2.4), with the medium-term estimates included in the Stability and Growth Program update continually projecting a return to balance, resulting in Portugal having one of the largest optimistic biases in Western Europe (Figure 2.5). Since the crisis, the record has improved (although still remains short of meeting the medium-term targets), yet it is an open question whether this is due to a stronger medium-term target, or the targets set within the economic adjustment program. In order to provide a more credible guide for future policy, the MTBF should be made more robust (see Paragraph 93), and the findings of the independent fiscal council should be followed to help prevent biased forecasts.

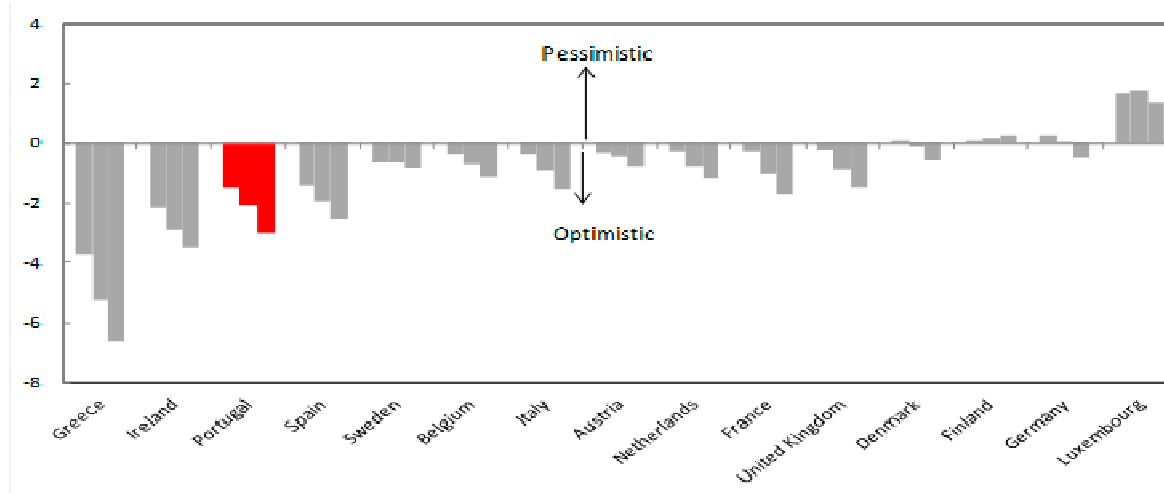
**Figure 2.4. Medium-Term Budget Balance Forecasts  
(Percent of GDP)**



Source: Staff estimates, European Commission.



**Figure 2.5. Average Medium-Term Budget Balance Forecasting Error, 1998-2007  
(Percent of GDP)**



Source: Staff estimates, European Commission.

Note: First column refers to budget year (BY), second to BY+1, third to BY+2.

#### 2.1.4. Investment projects (Basic)

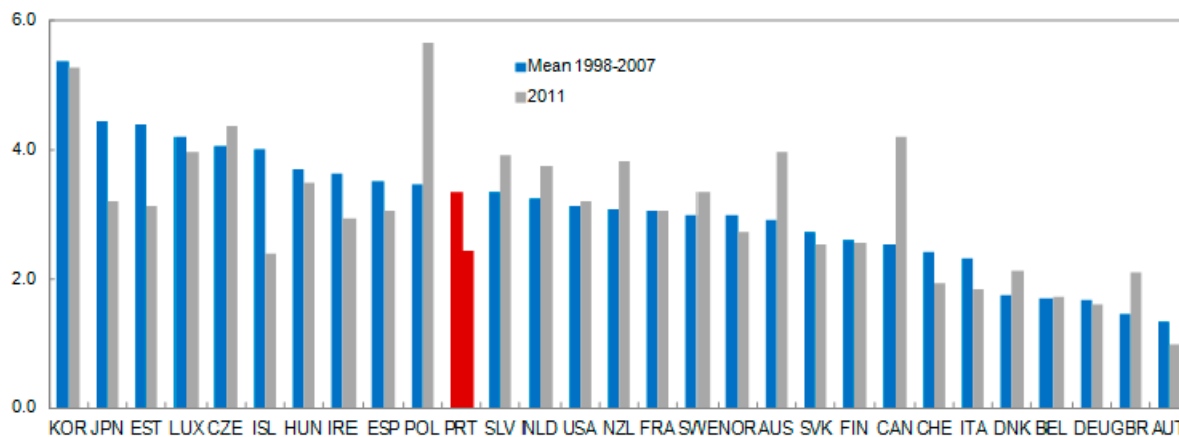
**68. There is little publicly available information on major public investment projects, though most do go to open tender.** The budget does include some information on particular projects, and an internal monitoring database exists. However this is not translated into any summary public documents that present major investment projects or detail their specific multi-annual obligations. All major projects are contracted via open and competitive tenders, in line with European requirements.

**69. It is not clear whether all new public investment projects undergo a cost benefit analysis, and the results of those that do are not routinely made public, though a more transparent process has been developed.** All new PPP initiatives that fall within UTAP's scope are now required to undergo a cost benefit analysis, as are all European financed projects (see Chapter 3). This analysis will be based on credible assumptions and international methodologies, as well as providing a public sector comparison to ensure value for money. There are no current plans to make these analyses public, and projects that are developed outside of the PPP model do not fall under UTAP's purview.

**70. Public investment is relatively low as a share of GDP, reflecting the recent fiscal consolidation effort, but is anticipated to increase in the coming years (Figure 2.6).** A large part of this investment will continue to be financed by EU structural funds with their standard cost-benefit analysis and information disclosure requirements. The approval and selection process for investments undertaken through alternative arrangements (such as through public corporations) or traditionally publicly funded works do not follow the same criteria or assessment process. The scope

of UTAP could be extended to provide a centralized public investment project assessment office, undertaking or coordinating cost benefit analyses for all major projects regardless of financing, on a consistent basis, using the same major assumptions, making all cost benefit analyses public to improve investment decisions and the transparency of project selection.

**Figure 2.6. OECD Public Investment  
(Percent of GDP)**



Source: OECD.

## C. Orderliness of the Budget Process

### 2.2.1 Fiscal legislation (Good)

**71. Although still fragmented, the Budget Framework Law (BFL) provides most of the elements required to guide the budget process.** The timing of the major interactions between the executive and the parliament are clearly laid out, detailing the process for submission of the budget strategy and budget documents, the process of discussion and voting in parliament and their publication and implementation. The content requirements are laid out, perhaps in an overly detailed manner, focusing on which particular tables and charts should be included, rather than focusing on what key requirements and minimum levels of detail should be provided.

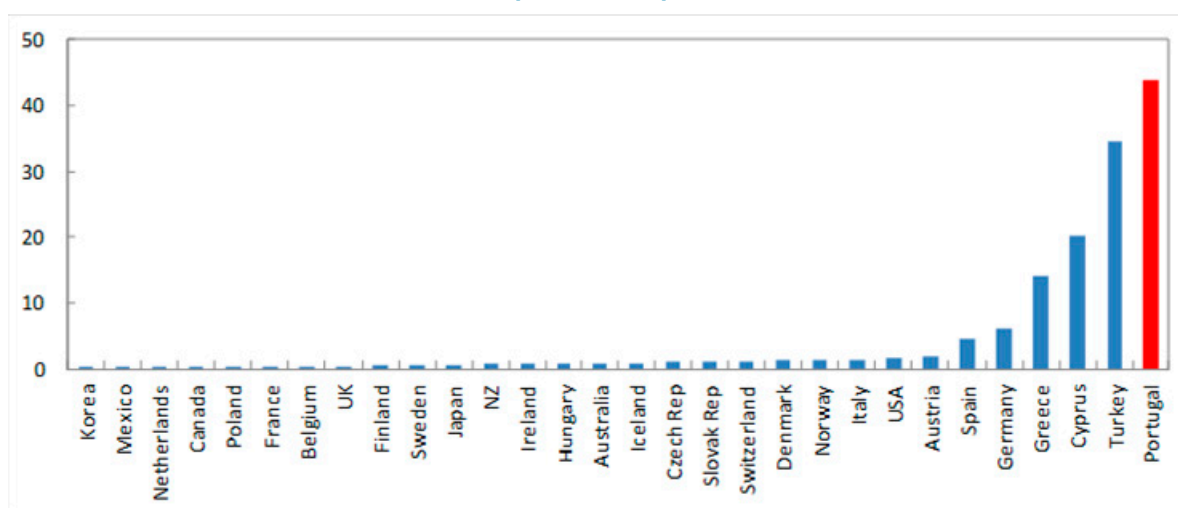
**72. The law does not include any limits on the legislature's power to amend the executive's budget proposal.** However, this does not appear to have been a major issue in Portugal over the past decade, with parliamentary amendments increasing expenditures only once, by only 0.5 percent of expenditure in 2012 (Figure 2.7).

**73. The law also includes a number of other favorable elements, and considerable work has gone into improving the BFL over recent years.** The reform of the budget framework law in 2011 introduced most of the elements that are part of modern financial management legislation, strengthening the macro-fiscal focus of the law, including extending the coverage of the budget to all entities included within the general government; introducing a medium-term budgetary framework with binding expenditure ceilings; and introducing fiscal rules and medium-term

objectives in line with European requirements. Some of these elements were introduced with the 2013 amendments, and further amendments to transpose the EU fiscal compact provisions will be completed this year.

**74. Nevertheless, there remain a number of weaknesses in the BFL. The law is fragmented, heavily detailed, and unclear in a number of areas, such as the fiscal rules and principles.** There are a range of inconsistencies within the law, particularly regarding the key budgetary principles and subsidiary legislation. A number of key areas of the budget cycle remain unaddressed within the law, such as the Treasury function, and requirements for audit opinions. The law requires excessively detailed levels of appropriations, with Portugal having the highest number of budget appropriations in the OECD (Figure 2.7) and results in an overly fragmented and transaction oriented system, requiring the Budget office to interact with 443 entities.

**Figure 2.7. Number of Budget Appropriations (Thousands)**



Source: OECD Budget Practices Database and staff estimates.

**75. The government continues to work on addressing these issues, with a process underway to undertake a large scale revision to the law by late 2014.** A working group has been established to amend the law, with the objectives of improving its clarity; reducing the number of entities by raising the level of budget preparation, monitoring, and execution; streamlining the budget appropriation structure; and introducing properly resourced program coordinators to manage the budget.

### 2.2.2 Timeliness of Budget Documentation (Good)

**76. The budget is presented to Parliament in mid-October, two and a half months prior to the budget year, and approved before the beginning of the budget year.** This is in line with the European requirements for budgets to be submitted by October 15—the same date as specified within the Budget Framework Law, though falls slightly short of the advanced level of practice. These requirements have been met over the past five years in all but one year, when the 2010 budget was

presented on January 26 due to an election in late 2009, and passed on April 22. In that year, the budget reverted to 1/12th of the previous year's appropriation, as provided for under the BFL. In order to meet advanced level, the budget needs to be submitted three months before, and passed one month prior to the beginning of the budget year.

## D. Policy Orientation of the Budget

### 2.3.1 Fiscal policy objectives (Good)

**77. Portugal's fiscal objectives are clearly stated in the BFL and reported against in its budget documentation.** Prior to the crisis, the government's fiscal objectives were set by the EU Stability and Growth Pact (i) aiming for budget balance; (ii) keeping the general government fiscal deficit below the 3 percent of GDP limit; and (iii) targeting the debt level to below the 60 percent of GDP limit. In the aftermath of the crisis, the government's near-term fiscal objectives followed the EFF arrangement, targeting a reduction in the general government deficit from 10.2 percent of GDP in 2009 to 4.0 percent in 2014. Between 2011 and 2013 the structural balance improved by 3.5 to 2.8 percent of GDP, the second biggest structural effort in the Euro area. Since 2011, the structural primary balance has also improved and turned into surplus, increasing from -2.2 to 1.5 percent of GDP in 2013.

**78. After the conclusion of the Economic Adjustment Program, Portugal's fiscal policy objectives will be anchored by its BFL and the new 2012 European fiscal provisions.<sup>41</sup>**

Articles 10-G and 12-C of the Portuguese BFL establish the four fiscal policy objectives that Portugal will need to follow in line with the EU requirements:

- **general government fiscal deficit** below the 3 percent of GDP limit;
- **medium-term structural balance objective** of a structural deficit no larger than 0.5 percent of GDP; or if in exceptional circumstances (as it is now), a convergence of the structural budget deficit towards the medium-term target of 0.5 percent of GDP a year;
- **debt rule:** when general government debt exceeds 60 percent of GDP, the annual pace of debt reduction must be no less than 1/20th of the distance between the actual debt ratio at the end of each year and the 60 percent of GDP limit. The reduction in the debt takes further into consideration the business cycle and statistical reclassification of the general government by INE and BdP; and
- **medium-term expenditure benchmark** limiting annual growth in general government expenditure to potential GDP growth, as assessed over the past five years, the estimate for the current year, and projections for the next four years, with expenditure levels adjusted for (i) the

<sup>41</sup> The Fiscal Compact, formally known as the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, was signed on 2 March 2012 by all member states of the European Union at the time, except the Czech Republic and the United Kingdom.

impact of any new revenue measures; (ii) expenditure on EU programs; (iii) interest expenditure which is fully matched by EU funds revenue; (iv) gross fixed capital formation averaged over the last four years; and (v) cyclical unemployment benefit expenditure.

**79. Compliance with these EU provisions will require an improvement in the reporting of general government fiscal forecast and outturn in budget documents.** This includes a precise identification of the expenditure ceilings compatible with complying with the fiscal rules, which will then be assessed by the CFP. The budget documentation should:

- describe the rules and include a section demonstrating how the budget is performing against each of these general government rules, both historically and into the future. In some cases this is already being done, for instance with the fiscal balance rule; in other cases, such as the expenditure growth rule, this has only been recently implemented; and
- clarify how to apply the expenditure rule laid down by the EU requirements and the MTBF, when the information needed to feed the parameters does not use the same accounting system. Since 2014, the DEO does include the expenditure ceilings by program for t+1 (2015) compatible with medium-term fiscal policy objectives, however these ceilings are not yet compared with the expenditure growth rule, which is one of the fiscal policy objectives.

### 2.3.3 Performance information (Basic)

**80. Portugal's performance reporting focuses mainly on inputs used, by programs and functions.** Both current and capital expenditure are allocated to programs. Budgets do not specify outputs to be delivered or outcomes expected to be achieved. Therefore there is no comparison of actual performance to targets' in the budget. Information about outputs and outcomes is not systematically reported. However, some programs provide brief comments on achievements at a high level, without assessing the performance against targets. The Ministry of Health, partly in response to the requirement to reduce costs under the recently concluded program, publishes monthly performance information about hospitals, such as number of outpatients, length of hospital stay. The ministry of education and science also publishes activity data of schools on the internet.

**81. The BFL requires a report on implementation of budget programs.** The report is required to be submitted to the Parliament by the end of March highlighting the results achieved and resources used by programs in the preceding year. The report on the Implementation of Program Budgets for 2012 is publicly available, while the report for 2013 has been submitted to parliament but is not yet published. The 2012 report notes that the report is provisional since the final results of the implementation of the Budget would be included in the General State Accounts. In addition to the BFL, a law established an integrated management and performance information system in public administration (SAIDAP), requiring performance evaluation against objectives.

**82. Programs are treated as synonymous with ministries.** The exceptions are the MoF, which has two programs: (i) debt management and (ii) financial and public administration; and the ministry of education and science, which has two programs: (i) education and (ii) science and higher

education. There are 13 ministries or comparable entities and 15 programs. Programs are analyzed by what are referred to as measures that are broadly comparable to functions. Thus the MoF's financial and public administration program may perform functions as varied as education, health, housing, cultural services and transportation.

### 2.3.4 Public participation (Basic)

**83. A Citizen's Budget document was released for the first time in 2014, but there remains relatively little formal public participation in the budget process.** The citizen's budget provides an explanation of the major economic and fiscal developments, as well as a description of what the major expenditures and revenues are. The document also provides some information on what taxes are paid and social security payments are received by different income groups, but does not go so far as to present information on the impact of the budget measures on those groups. In the first year of production, the citizen's budget was released only in February of the budget year, after the budget had already been presented and approved by parliament, and after a supplementary budget had been passed. There is no formal public consultation process or engagement with the community in either the lead up to, or approval of the budget, outside the usual parliamentary debates that occur within parliament and the press.

## E. Credibility of Forecasts and Budgets

### 2.4.1 Independent evaluation (Advanced)

**84. Portugal's macroeconomic and fiscal forecasts are analyzed by the independent Fiscal Council (Conselho das Finanças Públicas, CFP).**<sup>42</sup> The CFP was established in May 2011 and began operating in early 2012, with the mandate to conduct an independent evaluation about the consistency, compliance and sustainability of fiscal policy, promoting its transparency, in order to contribute to the quality of democracy and of economic policy decisions and to strengthen the Portuguese State's financial credibility. It independently assesses and publicly comments on whether the government is meeting its fiscal targets and objectives, as well as the appropriateness of its overall fiscal stance.<sup>43</sup> It further assesses the financial situation of the regional and local governments and public entities of the general government.

**85. The CFP prepares and publishes two reports assessing the Budget and the Fiscal Strategy document.** Since its creation, it has prepared around 20 reports analyzing several issues

<sup>42</sup> See Article 12-I of the BFL and Law 54/2011. The Conselho Económico e Social also expresses an opinion on the programs and policies drafts for social and economic development, including on the State Budget and on the Fiscal Strategy Document. This council is a constitutional body with the objective to promote the participation of social agents in sovereign decision-making of socio-economic issues.

<sup>43</sup> Law 54/2011 establishes various mechanisms to guarantee CFP independence. In particular, (i) Article 13 on the members nomination; (ii) Article 14 on the (7-years) duration of the superior board members; (iii) Article 15 on the member mandate cessation; and, in particular (iv) Article 16 on the CFP board members guarantees of independence and incompatibility.

on fiscal policy, including the BFL, general government budget outturns, regional and local finances, and fiscal statistics. In its two analyses about the draft budget, the council provides an overall opinion about the government reports and assesses: (i) the macroeconomic evolution scenarios adopted by the government and the consistency of fiscal forecasts with them; (ii) the compliance with the fiscal rules; and (iii) public debt dynamics and sustainability. In these reports, the CFP also includes different themes for different years, such as a comparison of the 2014 Budget with the targets and measures envisaged in the adjustment program and budget transparency.

**86. Given Portugal's poor record on macroeconomic and budgetary forecasts, the council's assessments of fiscal plans and performance are an important new institutional feature.** By providing an independent evaluation of the budget forecasts, it will raise reputational costs to overly optimistic forecasts, assist the public to interpret the fiscal rules, and assess whether the government's policies are in line with the fiscal objectives.

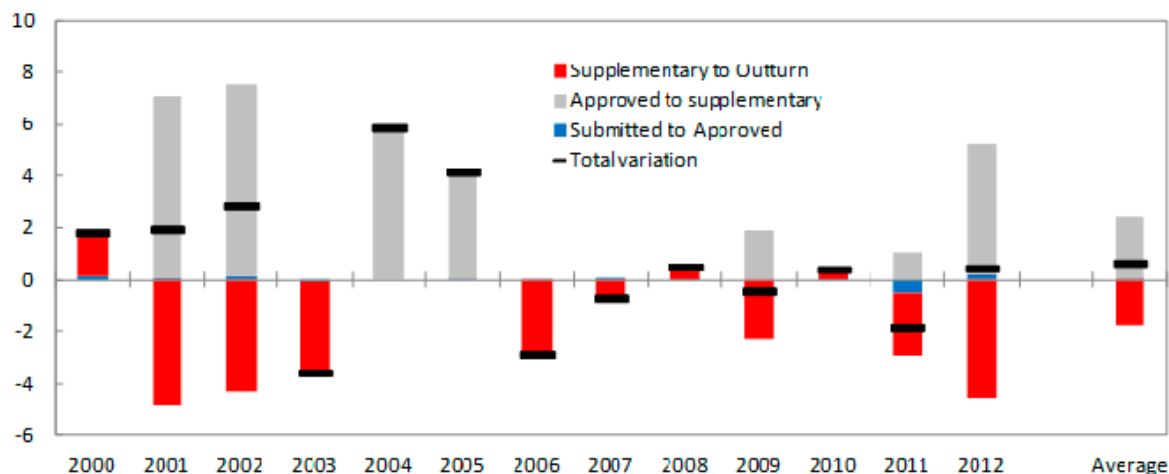
#### 2.4.2 Supplementary budget (Good)

**87. Any material increases in total expenditure or movements between programs require approval by Parliament.** This approval takes the form of a supplementary budget, which is required whenever there is an increase in expenditures funded from general revenues, or whenever there is a transfer of expenditure allocations between programs. In practice this allows increases in expenditure financed from own revenues, or transfers within programs. As these programs are very broad (see 2.3.3.) this still leaves scope for substantial alterations in expenditure within programs, which often cover multiple areas such as science and higher education.

**88. Despite large adjustments through the year, the annual budget provides a good guide to aggregate expenditure outturns.** Over the past decade, expenditure outturns have been only 0.7 percent higher than the initial budget and there has only been an average of one supplementary budget a year since 2000. However, breaking up the variation into different stages of the budget cycle reveals a pattern of large increases in expenditure through supplementary budgets. This has been offset by large underspends in the execution of the budget as savings are identified in other areas, resulting in the relatively small average overspend (Figure 2.8). The years in which spending has exceeded both original and supplementary budgets (2000, 2008, and 2010) have been due carryovers from previous years. It is anticipated that 2013 may alter this pattern due to the impact of the constitutional court's decisions, however the figures are yet to be finalized.

**89. The composition of expenditure by program remains relatively stable through budget execution, even if the individual appropriation lines provide little information.** The allocation of funds for the large programs within the budget provide a good guide to where the major expenditures will be made, with only minor movements between programs over the course of the budget year. The same is not true at the level of appropriation however, which is very detailed, with some 44,000 appropriation lines in the budget, of an average size of €3.8m. This amount of details overwhelms rather than increases transparency, and contains very little informational content, with variations of appropriations smaller than €1 million in the range of 120 percent over the course of the budget year.

**Figure 2.8. Portugal: Variations in Expenditure from Budget Submission to Outturn  
(Percent of Expenditure)**



Source: Ministry of Finance.

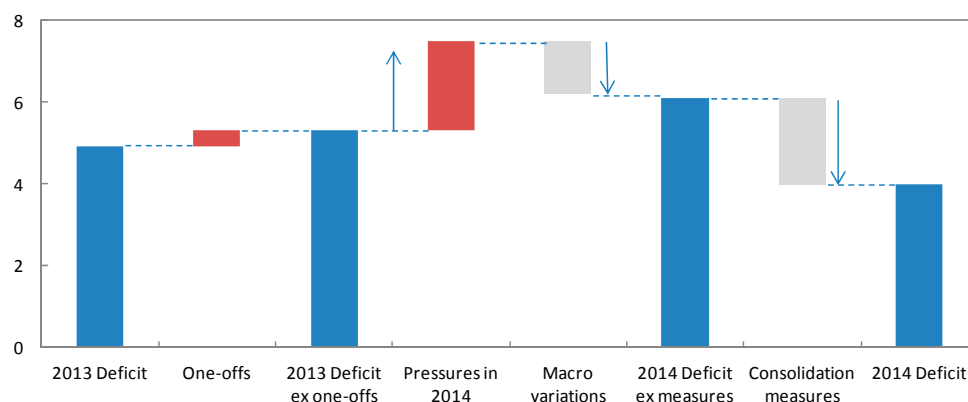
### 2.4.3 Forecast reconciliation (Not met)

**90. Neither the budget nor budget strategy documents compare the latest fiscal forecast to previous forecasts.** This makes it difficult to understand how the budget compares to the commitments described in the budget strategy document. This is particularly relevant in Portugal, where new policy decisions are continually being taken in light of necessities of the program, and there have been large revisions to the economic and fiscal forecasts.

**91. The budget now includes a measures and pressures chart, which explains the impact of new policy measures on the forecast budget balance.** While it does not reconcile to previous fiscal forecasts, it does provide a baseline forecast for the upcoming two budget years, and the expected impact of new policy measures on the fiscal aggregates (Figure 2.9). This will also be useful to demonstrate the government's compliance with the expenditure benchmark, which allows discretionary expenditure increases only where they are offset by discretionary tax increases over the medium term. This analysis could be more strengthened with detailed explanations about the drivers of the pressures, as well as full description of all the measures.



**Figure 2.9. Portugal: 2014 Measures and Pressures Table for the Budget Deficit (Percent of GDP)**



Source: 2014 Fiscal Strategy Paper.

**92. Concerns about the unreliability of fiscal forecasts have been raised by both the CFP and parliament.** These concerns could be addressed by providing a clear reconciliation table of the different vintages of forecasts (such as in Table 2.3 for total expenditure) which would:

- Begin with the previous fiscal forecast over the medium term.
- Adjust for any accounting or classification changes.
- Identify the impact of baseline macroeconomic forecast variations, due to economic and demographic parameter variations.
- Identify the impact of policy decisions taken over the intervening period and in the budget.
- Show the new fiscal forecasts over the medium term.

**Table 2.3. Portugal: Indicative Reconciliation Table for Expenditure Ceilings**

	2014	2015	2016	2017	2018
	Budget year	BY+1	BY+2		
<b>2014 Budget</b>					
Total Expenditure	100	110	120		
Reconciliation in terms of:					
- Accounting or one-off	-5	-6	-8		
- Macroeconomic factors	3	4	6		
- Policy measures	0	5	3		
<b>Total Variation</b>	<b>-2</b>	<b>3</b>	<b>1</b>		
<b>2015 Budget</b>					
Total Expenditure	98	113	121	130	
Reconciliation in terms of:					
- Accounting or one-off		2	13	15	
- Macroeconomic factors		-2	-2	-3	
- Policy measures		0	-11	-12	
<b>Total Variation</b>		<b>0</b>	<b>0</b>	<b>0</b>	
<b>2016 Budget</b>					
Total Expenditure		113	121	130	139

Source: IMF.

## F. Priorities

**93. Focusing on the following priorities will strengthen the government's budget and fiscal forecasting practices.** Table 2.4 summarizes the evaluation of this pillar.

- Strengthen the Medium-Term Budget Framework by broadening the coverage to all state budget expenditure; providing further breakdowns at the administrative level; and presenting a reconciliation table for the latest allocations over the medium-term back to previous vintages to build credibility.
- Continue the current process of reforming the budget framework law in order to reduce fragmentation and improve transparency through streamlining the appropriation structure and reducing the number of budgetary entities.
- Strengthen and centralize reporting and analysis of major investment projects by providing a summary report of all publicly financed capital expenditures as part of the budget documentation, and publishing cost benefit analyses undertaken by a centralized unit for all major projects, irrespective of whether they are PPPs, traditional public sector financed or undertaken by public corporations.

Table 2.4. Summary Assessment of Portugal's Fiscal Forecasting and Budgeting

Principle		Assessment	Importance	Priority
2.1.1	Budget Unity	<b>Advanced:</b> Gross spending and revenues from all sectors in the general government are presented in the budget	<b>Medium:</b> Own revenues represent 35 percent of total revenue	
2.1.2	Macroeconomic Forecasts	<b>Good:</b> Detailed macroeconomic forecasts are presented and explained, but are not always consistent with fiscal forecasts	<b>High:</b> There is a large optimistic forecast bias (1.7 percent of GDP in T+2).	Y
2.1.3	MT Budget Framework	<b>Good:</b> Fiscal aggregates are presented over the medium-term, but departmental breakdown is limited to one year	<b>High:</b> Limits have not been kept, with considerable MT deficit drift (3.0 percent in T+2) and 0.5 percent unidentified measures	
2.1.4	Investment Projects	<b>Basic:</b> All major projects go to tender, but no complete reporting of major investment projects or their cost benefit analyses	<b>Medium:</b> Public investment is relatively low as a share of GDP, but is anticipated to increase in the coming years	Y
2.2.1	Fiscal Legislation	<b>Good:</b> Budget Framework law includes key elements	<b>High:</b> Deficiencies remain, such as excessive number of appropriations, leading to fragmented and opaque budgeting	Y
2.2.2	Timeliness of Budget Documents	<b>Good:</b> Budgets are presented and authorized prior to the budget year	<b>Low:</b> Parliament has 45 days to approve the budget	
2.3.1	Fiscal Policy Objectives	<b>Good:</b> The government's fiscal objectives are clearly defined and explained, but track record needs to be established over time	<b>Low:</b> European requirements will set the fiscal course	
2.3.2	Performance Information	<b>Basic:</b> Reporting is focused on inputs, with no comparison of outputs or outcomes achieved against targets	<b>Low:</b> Emphasis should be on improving financial reporting	
2.3.3	Public Participation	<b>Basic:</b> A citizen's budget was produced in 2014, but was released too late, and no formal public consultation process exists	<b>Medium:</b> Complex fiscal rules and prolonged period of tight fiscal policy will require clear communication	
2.4.1	Independent Evaluation	<b>Advanced:</b> The Council on Public Finance assesses macro and fiscal forecasts	<b>Medium:</b> Complex fiscal rules and poor macro forecasting record increase importance of independent evaluation	
2.4.2	Supplementary Budget	<b>Good:</b> Any material increase requires ex ante approval by Parliament, but large adjustments within budget can occur	<b>Low:</b> Average overspending of 0.7 percent of expenditure in budget year	
2.4.3	Forecast Reconciliation	<b>Not met:</b> Measures and pressures are shown, but no reference to previous forecasts	<b>Medium:</b> Downward revenue revisions of 3 percent of GDP over the medium term	

## FISCAL RISK ANALYSIS AND MANAGEMENT

### A. Overview

**94. This chapter assesses the adequacy of the government’s analysis, reporting and management of fiscal risk relative to the FTC in three areas:**

- a. general arrangements for disclosure and analysis of fiscal risks;
- b. risks emanating from specific sources such as government assets and liabilities, guarantees, public-private partnerships and the financial sector;<sup>44</sup> and
- c. coordination of fiscal decision-making between central government, local governments, and SOEs.

**95. There has been considerable progress in the reporting and management of fiscal risks in recent years.** A fiscal risk statement that is put together by GPEARI has been included in the budget since 2013. The oversight and control of the MoF in the areas of PPPs and SOEs was also recently strengthened. A central monitoring unit for PPPs (UTAP) was established in the MoF in 2012, which provides technical support on the launch, tender, monitoring and evaluation of PPPs. By end-2014, a central technical unit—Unidade Técnica de Acompanhamento a Monitorização do Sector Público Empresarial (UTAM)—will also be set up in the MoF to provide advice on the financial situation and performance of SOEs and assess the sustainability and efficiency of any new SOE.

**96. Despite considerable progress, fiscal risks remain relatively large and their disclosure and management are diffuse.** The reporting of some of Portugal’s approximately 122 percent of GDP in quantified contingent liabilities and other specific fiscal risks is scattered across many documents published by many agencies. While the fiscal risk statement is an important step in the right direction, its documentation of fiscal risk is far from comprehensive. GPEARI collects information from different agencies on fiscal risks, but does not analyze the joint effect of those risks on public finances and possible correlations between risks. Despite the substantial realization of fiscal risks from sub-national governments, there is still no systematic monitoring or reporting of activities outside the perimeter of the general government, including on local government’s SOEs or PPPs. There is also limited reporting on PPPs and concessions that fall outside of the relatively narrow mandate of UTAP. Relevant data for monitoring fiscal risks should be available for the entities in charge of fiscal monitoring and reporting to allow a comprehensive regular assessment of risks.

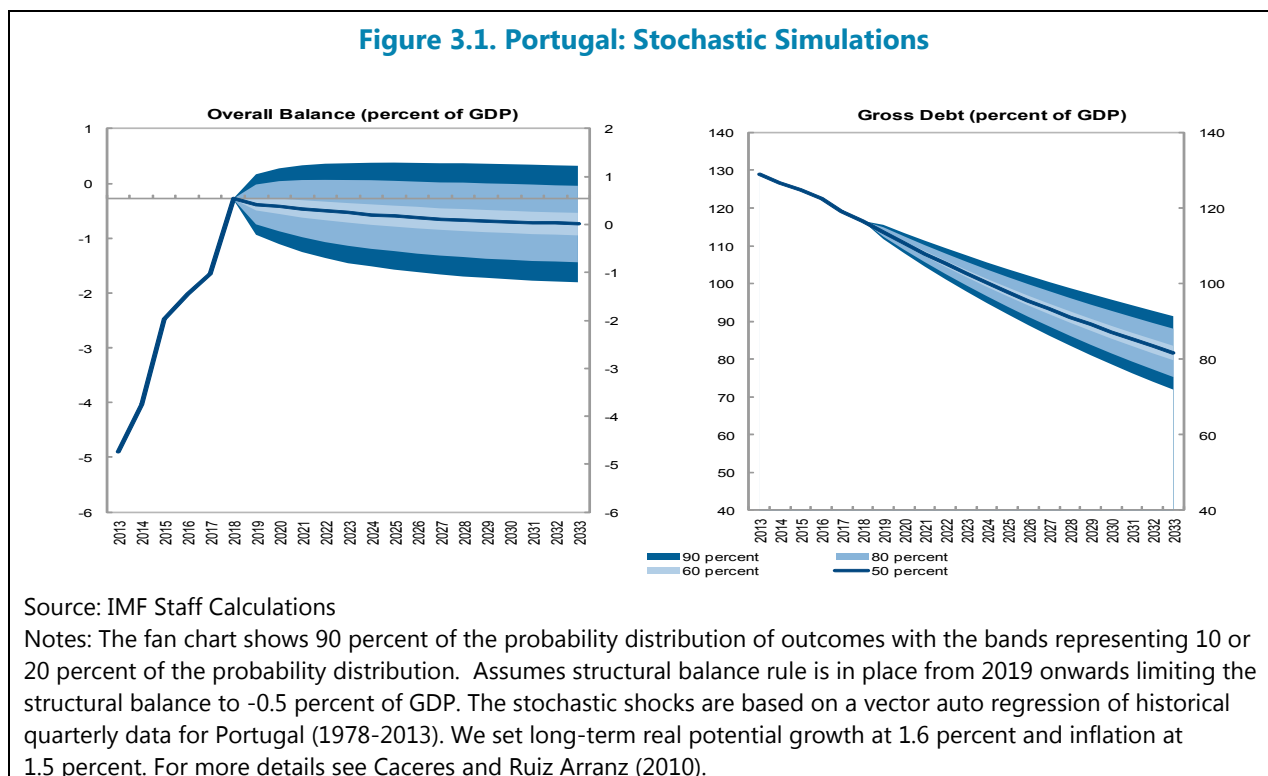
<sup>44</sup> For a discussion of the relations between fiscal transparency and risk, see IMF (2012).

## B. Fiscal Risk Disclosure and Analysis

### 3.1.1 Macroeconomic risks (Good)

**97. The fiscal strategy document (DEO) analyses the impact of macroeconomic risks on fiscal variables but could be enhanced to reflect a more realistic shock scenario.** The 2014 DEO includes medium-term macroeconomic sensitivity analyses based on a variety of external and domestic risks. However, the scenarios could be enhanced. For example, the size of shocks could be larger to reflect the difficulty of forecasting in Portugal, evidenced by the large forecast revisions in recent years. In the case of real growth these revisions were substantial, sometimes close to 3 percentage points, which is three-times the size of the shocks used in the MoF’s macroeconomic risk analysis.

**98. The analysis in the DEO could include random shocks to fiscal outcomes based on their historical distribution.** Figure 3.1 provides an example of an indicative stochastic macro-risk sensitivity analysis. The charts present the path for the overall balance and public debt under the IMF baseline scenario until 2018. Beyond 2018, the simulations assume that a structural balance rule is in place, restricting the maximum structural deficit to 0.5 percent. Even under this constraint, the outcomes of the stochastic simulation show that the baseline scenario is subject to significant risks. The stochastic bands for the overall deficit and debt define the intervals of deficit and debt paths with a certain probability, given the estimation of a vector auto-regression of historical quarterly data for Portugal (1978–2013). For Portugal these bands are large, indicating the sensitivity of the fiscal paths to macroeconomic shocks.



### 3.1.2 Specific fiscal risks (Basic)

**99. Unlike most countries, Portugal publishes a fiscal risk statement.**<sup>45</sup> This is put together by GPEARI using inputs from different agencies and was first included in the 2013 annual budget. It provides quantitative information including on (i) guarantees by the state to the financial sector and non financial SOEs (both inside and outside of general government); (ii) debt and financing needs of SOEs outside of general government; (iii) future net charges related to PPPs; (iv) outstanding litigation cases related to derivatives contracts by SOEs; and (v) interest rate risk on public debt. It provides some qualitative information on (i) the probability of guarantees being called; (ii) outstanding litigation cases relating to PPPs; (iii) reclassification risks; and (iv) regional and local finances. The fiscal risk statement does not analyze how different risks could interact in a crisis situation. This is problematic since in the past, fiscal risks have materialized at the same time and reinforced each other. However, it has to be acknowledged that such an analysis is extremely difficult and not commonly done.

**100. Information on a number of significant fiscal risks not reported in the fiscal risk statement can be found in various other reports.** These risks include (i) guarantees by SOEs; (ii) other contingent liabilities of SOEs; (iii) amount involved in outstanding litigation cases related to PPPs;<sup>46</sup> (iv) minimum revenue/demand guarantees by the government to concessionaires; (v) callable capital in international organizations; (vi) deposit guarantee scheme. However, the value of this information is significantly reduced by its fragmentation. The fiscal risks information shown in Table 3.1. can be found in a number of different reports.<sup>47</sup>

**101. However, a number of large fiscal risks, some of which have materialized in the past, are not reported at all.** In particular, fiscal risks related to local governments and the regions are not systematically disclosed. These include liabilities associated with local governments' public enterprises and PPPs. Nor is there any comprehensive information on risks related to the values of assets and liabilities arising from changes in interest rates, exchanges rates and other variables. Beyond, some implicit liabilities are also relevant, such as potential support to systemic banks or the compensation of victims of a natural disaster, albeit there is no legal obligation to do so. There is also no information on indemnities and letters of comfort.

<sup>45</sup> Orçamento do Estado, 2014: Análise de Riscos Orçamentais.

<sup>46</sup> €2 billion of the €2.6 billion in PPP claims under litigation originate from bankrupt companies and there is therefore no risk of a positive ruling by the court.

<sup>47</sup> This includes the annual report by DGTF on SOEs, the annual report by UTAP on PPPs, individual contracts of PPPs displayed on UTAP's website; relevant audit reports and the Banco de Portugal report on deposit insurance.

**Table 3.1. Size of Selected Fiscal Risks, 2012-13**

	€ billion	Percent of GDP	Source
<b>Quantified</b>			
Deposit Guarantee Scheme	113.7	68.9	Deposit Guarantee Fund (Relatório de atividades)
Guarantees	34.7	21.0	Fiscal Risk Statement OE 2014; DGTF 2013Q3 report
Investment value of 75 unmonitored concessions	21.3	12.9	DGTF 2012 Q3 report on PPPs and concessions
Public Private Partnerships	10.6	6.4	Present value of payments, UTAP 2012 Annual report
Litigation	0.9	0.5	
Derivatives of SOEs	1.1	0.7	Fiscal Risk Statement OE 2014
PPPs	0.6	0.4	UTAP Annual Report
SOEs	0.3	0.2	DGTF 2013 Q3 Report
SOEs other contingent liabilities	0.8	0.5	DGTF 2013 Q3 Report
Callable Capital in ESM	17.6	10.6	GPEARI
Callable Capital in EIB	1.7	1.0	GPEARI
Contingent obligations to IMF	0.7	0.4	BdP; Activities and Accounts, 2013. NAB.
<b>Total</b>	<b>201.9</b>	<b>122.2</b>	
<b>Not quantified</b>			
Revenue/demand guarantees related to Central Government PPPs	-	-	PPP contracts on UTAP website
Guarantees by local governments/regions	-	-	
Min Demand Guarantees for water concessions by local govts	-	-	Audit Report (RELATÓRIO DE AUDITORIA N.º 03/14)
Indemnities, Letters of Comfort	-	-	

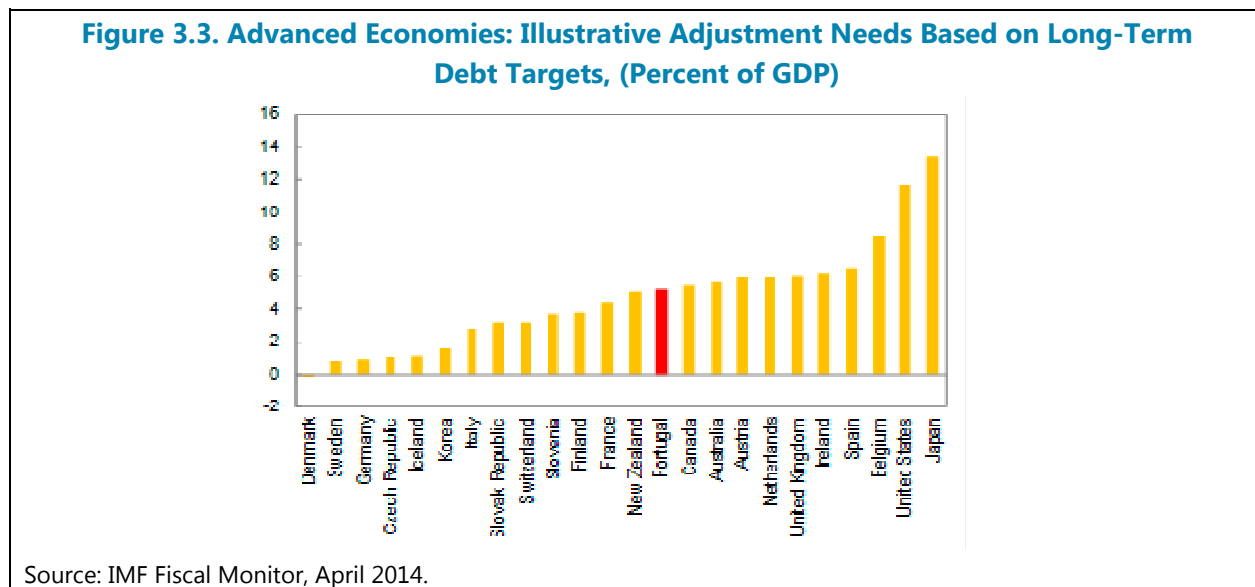
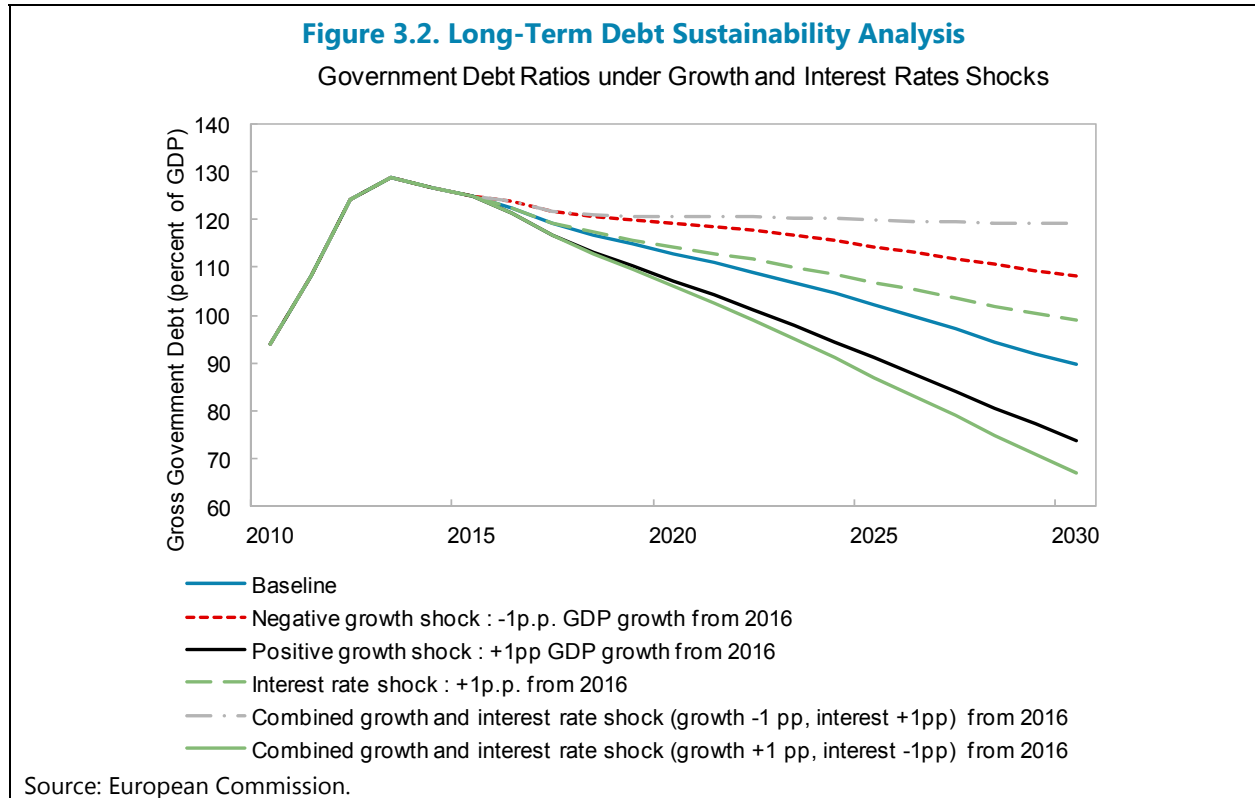
Notes: The risks reported in the table have different probabilities of materializing, which are hard to quantify and hence the report does not attempt to do so. In particular, considering the entire deposit guarantee scheme is an extreme and unlikely scenario. Rather than using the sum of investments in concessions not monitored by UTAP, it would be preferable to perform an assessment of risks based on the PPPs/concessionaires balance sheet position/cash flow. Unfortunately, this information could not be obtained.

### 3.1.3 Long-term fiscal sustainability analysis (Basic)

**102. Information about the long-term sustainability of fiscal policy is not regularly provided (see also Sections 1.1.1 and 1.1.2).** The 2012 DEO was the first and only document that included detailed analyses of the long-term sustainability of fiscal policy, presenting a projection for the debt path for the next 30 years and sensitivity analyses for changes in interest rates and nominal GDP growth. Such analysis was not repeated in the 2014 DEO, which only published the debt dynamics for the medium-term (t+4). The DEO, however, regularly provides a summary of the EC's 2009 Aging Report's long-term demographic and spending projections for Portugal up to 2060, jointly developed between the EC and Member States.

**103. In light of the sizable debt burden and growing demographic pressures, regular analyses of the long-term sustainability and net worth dynamics are crucial.** While the gross debt-to-GDP ratio is projected to decline gradually starting in 2015 from around 130¼ percent of GDP peak in 2014, Portugal still faces a long period of tight fiscal policy in order to bring public debt down to the long-term objective of 60 percent of GDP. This high indebtedness increases the sensitivity of the main fiscal aggregates to variations in interest and GDP growth rates (Figure 3.2). Looking beyond the immediate consolidation, like most advanced economies, Portugal is also facing

considerable demographic pressures, which will require significant adjustment to bring the debt ratio to the long-term objective by 2030 (Figure 3.3) and calls for reporting general social security obligations (see also Sections 1.1.2 and 1.1.3). The contingent liabilities coming from guarantees for SOEs and PPPs (see Sections 3.2.4 and 3.3.2) pose additional risks to its fiscal sustainability.





## C. Risk Management

### 3.2.1 Budgetary contingencies (Basic)

**104. Portugal's budget includes three types of contingencies but no transparent access criteria or regular in-year reporting on their utilization.** Budgetary contingencies account for between 0.5 to 1 percent of GDP each year. In the original 2013 budget those contingencies amounted to €1.2 billion (0.7 percent of GDP). Their access criteria and amounts have changed frequently in recent years. Until now they are not fully reported and the frequent changes in the access criteria make them confusing.

**105. The state contingencies in the budget consist of three different elements (Table 3.2):**<sup>48</sup>

- Provisional allocation (dotação provisional). Around €500 million is usually assigned to this allocation. The value executed is in some years even higher than the initial budget due to the change in the allocations throughout the year via supplementary budgets. The use of this allocation is reported quarterly by DGO on its website.
- Contingency reserves (reservas orçamentais). These correspond to 2.5 percent of total operating expenditures fluctuating by around € 300mn each year. Only a small fraction (less than 20 percent on average) of these reserves is normally executed although in 2013 they were fully used. Since 2014, the reserves are being registered in each program coordinator line. They are annually reported in the State General Account, but there is no quarterly reporting of their use.
- Frozen allocation (cativos). For non-EU investments projects this contingency corresponds to 12.5 percent of its total spending in the spending item (Chapter 50). For the acquisition of goods and services the allocation is about 15 percent of the spending item. This allocation is not accounted in the budgeted gross total spending of each program. Thus, any execution of it, which normally tends to be high (more than 50 percent), breaches the program spending ceiling previously budgeted. Some public entities (presidency, parliament) are exempted from this contingency and so is all spending on goods and services financed by entities' own resources. This type of allocation is also annually reported in the State General Account, with both initial budget and its outturn, but there is no quarterly reporting of its use. Its unfreezing (descativação) is done through an authorization by the MoF.

<sup>48</sup> See Article 2 of the annual budget law and ¶ 5 of Article 8 of the BFL. Notice that Table 3.2 does not include the SFA budgetary contingencies as well.

**Table 3.2. Portugal: State Budgetary Contingencies  
(€ millions, unless stated otherwise)**

Budget contingencies	2009			2010			2011			2012		
	Initial	Final	Percent	Initial	Final	Percent	Initial	Final	Percent	Initial	Final	Percent
Frozen allocations (cativos)	341	214	62.8	1,074	770	71.7	381	193	50.8	422	278	65.8
Contingency reserve	284	56	19.7	303	53	17.4	294	50	17.0	247	128	51.8
Provisional allocation	650	1,727	265.6	428	420	98.1	500	776	155.2	400	305	76.4
<b>Total</b>	<b>1,274</b>	<b>1,996</b>	<b>156.7</b>	<b>1,805</b>	<b>1,243</b>	<b>68.8</b>	<b>1,175</b>	<b>1,019</b>	<b>86.7</b>	<b>1,069</b>	<b>711</b>	<b>66.5</b>

Source: Portuguese State General Accounts and Budget Reports (several years).

### 3.2.2 Asset and liability management (Basic)

**106. Government borrowing is authorized by law and the IGCP's annual report discusses some cost and risk management indicators related to government debt.** The public debt law states that all state borrowing has to be authorized by parliament. Moreover, the annual budget law establishes limits for the amounts that the government is authorized to borrow during the year (in terms of net borrowing).<sup>49</sup> It is IGCP's responsibility to negotiate and execute all financial transactions related to the issuance of central government debt, and to manage the public debt portfolio in compliance with the guidelines approved by the Minister of Finance. These guidelines include restrictions on the portfolio exposure to interest rate risk, currency risk, and refinancing risk.<sup>50</sup> IGCP's annual reports include information on the debt structure by type of instrument and currency structure of direct government debt. IGCP calculates the annual cost associated with the debt portfolio and assesses its performance relative to the above guidelines on interest, currency, and refinancing risks.

**107. There is no comprehensive asset management strategy and risks around major assets are not disclosed.** While there are large cash deposits, IGCP does not provide a regular complete picture of cash holdings and cash management remains highly fragmented.<sup>51</sup> Currently about €4.1 billion (about 2.5 percent of GDP) of deposits of central government entities plus those related to social security are outside of IGCP.<sup>52</sup> Information from the monetary survey of the BdP is needed to put together a complete picture of central government cash holdings. While there are several

<sup>49</sup> Law No. 7/98, 3 February.

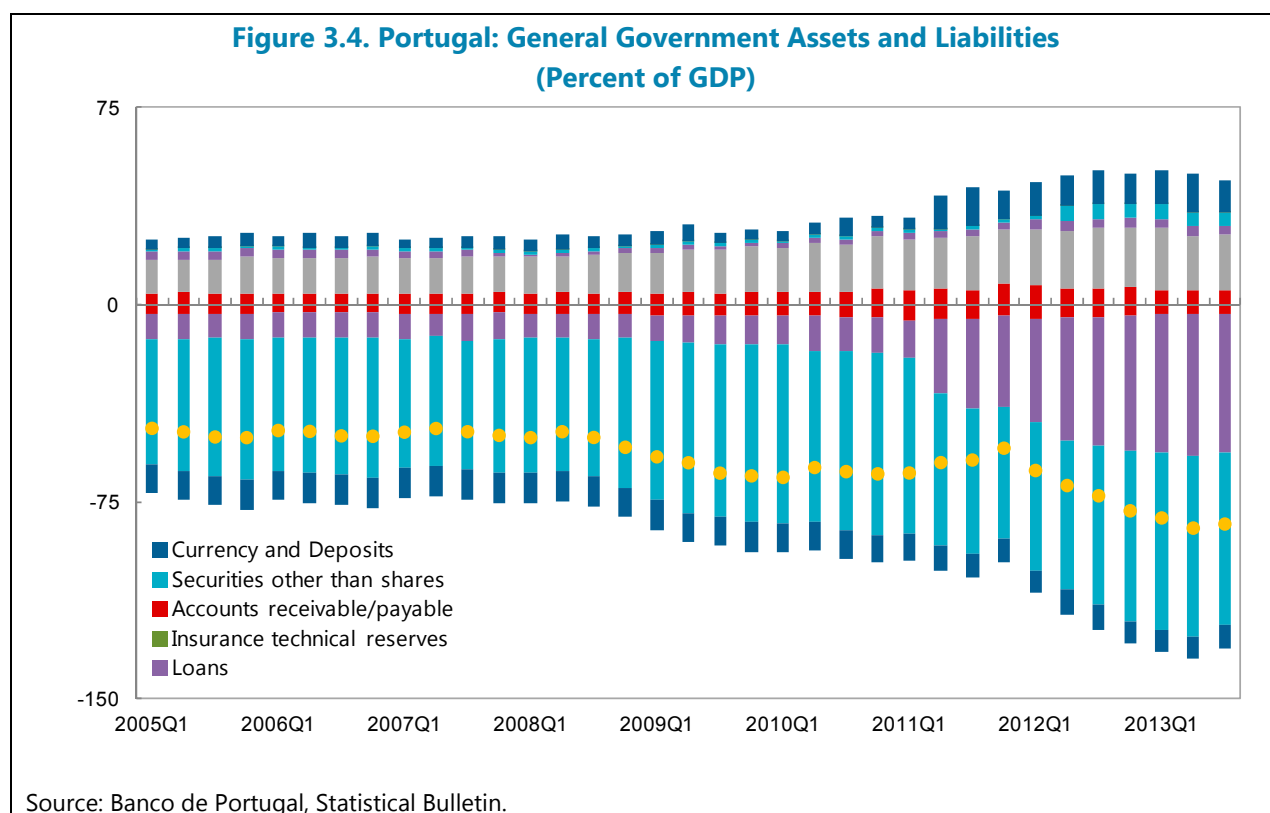
<sup>50</sup> Refinancing: The absolute limits set on the percentage of the portfolio maturing in a 12-month, 24-month and 36-month period are 25 percent, 40 percent and 50 percent, respectively. Interest rate: The modified duration which measures the elasticity of the portfolio's market value to changes in market yields, has to be at least 4 years. Exchange rate: The exchange rate exposure of the portfolio has to be below 10 percent.

<sup>51</sup> In 2011, the BFL was broadened to include all entities comprising the general government, (European System of National Accounts, Law no. 22/2011). This also implied the move to a centralized cash management system, including the accounts of non-financial state-owned corporations.

<sup>52</sup> The existence of large cash deposits is relatively recent. IGCP discloses cash holdings for year-end in its institutional presentation and provides figures for the average over the year in its annual report. The possibility of more regular reporting is being considered.

registers of fixed assets, there is no valuation of them. There is also no published information on risks related to government’s nonfinancial assets and how they are managed. The lack of a comprehensive asset management strategy is problematic given the large balance sheets of SOEs.

**108. The government’s holdings of financial liabilities have increased significantly in recent years.** At the end of 2008 financial assets and liabilities amounted to 27 and 80 percent of GDP, respectively. By the end of 2013, financial liabilities had risen to 131 percent of GDP while financial assets had increased to 48 percent of GDP, resulting in a decrease of net worth by about 30 percent of GDP (Figure 3.4). As stressed in Chapter 1, the government has also various assets and liabilities not included in the financial balance sheet of Figure 3.4. (see Table 0.1).



**109. The central government’s and SOEs’ holdings of derivatives are a potential source of fiscal risk.** IGCP manages the derivatives of the central government as well as of SOEs. The market value of central government derivatives as well as those by SOEs was about -1 percent of GDP in April 2014 (Table 3.3). According to the information provided in the 2013 annual report on SOEs, a change of 1 percent in Euribor would change the market value of the derivatives portfolio by about €0.8 billion. There are also a number of litigation processes related to SOEs’ derivatives which are still unresolved. The total amount outstanding is about €1.1 billion (see Table 3.1).<sup>53</sup>

<sup>53</sup> Relatório OE 2014, p. 78.

**Table 3.3. Portugal: Notional and Market Values of Derivatives, April 2014**

	Market Value		Notional Value	
	€ billions	Percent of GDP	€ billions	Percent of GDP
Republic of Portugal	-0.4	-0.2	20.2	12.0
SOEs (reclassified)	-1.2	-0.7	1.1	0.7
SOEs (not reclassified)	-0.4	-0.3	1.2	0.7
RAM	-0.2	-0.1	0.8	0.5
<b>Total</b>	<b>-2.0</b>	<b>-1.2</b>	<b>22.6</b>	<b>13.4</b>

Source: IGCP.

**110. There is comprehensive reporting of risks associated with SOEs derivatives.** However, there is no comprehensive reporting of central government derivatives. The annual report by DGTF on state enterprises contains information on their derivatives position. It discloses both their notional and market values including an analysis of how these have evolved over the last three years. It also provides a sensitivity analysis of the derivative portfolio to changes in Euribor.

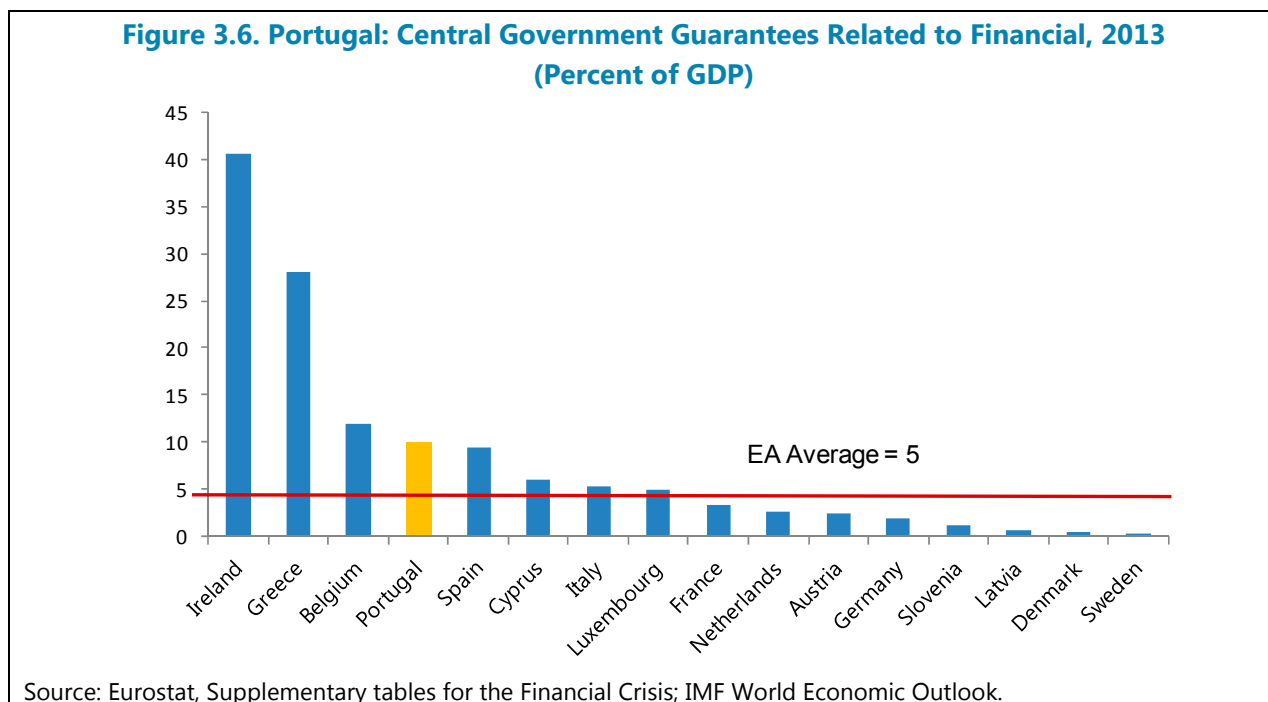
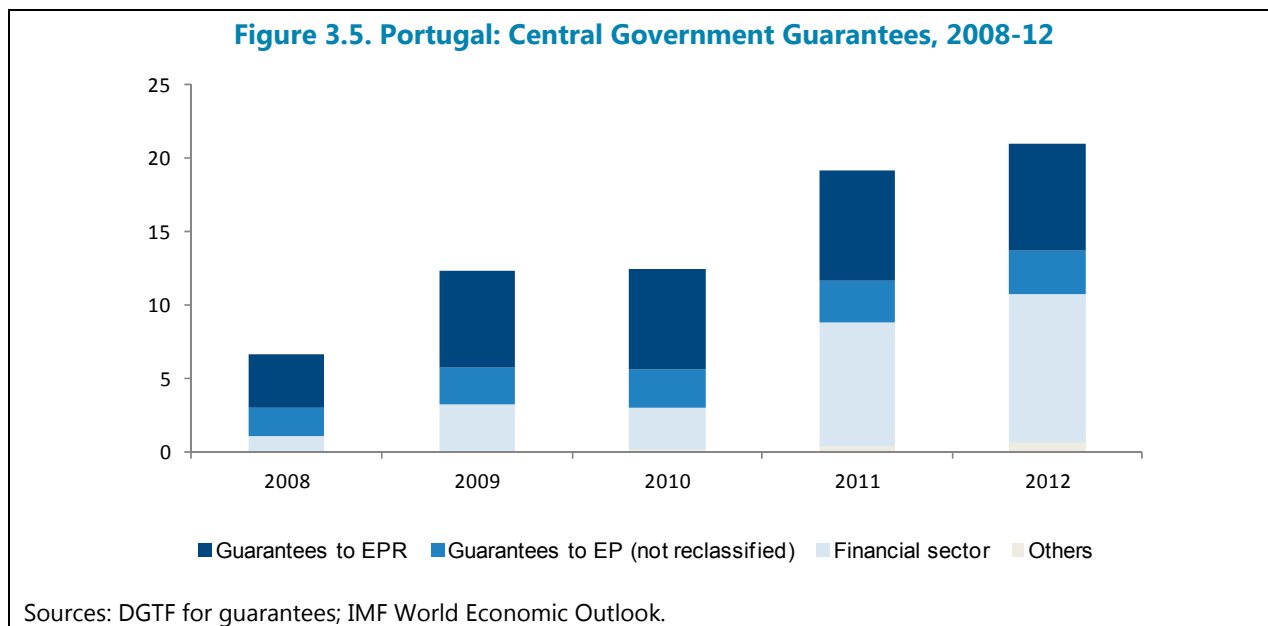
### 3.2.3. Guarantees (Good)

**111. Government guarantees have tripled in recent years, mostly as a result of the financial crisis.** State guarantees to SOEs and the financial sector increased from about 7 percent of GDP in 2008 to 21 percent of GDP in 2012 (Figure 3.5). This is to a large extent due to banking sector guarantees related to the financial crisis, which are significantly above the simple Euro Area average but below those issued by some of the other countries under stress (Figure 3.6). In 2012, about 50 percent of all central government guarantees were issued to SOEs. The proportion of guarantees granted to non-general government entities decreased significantly recently due to the decision to reclassify a number of large corporations into general government as part of the April 2011 EDP notification (REFER (railways), Metropolitano de Lisboa, Metro do Porto and Transtejo (all transport)). There are also some guarantees issued by SOEs, most of which are outside of the general government (Table 3.4).

**112.** The annual budget law sets limits on new guarantees granted by general government. DGTF is responsible for the concession process of state guarantees.<sup>54</sup> It closely coordinates with the sectoral ministry responsible and the IGCP to determine whether the project for which the guarantee is granted is of national interest, financially sustainable and not in conflict with competition policy. Once a guarantee has been issued, and in case beneficiaries are unable to meet their debt obligations, they are required to report this to the DGTF 30 days in advance. While the DGTF does

<sup>54</sup> The details of this process are specified in Law 112/2007.

not report on the probability of guarantees to be called beyond the next budget year, historically, few guarantees have been called.<sup>55</sup>



<sup>55</sup> Between 2008 and 2012 about 0.4 percent of GDP worth of guarantees have been called. The FTC requires a systematic assessment of the probability of guarantees being called for an advanced score. However, it has to be acknowledged that such an assessment is not straightforward and not common.

**113. The fiscal risk statement included in the annual budget report contains information on the stock of general government guarantees.** The information, which is prepared by DGTF, includes guarantees (i) to the banking sector; (ii) to public corporations within general government and (iii) to SOEs outside of general government. The annual report prepared by DGTF contains details on guarantees granted by SOEs (Table 3.4).

**Table 3.4. Portugal: Guarantees, 2013**

	€ billion	Percent of GDP	In GG
<b>Central Govt guarantees</b>	<b>32.5</b>	<b>19.6</b>	
Banking Sector	14.5	8.7	No
CGD	4.6	2.8	No
BES	4.8	2.9	No
Grupo Banif	0.9	0.5	No
BCP	4.3	2.6	No
Entities within GG	11.9	7.2	Yes
Entities outside of GG 1/	6.1	3.7	No
<b>Guarantees by SOEs 2/</b>	<b>2.2</b>	<b>1.4</b>	No
<b>Total</b>	<b>34.7</b>	<b>21.0</b>	
Memorandum items			
Guarantees, included in general government	11.9	7.2	

Sources: DGTF Boletim SEE 4T 2013; Ministry of Finance Orçamento do Estado para 2014; IMF World Economic Outlook.

1/ These include public and private entities and autonomous regions.

2/ 81 percent of those are by utility companies, which are outside general government.

**114. However, DGTF does not disclose a number of commitments, which are financially similar to guarantees, even if they have a different legal form.** These effective guarantees include the callable capital in international financial institutions, the deposits insurance scheme covering deposits up to €100000 and minimum revenue guarantees under PPPs (see Section 3.2.4). No information exists on guarantees to SOEs at the local government level.<sup>56</sup>

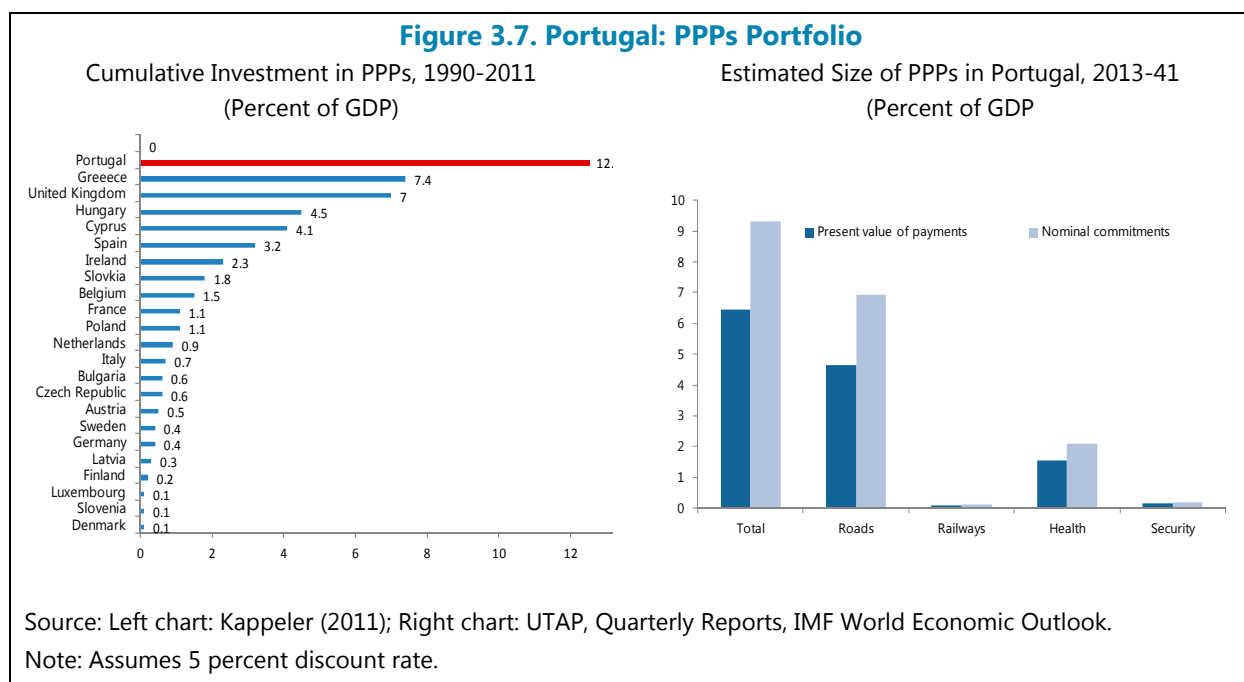
### 3.2.4 Public Private Partnerships (Basic)

**115. PPPs are still a significant source of fiscal risks in Portugal.** Relative to its GDP, Portugal had the highest cumulative investment in PPPs in the EU in the past decade (Figure 3.7). Moreover, the estimated present value of central government's recorded financial commitments was about 6 percent of GDP at end-2013 (Figure 3.7).<sup>57</sup> Not included in this estimate, however, are any projected

<sup>56</sup> According to law 73/2013 it is not possible for local governments to issue guarantees but for some exceptions outlined in the law.

<sup>57</sup> This is based on staff calculations using information on net payments by the government until 2041 provided in UTAP's quarterly reports and assuming a discount rate of 5 percent. See Figure 3.7.

payments undertaken by local governments and the regions. Moreover, there are a number of concessions in the water waste and energy sector, which are not included in figures below.



**116. The government has taken major steps to reduce the risks associated with some PPPs.**

A major renegotiation of road contract PPPs is about to be finalized with expected gross savings of over €6.6 billion (including VAT) over the life cycle of these concessions. According to the State Budget, the foreseen savings for 2014 will reach €250 million. The savings are mainly generated through the restructuring of the major repairs mechanism and capital expenditure, which will only be executed when technically needed and then financed by Estradas de Portugal directly; and an internal rate of return (IRR) reduction in order to allow a significant cut in payments throughout the subconcession period.

**117. The new central PPP unit (UTAP) significantly enhances the MoF’s oversight and control of those 35 projects that it monitors.**

UTAP consists of 9 experts and was established in 2012 as part of the new PPP framework law. It reports directly to the Secretary of State for Finance. Its main responsibilities include (i) providing technical support in the launch, tender, execution, monitoring and evaluation of PPPs; (ii) informing the Ministry of Finance on the economic and financial state of PPPs; and (iii) producing annual and quarterly reports on PPP financial commitments and costs borne by the public sector. Under the Portuguese legal framework, PPPs are defined as those contracts for which a private entity, provided for a return, is long-term committed with ensuring/developing a public interest activity and where the responsibilities associated with the investment, financing and development/execution of an activity, as well as the risks deriving thereof, are substantially borne by the private entity.

**118. UTAP provides detailed information and analysis on the PPPs falling under its mandate.** UTAP's annual reports assess the economic situation of PPPs, and provide a summary analysis of net financial flows as well as forecasts of future PPP financial flows. It also lists contingent liabilities, related to law suits, which on December 31, 2012, amounted to 2.1 € billions (1.3 percent of GDP). There is currently only one PPP contract of those 35 contracts supervised by UTAP that involves a minimum demand/revenue guarantee. This information is included in the reports published by UTAP.<sup>58</sup> UTAP also publishes the individual PPP contracts on its website.

**119. However, the new PPP framework law excludes a large number of PPPs and concessions from UTAP's mandate.** UTAP's mandate excludes (i) any PPP that over the life cycle of the project leads to responsibilities for the government of less than €10 million or an investment of less than €25 million; (ii) all contracts entered into with municipalities and Autonomous Regions; (iii) water, waste, and sanitation companies; and (iv) concessions given by the state to entities 100 percent public or created by 100 percent public capital.<sup>59</sup> UTAP can monitor any PPP or concession outside of its mandate upon request by the relevant region, local authority, ministry or public corporation. However, since there is no entity within the MoF that has general competences to monitor those concession contracts which fall outside the legal concept of what a PPP is, this means that a relevant gap remains to be fulfilled so as to guarantee a fiscally prudent model.

**120. Little or no information is provided on the 75 central government concessions or on PPPs at the local level.** These used to be monitored in greater detail by DGTF until 2012. UTAP only produces a quarterly report summarizing the total investment and receipts from some of the concessions in the areas of water, energy, waste management, and ports.<sup>60</sup> According to the 2012 quarterly reports by DGTF, the total investment value of the 75 concessions not covered by UTAP amount to around €21.3 billion (13 percent of GDP).<sup>61</sup> UTAP also is currently not responsible for monitoring PPPs or concessions by local governments and regions, although a recent audit report suggests that these concessions create significant fiscal risks for municipalities.<sup>62</sup>

### 3.2.5 Financial sector exposure (Good)

**121. The government has enhanced its reporting of explicit financial sector exposure since the beginning of the crisis.** The DEO reports annually on the current year's executed and estimated guarantees and capital injections into the banking sector, even though the risks coming from the financial sector could be reported in more detail in this document. The MoF also prepares public

<sup>58</sup> The guarantee relates to the MST contract, a light rail network located near Lisbon. The value of the payment is included in the annual budget since demand levels are always under the contractually agreed minimum and thus trigger the minimum payments.

<sup>59</sup> Declaração de Retificação n.º 25/2012.

<sup>60</sup> See UTAP Boletim Trimestral de Concessões. The quarterly UTAP publication on concessions is a continuation of reports that DGTF used to produce.

<sup>61</sup> Boletim Informativo Parcerias Público-Privadas e Concessões-3.º Trimestre 2012.

<sup>62</sup> Relatório de auditoria N.º 03/14, p.8 and 9.



communiqués whenever commercial banks are recapitalized. The BdP further discusses public guarantees on its quarterly Financial Stability report.

**122. There are a range of other explicit exposures to the financial sector that are not reported in the government's own documentation.** However (most of) these exposures, such as deposit insurance and Special Purpose Vehicles are reported in the responsible entities' annual reports (see Box 5). One exposure that remains unreported is the government's own deposits at private sector banking institutions, which are approximately 3.5 percent of GDP.

**123. Bank of Portugal has further improved the reporting on the stability of its financial system and the implicit financial exposures.** The Financial Stability Report is published quarterly and includes a thorough assessment of recent developments in the financial sector and of the risks to financial stability, although with limited coverage of fiscal liabilities and risks. The latest developments of the banking system are further updated and published on a quarterly basis on the BdP website. FGD also publishes an annual report on deposits guarantees, which currently covers €113.7 billion in deposits. The financial stability BdP webpage includes links to several other websites containing information on Portugal's and other countries' financial stability.

**124. After the crisis turmoil, Portuguese banks' liquidity and solvency reached more comfortable levels at end-2013.** Nevertheless the banks' profitability remains under pressure (Table 3.5).<sup>63</sup> The banking system funding has been gradually adjusting towards more stable funding sources, notably deposits from households. The dependence on Eurosystem funding is gradually decreasing, standing at €47 billion at end-March 2014. Although at a slower pace, non-performing loans (NPLs) continued to increase in 2013 reaching over 10 percent, mainly resulting from the non-financial corporate sector.

**Table 3.5. Recent Indicators of Banking Financial Stability in Europe**

Country	Quarter	Capital	Asset Quality	Liquidity			Profitability
		Tier 1 Capital Ratio	Gross NPL ratio	Loan to Deposit	Liquid Assets Ratio	Liquid Assets to Short-Term Liabilities	Return on Assets
<b>Portugal</b>	<b>2013 Q3</b>	<b>12.0</b>	<b>11.0</b>	<b>122.6</b>	<b>15.7</b>	<b>155.1</b>	<b>-0.5</b>
Greece	2013 Q3	11.3	31.3	110.2	31.3	42.0	2.1
Ireland	2013 Q3	18.2	24.6	n.a.	n.a.	n.a.	-0.4
Italy	2013 Q2	10.9	15.1	149.2	15.9	97.7	0.0
Spain	2013 Q2	10.8	8.2	119.8	n.a.	n.a.	0.5
Austria	2013 Q4	13.7	2.9	123.1	24.5	68.9	0.1
France	2013 Q2	13.1	4.3	145.6	39.4	78.5	0.5
Germany	2013 Q4	15.6	n.a.	118.3	45.0	140.5	n.a.
Netherlands	2013 Q3	12.8	3.0	n.a.	23.7	167.6	0.4
UK	2012 Q2	14.1	3.7	101.2	22.5	40.0	0.3
Denmark	2013 Q4	17.3	4.6	343.9	n.a.	n.a.	0.1
Switzerland	2012	15.7	0.8	94.9	20.9	43.7	0.6
Sweden	2013 Q3	11.1	0.6	n.a.	10.7	143.3	0.6

Source: IMF FSI website: <http://elibrary-data.imf.org/Report.aspx?Report=4160268>

<sup>63</sup> Based on Portuguese Banking System, Latest Developments (Updated: 4Q 2013), March 17, 2014, BdP.

### Box 5. Government-Supported Initiatives to Financial Sector During the Crisis

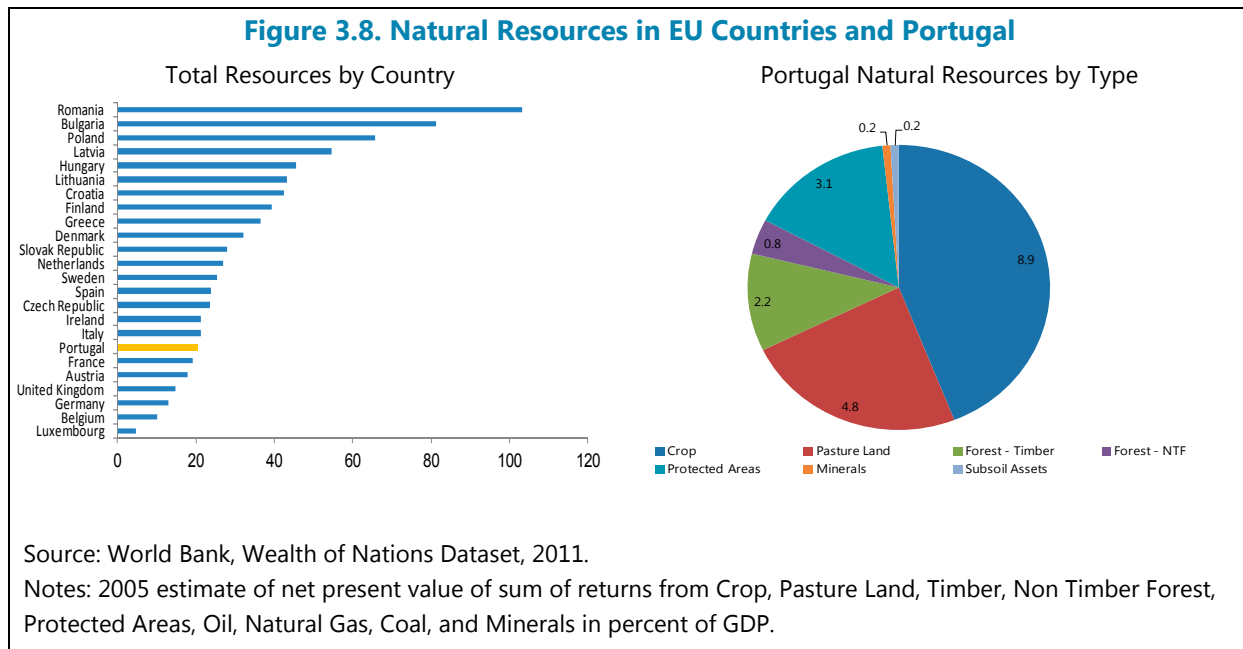
**The sovereign debt crisis and loss of access to the wholesale market led to a quick deterioration of banks' balance sheets.** Profitability deteriorated with NPLs peaking at over 10 percent by end-2013, requiring a number of government-supported initiatives:

- **Recapitalization of four top banks (Banif, BCP, BPI, and CGD).** The total recapitalization costs to Banif, BCP, and BPI amounted to €5.6 billion (over 3 percent of GDP), out of a €12 billion dedicated fund (BSSF), mainly through Contingent Convertibles (CoCos) to avoid the nationalization of the banking sector and excessive dilution of shareholders. For CGD, the recapitalization costs amounted to €1.65 billion. To date, some of the aided banks have already repaid early about €1.2 billion of the capital injection back to the state, with the remainder amortizing at the latest by 2017. Public resources, for €495 million, were used to finance the resolution of a failed state-owned bank, BPN. The bank's distressed assets have been transferred to the Portuguese state and isolated in three special purpose vehicles (SPVs), Parvalorem (loan portfolio), Parups (real estate and other assets), and Parparticipadas (shares in companies). As of March 2014, the loan portfolio under management (principal outstanding) of Parvalorem is about €3.5 billion. Most of the companies' participations in Parparticipadas have already been liquidated. The asset portfolio of Parups is about €0.7 billion.
- **National Guarantee System (implicit exposure).** The coverage of the National Guarantee System (NGS) has increased with the establishment of several guaranteed-credit lines dedicated to SMEs (about €11.5 billion of lines extended since 2008, with €4.1 billion in outstanding credit guaranteed). The state counter-guarantee covers on average 40-45 percent, in case of default. To promote effective use of these lines while minimizing risks for the State, the authorities requested in 2013 an external audit of the NGS processes and operations. The government has also recently established a quarterly monitoring framework, with information on amounts disbursed, average interest rates, and default rates, by different sectors of the economy.
- **Government-guaranteed bank bonds (GGBBs) for own use (implicit exposure).** To mitigate banks' financing pressures and support collateral buffers, the government extended guarantees on bank bonds to be used as temporary collateral for Eurosystem financing. About €17 billion of GGBBs were used at the peak of the crisis out of the total approved amount of €35 billion by the government. Since then, banks have gradually replaced them by strengthening their collateral buffers and reducing their reliance on Eurosystem liquidity. The current outstanding stock of GGBBs stands at €4.9 billion. These are expected to be fully phased out as they come to maturity and in any case by 2017.
- **Deposit and resolution fund (implicit exposure).** Portugal has two Deposit Guarantee Funds: FGD and the Guarantee Fund for Mutual Agricultural Credit Institutions (FGCAM). By the end of 2012 the total value of deposits covered by the guarantee of the FGD holders amounted to € 99.9 million. The total number of depositors covered amounted to approximately 16.1 million, with a total amount of deposits covered by the guarantee (i.e., cardholder deposits covered accounting for only up to a limit of EUR 100,000) close to €113.7 billion. A Resolution Fund was established in 2012 to strengthen depositor protection and adequately fund resolution of distressed credit institutions, financed through upfront and regular contributions from the banking system. The Fund also envisages a back-stop credit line from the State (up to €1.5 billion, whose repayment conditions are yet to be defined).

### 3.2.6 Natural resources (Not Assessed)

**125. There are no significant exhaustible natural resources in Portugal.** According to the Wealth of Nations Database by the World Bank, the net present value of minerals and subsoil assets is less than 0.4 percent of GDP. The report therefore does not assess this indicator.

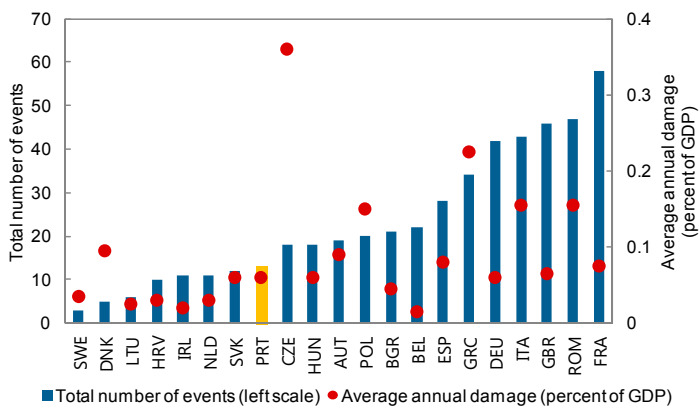
**Figure 3.8. Natural Resources in EU Countries and Portugal**



**3.2.7 Environmental risks (Basic)**

**126. Annual costs from natural disasters have been low over the past decade.** The average annual cost of damages from natural disasters between 1993 and 2012 was 0.06 percent of GDP in Portugal (Figure 3.9).<sup>64</sup> The Portuguese environment agency discloses some basic mainly qualitative information on risks associated with fires and floods and other environmental risks in its annual reports.<sup>65</sup>

**Figure 3.9. Natural Disasters in EU Countries, 1993-2012**



Source: World Bank Development Report, 2014.

<sup>64</sup> The last major earthquake in Lisbon was in 1755, the estimated economic cost of which was between 32 and 48 percent of GDP. See Pereira (2009).

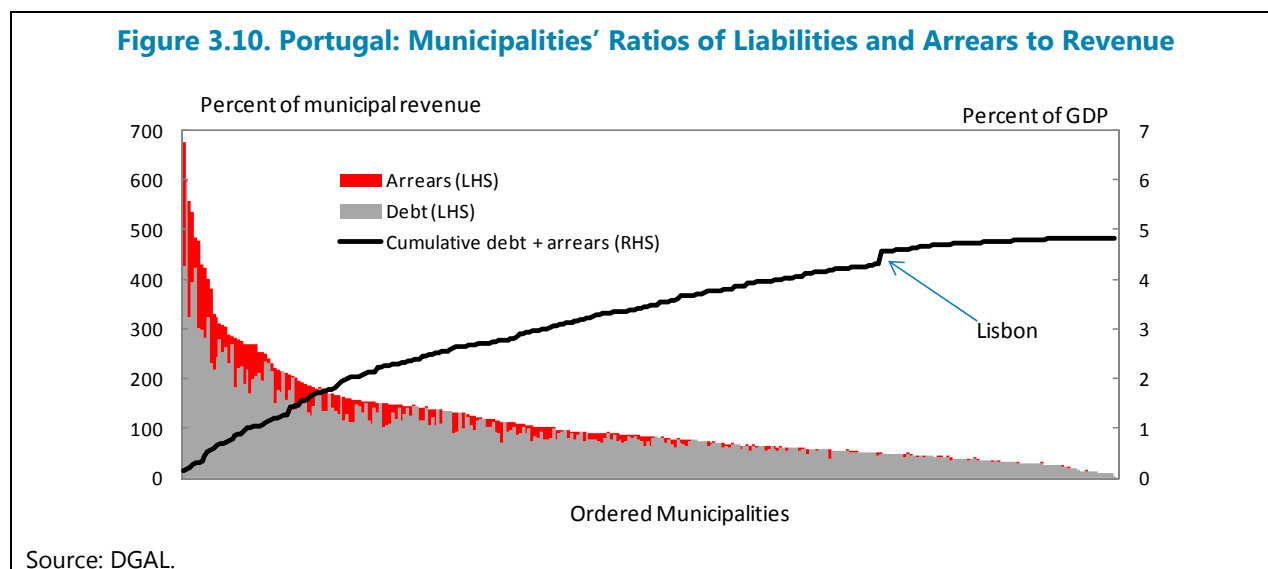
<sup>65</sup> Relatório do Estado do Ambiente, 2013.

## D. Fiscal Coordination

### 3.3.1 Sub-national governments (Basic)

**127. Despite some improvements in the monitoring and coordination of sub-national finances, there are large gaps that remain unanalyzed and unpublished.** The government has improved the reporting of monthly revenue, expenditures, and balances of the municipal sector as a whole, and the two regional governments in the monthly budget execution report. The coverage of these reports has expanded to include arrears and commercial debts (payables) of the sector. The municipal sector has always been subject to debt limits, however these have been tightened as part of the reforms of the Regional and Local Government Finance laws in 2012, which come into force in 2014. The new limit is set at 1.5 times the average current revenue from the previous three years.

**128. While reporting has improved for the overall sector, the only public reporting providing information by municipality is via the internet.** This means there is no summary information describing how individual municipalities are performing against the debt limit. Internal information reveals that there are indeed a large number of municipalities that exceed the debt limit by considerable margins (Figure 3.10), with some municipalities running debt to revenue ratios, once arrears are included, in excess of 600 percent. Many of these municipalities are involved in the Programa de Apoio à Economia Local (PAEL) with the central government, where the municipal government arrears are being cleared through central government transfers in return for enhanced surveillance and program controls.



**129. Despite the substantial realization of fiscal risks from sub-national governments, there is still no systematic monitoring or reporting of activities outside the perimeter of the general government.** While sub-national governments are relatively small as a share of expenditure in Portugal, over the course of the program, the sub-national sector has been a major factor in unanticipated shocks to the general government. This includes the uncovering of previously

unmeasured arrears worth 1 percent of GDP, and large problems from Madeira that led to a 0.6 percent of GDP revision to public debt in September 2011. The major cause of the latter revision was due to a reclassification of PPP and SOE debts from outside the general government perimeter, and the calling of a range of guarantees. There is information on guarantees for regions (€509m for Azores, and €1,159m for Madeira), and municipal governments are legally unable to issue guarantees. However there remains no information available on the number or value of PPPs at local level, though anecdotal reports are that they are numerous, and while authorities do know the number of municipal and regional corporations, there is no information on their financial status.

**130. These operations carried out by public corporations and PPPs at sub-national level could be substantial, though little information is available.** According to the institutional tables maintained by BdP, there are 494 SOEs and other entities at the local and regional government level, of which 148 are inside the general government perimeter. No financial information on the remaining 346 entities that are outside the perimeter is published separately, although BdP publishes the total debt of nonfinancial corporations outside the perimeter, including corporations held by local and regional governments. However, as an illustration of what could potentially fall within this sector, the region of Madeira had 43 entities outside of the general government perimeter in 2011, with cumulative liabilities of 1.4 percent of GDP. A private sector report from 2011 covering the majority of entities provides an estimate of total debt from local municipal owned enterprises of 1.5 percent of GDP.

**131. There are improvements to reporting of sub-national sector finances underway.** As part of the local financing laws, municipalities will be required to report all financial operations, including municipal, parish, foundation and state owned enterprises, beginning in mid-2014, which is intended to be reported in DGAL's improved transparency website. A municipal finance coordination council has been set up with the objective of taking a whole sector approach to local and regional finances and assist in the balanced development of the country. Finally, a municipal resolution fund is being set up to assist municipalities in financial distress, which will be initially funded through the state budget, and progressively financed by municipalities themselves.

### 3.3.2 State-Owned enterprises (Basic)

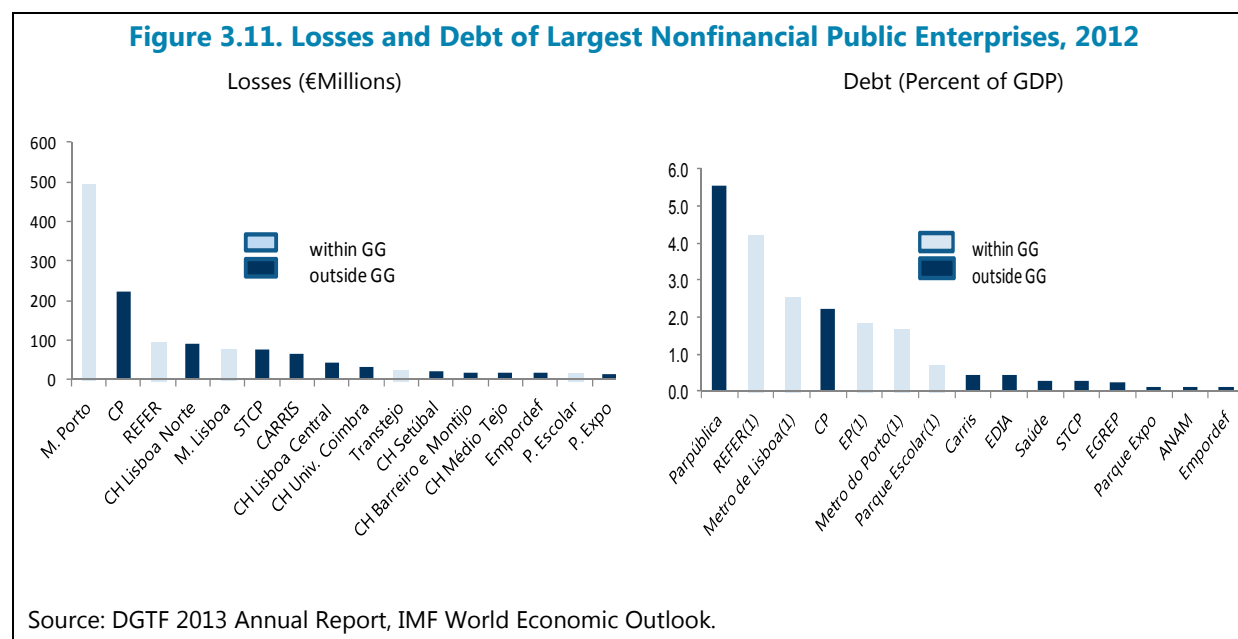
**132. SOEs created significant fiscal risk in recent years.** As Table 3.6 shows, in 2013 non-financial SOEs held through DGTF had liabilities of 33 percent of GDP, of which about 10 percent are outside of general government. Moreover, while the total loss of the sector as a whole was about 0.3 percent of GDP in 2012, a number of entities including outside of general government were incurring significant losses (Figure 3.11.). Furthermore, the debt of some of the largest SOEs is still not included in general government. There are also a number of contingent liabilities by SOEs.

In addition to the guarantees reported above (of about 1.4 percent of GDP), in 2013, they included contingent liabilities from litigation and leasing of 0.3 percent of GDP in total (Figure 3.12).<sup>66</sup>

**Table 3.6. Portugal: Nonfinancial SOEs  
(Percent of GDP)**

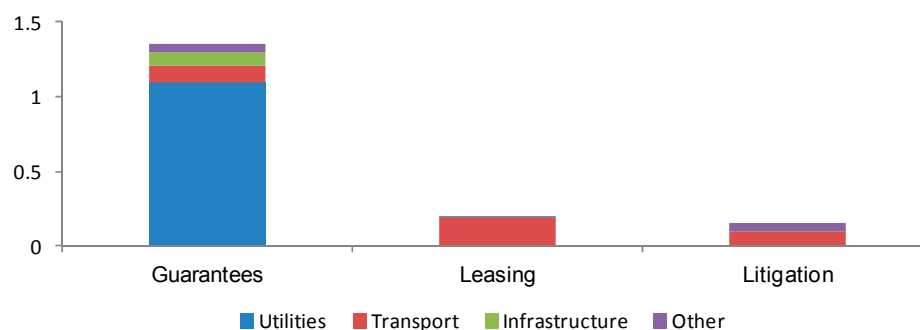
	2012			2013		
	Inside GG	Outside GG	Total	Inside GG	Outside GG	Total
Profit and Loss	-0.4	0.1	-0.3	-0.2	0.1	0
Assets	20.7	11.5	32.2	21	11.2	32.2
Liabilities	22.4	10.6	33	22.5	10.3	32.8
Debt	11	8	19	11.6	8	19.6

Source: DGTF.  
Notes: Data exclude health sector.



<sup>66</sup> The recent strengthening of a number of SOEs' equity through capital injections and/or conversion of state credits into equity will lead to a sizeable reduction in fiscal risks from 2014 onward.

**Figure 3.12. Contingent Liabilities of SOEs in 2013  
(Percent of GDP)**



Sources: DGTF, 2013Q3 Report, IMF World Economic Outlook.

**133. Reforms are underway to reduce risks associated with SOEs.** The 2013 law on SOEs significantly enhances the MoF's oversight and control. A dedicated technical unit (UTAM) will be set up in the MoF to provide advice on the financial situation and performance of SOEs, assess their budget plans and execution and evaluate the sustainability and efficiency of any new SOE. This unit will be operational during 2014. This unit will also be responsible for collecting information on local governments' SOEs from DGAL. The law gives greater decision power to the MoF, which will be responsible for: (i) defining economic and financial targets to be achieved by each public corporation; (ii) approving annual budgets and action plans; (iii) authorizing all financial transactions that are not in the annual activity and investment plans; and (iv) appointing one of the non-executive Board members if the company has one. Finally, the law introduces stricter borrowing and debt management requirements. Nonfinancial SOEs inside general government cannot contract new debt with the private sector or engage in derivative transactions without MoF and IGCP approval.

**134. DGTF's annual reports provide detailed information on transfers between the government and public corporations and on their financial performance but only cover a subset of corporations.** The annual report lists: (i) transfers from the state to each corporation (e.g., subsidies, equity injections, loans, assumption of liabilities and guarantees); (ii) dividends paid by each enterprise; (iii) aggregated information on financial assets and liabilities, and profit and loss for each subsector of nonfinancial public corporations (transport, health, infrastructure, utilities); (iv) consolidated balance sheet information on CGD, a financial corporation wholly owned by the state; and (v) contingent liabilities by SOEs. DGTF also produces regular quarterly reports on public corporations, which contain the main tables from the annual report. In 2012 the state owned directly through DGTF 87 main public enterprises.<sup>67</sup> Nineteen of the 87 main enterprises owned through DGTF are included in general government.

<sup>67</sup> In addition, DGTF reports that were 27 companies in which the state either had minority or temporary holdings or which were in liquidation. However, the Banco de Portugal reports a total of 254 central government nonfinancial SOEs as of March 2014. There may be some significant SOEs outside of DGTF reporting, namely due to indirect participations.

**135. The DGTF website contains some information on quasi-fiscal activities.** A number of public and private corporations are required to provide services of public interest at below market prices and the state compensates these enterprises for the specific costs resulting from those obligations. Examples include airfares to Madeira, for which TAP, the national airline of Portugal, is required to offer below market fares to residents. DGTF lists the compensation from the state for these activities by enterprise on their website. In 2013 the total compensation from the state to public and private corporations for these activities amounted to about €340 million (0.2 percent of GDP).

## E. Priorities

**136.** The government meets the standard of basic practice in most areas of fiscal risk addressed by the Code, but there are a number of areas for improvement (Table 3.7). Focusing on the following priorities will strengthen the government's fiscal risk management:

- Provide a comprehensive fiscal risk statement in the budget that centralizes and analyses information provided by various ministries and agencies and takes into account how different risks could interact.
- Regularly perform and disclose long-term sustainability analysis including an assessment of sensitivity to macroeconomic shocks and the impact of aging.
- Develop an asset management strategy and disclose risks around major assets. Ensure complete coverage of the centralized cash management system.
- Extend the relatively narrow mandate of UTAP to monitor potential risks from central government concessions currently outside of its scope.
- Extend the ongoing transparency initiative to provide an annual summary report of individual municipal and regional finances against the new finance limits, and begin start systematically monitoring and reporting sub-national activities that fall outside the perimeter of the general government, particularly around SOEs and PPPs.



Table 3.7. Summary Evaluations: Fiscal Risk

Principle		Assessment	Importance	Priority
3.1.1	Macroeconomic Risks	<b>Good.</b> No probabilistic forecast of fiscal outcomes	<b>Medium.</b> Significant risks from macroeconomic shocks	
3.1.2	Specific Fiscal Risks	<b>Basic.</b> Some fiscal risks discussed in mainly qualitative terms in FRS, but incomplete coverage and quantification not	<b>High.</b> Specific fiscal risks could amount to 122 percent of GDP	Y
3.1.3	Long-Term Fiscal Sustainability Analysis	<b>Basic.</b> Reported DSA only once in the 2013 DEO	<b>High.</b> High debt call for regular long-term sustainability analysis	Y
3.2.1	Budgetary Contingencies	<b>Basic.</b> The criteria used have changed often in the last year and are not transparent.	<b>Medium.</b> Contingencies are between 0.5 to 1 percent of GDP	
3.2.2	Asset and Liability Management	<b>Basic.</b> Government undertakes debt management, but there is no consistent approach to asset management.	<b>High.</b> GG financial assets and liabilities of 48 and 131 percent of GDP. Plus large nonfinancial assets of 73 percent of GDP	Y
3.2.3	Guarantees	<b>Good.</b> Guarantees disclosed and granting of new guarantees controlled by law, but probabilities of them being called are not estimated	<b>Medium.</b> Total exposure from guarantees is about 21 percent of GDP	
3.2.4	Public-Private Partnerships	<b>Basic:</b> Information on 35 UTAP managed PPPs published. Only basic information on the 75 concessions outside of UTAP's mandate. No legal limit on accumulated obligations	<b>High.</b> Portugal has one of the largest PPP programs in Europe	Y
3.2.5	Financial Sector Exposure	<b>Good.</b> Authorities disclose explicit support but do not publish their own stress tests	<b>High.</b> Total exposure to the financial sector is high	
3.2.6	Natural Resources	<b>Not assessed. No major natural non-renewable resources</b>	<b>Low.</b> Net present value of non-renewable resources (minerals), less than 0.4 percent of GDP	
3.2.7	Environmental Risks	<b>Basic. Environmental risks are discussed in qualitative terms</b>	<b>Low.</b> Average annual cost from natural disasters of 0.06 percent of GDP	
3.3.1	Sub-National Governments	<b>Basic. Monthly reports are provided for the overall sector, but no reporting of individual municipalities</b>	<b>High.</b> Realization of fiscal risks (2½ percent of GDP) from this sector has been a factor, and risky areas remain unmonitored	Y
3.3.2	State Owned Enterprises	<b>Basic. Annual report includes all transfers to DGTF managed public corps and financial information. Transfers to corps outside of DGTF are only reported if paid by Treasury via Exceptional Expenditure</b>	<b>Medium.</b> SOEs have liabilities of about 30 percent of GDP, of which 20 percent of GDP are of corporations within GG. Recent debt management operation entails reduction of fiscal risks	

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