Conselho das Finanças Públicas
Portuguese Public Finance Council

Analysis of the General Government Budget Outturn 2013

Report no. 2/2014

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The Portuguese Public Finance Council is an independent body, set up by article 3 of Law no. 22/2011 of 20 May that introduced the 5th amendment to the Budgetary Framework Law (Law no. 22/2001 of 20 August, republished by Law no. 37/2013 of 14 June).

The decision to set up the Council was taken following the publishing of the final report of the Taskforce to the European Council on economic governance in Europe, and became a reality in October 2010 after agreement was reached between the Socialist Party (PS), in Government, and the Social Democratic Party (PSD). The final version of its Statutes was approved by Law no. 54/2011 of 19 October.

The Council began its work in February 2012 and its mission is to conduct an independent assessment of the consistency, compliance with the stated objectives and the sustainability of public finances, while promoting fiscal transparency, so as to contribute to the quality of democracy and of political economic decisions and so strengthen the State's financial credibility.

This report uses the information available up to April 15th 2014.

In the publications section at www.cfp.pt, a spreadsheet is available for download that contains all the figures used to build the charts and tables in this report.

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EXECUTIVE SUMMARY

Macroeconomic framework

In 2013 the Portuguese economy contracted by 1.4%, in real terms, a decline lower than forecasted at the beginning of the year (-2.3%), although it was larger than expected in the macroeconomic scenario set out in the initial State Budget (-1.0%).

The performance of the labour market, which reflected a net job creation since the 2nd quarter, had an important impact on the change in the macroeconomic climate, as shown by a more than expected positive change in private consumption and investment.

The external imbalance adjustment process went on at a rate above expected in most forecasts. The Portuguese economy increased its net external lending capacity (balance equal to +2.0% of GDP), mainly as a result of the rise in household savings and the drop in non-financial companies and general government borrowing requirements.

General government balances

The budget deficit stood at 4.9% of GDP from the national accounts perspective. This deficit compares favourably with the goal set in the first and second amendments to the State Budget for 2013 (5.5% of GDP and 5.9% of GDP, respectively), although unfavourably with the original goal of 4.5% of GDP. Unlike previous years, it reflects a less unfavourable result than that obtained from the public accounting perspective.

Net of the impact of temporary and one-off measures, the general government budget deficit stood at 5.3% of GDP in 2013 (8,701 M€). This represents an improvement of 0.7 p.p. of GDP *vis-à-vis* 2012 and compares favourably with the Ministry of Finance's revised forecasts issued during 2013. Nonetheless**,** it is the least significant annual improvement recorded in the last three years, which is explained to a large extent by the restoring of two bonuses to civil servants and pensioners which were not paid in 2012. The primary deficit (which excludes interest) fell to 1.0% of GDP, a figure slightly better than that recorded in 2008.

The fiscal developments over 2013 reflected the major contribution of revenue in the decrease of the public deficit, which was especially evident from the 2nd quarter of the year. Expenditure did not contribute to the budget imbalance correction, due to the poor performance of current primary expenditure, particularly in the 2nd half of the year, when three quarters of spending was undertaken.

Revenue and expenditure

In 2013, the adjusted general government revenue recorded a growth of 2.3 p.p. of GDP versus 2012, and stood at 42.9% of GDP. The performance of tax revenue accounted for over 80% of that growth as a result of the increased tax burden that totalled 34.7% of GDP, in non-adjusted terms. These indicators reflect the budget impact of a series of tax policy measures introduced in 2013 and designed to reduce the budget imbalance.

Adjusted general government expenditure rose by 1.6 p.p. of GDP, reversing the trend of the two previous years, while remaining below the figure recorded in 2010. This change reflects the 5.0% rise in current primary expenditure, which was strongly impacted by the restoring of holiday and Christmas bonuses to civil servants and pensioners. The reduction in capital expenditure and interest contributed to a move in the opposite direction. Expenditure outturn suggests that the budget consolidation measures on the expenditure side did not produce all the effects expected by the Ministry of Finance.

Social security funds

As was the case in 2012, the positive budget balance in the social security funds subsector was achieved by means of an extraordinary State Budget transfer. The impact of the economic cycle continued to worsen the budgetary position of this subsector, although to a lesser extent than in 2012; this led to a smaller drop in social contributions revenue and a slowdown in the rate of growth in unemployment benefits compared to the previous year. Expenditure continued to rise, reflecting the restoring of the holiday and Christmas bonuses to pensioners. Consequently, an extraordinary State Budget transfer was required without which the subsector would have recorded an adjusted budget deficit of 1,253 M€, up by 696 M€ on 2012 (excluding the extraordinary transfer received that year).

Regional and local government

Subnational governments produced a surplus once again (355 M€), 273 M€ from local administration and 82 M€ from regional administration. The 2013 outturn of the Madeira Autonomous Region exceeded the goal set for the budget balance in the adjustment program. Two years after the program was introduced, the results for the Region appear to reflect a path to budget imbalance correction.

Public debt

In 2013 the public debt ratio continued to rise, having gone from 124.1% to 129.0% of GDP, a figure higher than that forecast in all the budget programming documents. Although public debt rose more than the budget deficit, the differential corresponding to the stock-flow adjustment was the lowest of the last four years. That adjustment reflects, to a large extent, payments of arrears at the regional and local government levels and health sector debt settlement schemes which had already been taken into account under the national accounts perspective in previous years.

Over the last three years, corresponding to the period of the financial assistance program still in effect, the debt ratio deteriorated by 35 p.p. of GDP, of which 15.7 p.p. was due to cumulative budget deficits, 14.8 p.p. to the stock-flow adjustment and 4.5 p.p. were the result of the contraction of the economy.

1 INTRODUCTION

This report evaluates the fiscal developments over 2013 and whether budget outturn is consistent with the targets for the deficit and public debt in 2013 set in 2012 and 2013. This report was produced in accordance with the CFP's Statutes and following the publication on 31 March 2014 of the following statistical data: 1st notification in 2014 under the Excessive Deficit Procedure (EDP), published by Statistics Portugal (INE); quarterly national accounts by institutional sector for the 4th quarter of 2013, published by the INE and by the Bank of Portugal (BoP).

Unless stated otherwise all figures in this report on the budget outturn are expressed at current prices and in the national accounts perspective (ESA95) considering the methodological adjustments required by the EDP.[1] As usual in CFP reports, the general government budget aggregates have been adjusted for the impact of temporary measures, one-off measures and other special factors, so as to provide a better assessment of the consolidation effort. In regard to public debt, this report examines in detail the factors that, in addition to the deficit, explain the variation of that indicator.

This report is divided into six sections. The first is an introduction and describes the information underlying this analysis. The second contextualizes the various macro-fiscal forecasts made throughout the year. The third section describes the macroeconomic developments in 2013. The fourth examines the overall financial position of the general government and the social security funds and regional and local government subsectors. The fifth section deals with public debt and the sixth and final section compares the forecasts made in the various budgetary planning documents and the actual results.

This report benefitted from the information provided regularly by the BoP and the INE in national accounts (financial and non-financial statistics), from additional clarification provided by those bodies and also from information provided by the Directorate-General for Budget (DGO). The analysis of the social security funds subsector is based mainly on the financial information provided by the Social Security Financial Management Institute (IGFSS), although the CFP did not receive the physical data on the social security system it requested.

The data supporting this report have a preliminary nature and are subject to revision, as was the case in previous quarters.

2 2013 FORECAST FRAMEWORK

The macroeconomic and budget forecasts for 2013 were reviewed on a number of occasions in 2012 and 2013, which shows the high degree of uncertainty as to economic performance and its impact in fiscal terms.

[1] To be precise the difference in methodology is shown in the overall general government budget balance. In 2013, the deficit was -8,241 M€ in the ESA95 tables and -8,122 M€ in the EDP notification, as per the two INE sources referred to above. This difference is explained by the treatment the two sources give to swap agreements and forward rate agreements interests. This report uses the EDP approach.

In April 2012, the Fiscal Strategy Document (FSD/2012) estimated a return to economic growth (0.6% in real terms) and the correction of the excessive deficit (standing at 3% of GDP) in 2013. However, budget developments over 2012 did not confirm the official forecasts published in that document, mainly due to the change in tax revenue, which resulted in a weaker starting point for the fiscal adjustment to be made in 2013. The Constitutional Court decision of July 2012 led to a change in the adjustment strategy set out in the FSD/2012, since it held the suspending of the holiday and Christmas bonuses, effective from 2013, to be unconstitutional.

Thus the 2013 State Budget (SB/2013) published in October 2012 reflected a turnaround in the fiscal adjustment approach that had previously been adopted, forecasting a significant increase in taxes on income and property. The SB/2013 provides for budget consolidation measures that totalled 3.2% of GDP, aimed at compensating for the 2012 carry-over effect, the macroeconomic scenario's unfavourable impact on tax revenue and the partial restoring of the holiday and Christmas bonuses to civil servants and pensioners.

The significant deterioration of the economic perspectives in 2013 (from 0.2% to -1%),[2] as a result of both the expected less favourable international environment and the fiscal consolidation measures proposed following the Constitutional Court decision, led to the change of the 2013 fiscal goals agreed under the 5th Review of the Economic and Financial Assistance Program (EFAP) and incorporated in Economic and Financial Affairs Council (ECOFIN) Resolution of 9 October 2012. Thus the 2013 deficit target set in the SB/2013 accounted for an upward revision from 3% to 4.5% of GDP.[3]

The preliminary data for the 2012 budget outturn, along with the figures for economic activity published by INE in March 2013 which confirmed the deterioration in the economic conditions, were behind the sharp downward revision in the economic growth forecast for 2013, under the 7th Review of the EFAP (from -1% to -2.3% of GDP). This update reflected a fall in the contribution of domestic demand to the change in GDP and a more unfavourable trend in the labour market, leading to a revision of the 2013 budget deficit target from 4.5% to 5.5% of GDP. In order to achieve this new target the Government agreed to implement additional fiscal consolidation measures equal to 0.3% of GDP (adding up to an overall impact of 3.5% of GDP in 2013).[4]

These new forecasts were included in the FSD/2013, published in April. In addition to the impact of the new macroeconomic scenario, the document also reflected the fiscal effect of the Constitutional Court decision published on 5 April 2013 that declared the cut in the public sector and pensioners' holiday bonuses, as well as the proposed levying of a contribution on the sickness and unemployment benefits to be unconstitutional. However, despite amending the budget goal for 2013 as a result of the downward revision in revenue and the forecast

[2] In the 4th Review of the EFAP economic growth was revised to -0.2%. In the 5th Review it was changed to -1%.

[3] The correction of the excessive deficit originally intended for 2013 was postponed to 2014 under the 5th Review. Later, under the 7th Review, the goal for 2014 was amended and the excessive deficit correction was again postponed, this time to 2015.

[4] Speech by the Minister of State and Finance on 15 March, on the completion of the 7th regular review of the EFAP.

rise in expenditure, the FSD/2013 only defined the general government budget constraint without specifying the measures required to ensure the new goal was met.

These were included in the first amendment to the SB/2013 (1st ASB/2013), published at the end of May 2013, which set out to: i) comply with the Constitutional Court decision, ii) reflect the changes to the macroeconomic scenario incorporated in the FSD/2013 and iii) increase the expenditure appropriations to cope with the debt settlement programs at the regional and local government and health sector levels.[5] In this document the detailed quantification of the additional measures designed to achieve the new target of 5.5% of GDP, consistent with Council Recommendation of 21 June 2013, was incomplete.

Under the second amendment to the SB/2013, published in October, the Ministry of Finance (MF) estimate pointed to a fiscal deficit of 5.9% of GDP. That estimate incorporated the impact of the Banif capital injection, which would be set off by an extraordinary measure of equal impact on the revenue side. However, the results of the Exceptional Scheme for the Settlement of Tax and Social Security Debts (ESSD) exceeded the MF estimates, and contributed to a better than forecast fiscal performance.[6]

[5] The regional and local government debt settlement programs are the Madeira Autonomous Region Economic and Financial Adjustment Program (PAEF-RAM) and the Local Economy Support Program (LESP). These payments had no impact on expenditure in the national accounts, since they had already been recorded in the respective financial years.

[6] The revenue from the ESSD totalled 1,280 M€, 580 M€ up on the MF estimate.

3 MACROECONOMIC FRAMEWORK

Throughout the second half of 2013 the prospects of an economic upturn in the European Union improved and a return to growth was expected in 2014. This trend was seen across the developed nations and was reflected in forecasts favouring world trade and reinforcing the turnaround which occurred in 2013. This change was also seen in the Euro area – Portugal's main trading partner – which, in the last quarter of 2013, recorded a positive year-on-year change (0.5%), at both the domestic demand and net exports levels.[7]

Despite an average annual downturn of 1.4%, the Portuguese economy showed strong signs of recovery over the year that began in the 2nd quarter and even achieved year-on-year real growth of 1.7% in the 4th quarter. The reversal of the deterioration that had been seen in 2011 and 2012 (despite the positive contribution of foreign demand) was supported by the resilience of export growth and by the slowdown in the drop of domestic demand.[8] The less negative investment dynamic and the positive response from the labour market, by way of significant job creation, made possible substantial changes to the way in which the future is perceived.

The macroeconomic framework underlying the developments in the general government account in 2013 was also marked by a positive change in expectations, in contrast with the situation recorded since 2010. That trend is clearly reflected in the forecasts made over the year which are shown in Table 1. Note that the original budget was drawn up on the assumption of a reversal of the economic cycle in 2013, and later data published at the end of 2012 and the beginning of 2013 brought about major downward revisions (assuming a sharp contraction in domestic demand and weak performance on the part of foreign demand). Subsequent developments did not match these projections and were actually more in line with the original budget forecasts.

Thus, from a time marked by great pessimism as to the effects of implementing the EFAP and its successive adaptations, we have moved on to a period in which the outcomes exceeded the expectations in all macroeconomic variables. The changes in the forecasts went along with the changes in the economy which reached a turning point in the 2nd quarter of 2013 and was still the case at the time this report was written. The first amendment to the 2013 State Budget still adopted the macroeconomic scenario set out in the Fiscal Strategy Document which reflected deteriorating expectations in the first part of the year.

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[7] Eurostat (2014), *Euro area GDP up by 0.3%, EU28 up by 0.4%*.

[8] Numerical proof is given in the tables and charts below.

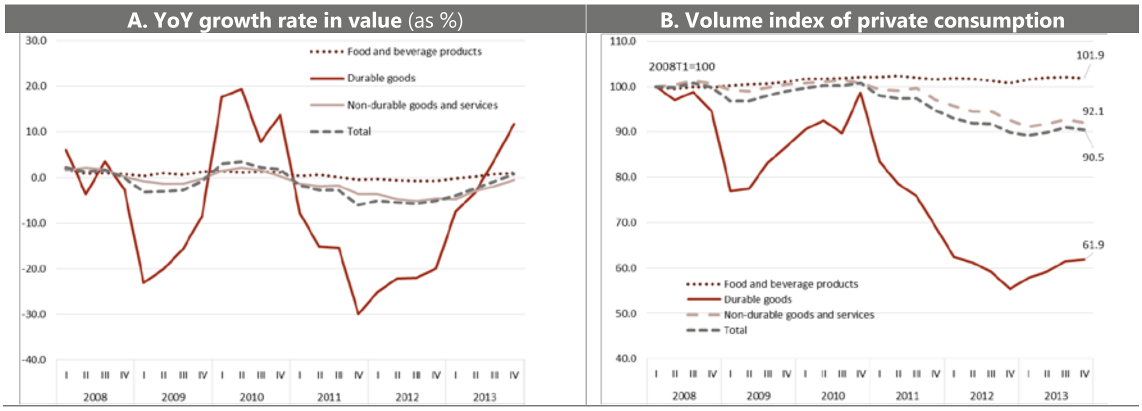
Table 1 – Macroeconomic projections for the Portuguese economy

	2012	2013							
	INE	FSD 2012	SB initial	BoP	FSD 2013	BoP	BoP	SB14	INE
	mar-13	apr-12	oct-12	mar-13	apr-13	jul-13	oct-13	oct-13	mar- 14
Real GDP	**-3.2**	**0.6**	**-1.0**	**-2.3**	**-2.3**	**-2.0**	**-1.6**	**-1.8**	**-1.4**
Private consumption	-5.4	-0.7	-2,2	-3.8	-3.2	-3.4	-2.2	-2.5	-1.7
Public Consumption	-4.7	-2.9	-3.5	-2.4	-4.2	-2.1	-2.0	-4.0	-1.7
Gross Fixed-Capital Formation (GFCF)	-14.3	-0.6	-4.2	-7.1	-7.6	-8.9	-8.4	-8.5	-7.3
Exports (goods and services)	3.2	5.6	3.6	2.2	0.8	4.7	5.8	5.8	6.1
Imports (goods and services)	-6.6	1.6	-1.4	-2.9	-3.9	-1.7	2.0	0.8	2.8
Contributions to change in GDP									
Domestic demand (p.p.)	-6.9	:	-2.9	-4.2	-4.1	-4.4	-3.1	-3.7	-2.6
Net exports of goods and services (p.p.)	3.7	:	1.9	1.9	1.8	2.4	1.4	1.9	1.2
Prices									
Inflation rate	2,8	1.3	0.9	0.7	0.7	0.4	:	0.6	0,3
GDP Deflator	-0.3	:	1.3	:	1.8	:	:	1.9	1.8
Labour market									
Unemployment rate	15.7	10.9	16.4	:	18.2	:	:	17.4	16,3
Employment growth	-4.2	:	-1.7	:	-3.9	:	:	-3.9	-2.8
Current account (inc. capital transfers)	0.1	-0.4	1.0	3.6	1.4	:	:	2.3	2.0
Memo items:									
GDP at current market prices	165.6	167.5	166.8	:	164.5	:	:	162.2	165,8
General gov. balance (% GDP)	-6,4	-3.0	-4.5	:	-5.5	:	:	-5.9	4,9
Public Debt (% GDP)	124.1	115.7	123.7	:	122.3	:	:	127.8	129.0

Source: INE, Ministry of Finance, Bank of Portugal, European Commission and IMF. | Note: The macroeconomic scenario underlying the 1st ASB/2013 is identical to the scenario contained in the April FSD/2013. The change in prices is expressed in percentages; the unemployment rate is expressed as a percentage of the working population; the employment indicator is expressed as a change in percentage; the net external lending/borrowing position is expressed as a percentage of GDP.

The fall in private consumption that had been recorded since 2012 continued to slow down and in the last quarter of the year this variable had a positive year-on-year change (0.7%), for the first time since 2010. This change stems from the reversal of the trend in durable goods consumption and a proportionally lower recovery in non-food consumables and services. The restoring of holiday and Christmas bonuses to civil servants and pensioners, plus the signs of recovery from the 2nd quarter onwards, will have produced this change which had an impact on the budget outturn.

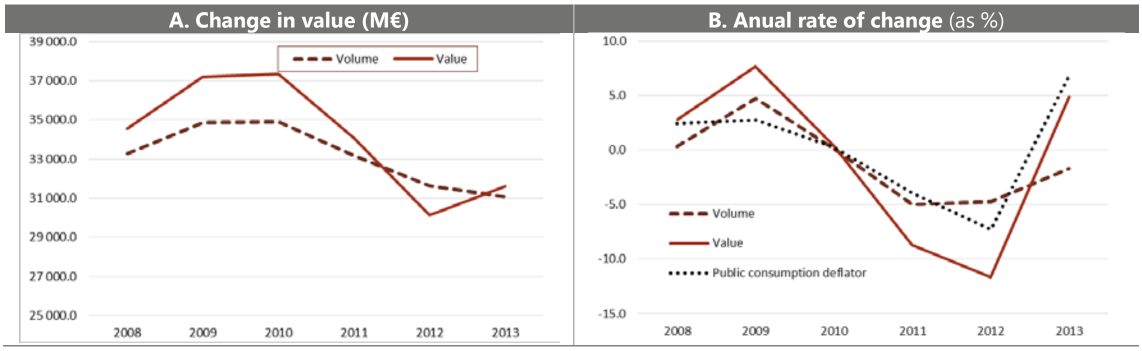
Chart 1 – Resident household consumption



Source: INE, quarterly national accounts, March 2014. Resident households final consumption expenditure, chain-linked volume data (reference year = 2006).

Public consumption grew in nominal terms (4.9%), largely due to the restoring of civil servants' bonuses. In real terms general government consumption followed the downward trend recorded since 2011. The erratic performance of public consumption deflators is the result of measures that impact directly on wage cost calculations: the partial suspension in 2012 and the reintroduction in 2013 of the bonuses and the increased number of working hours per week (from 35 to 40 hours) in 2013.[9] The performance of the public consumption deflator had a significant impact on the GDP deflator which stood at 1.8%, compared to the 2012 figure of -0.3%.

Chart 2 – General government final consumption

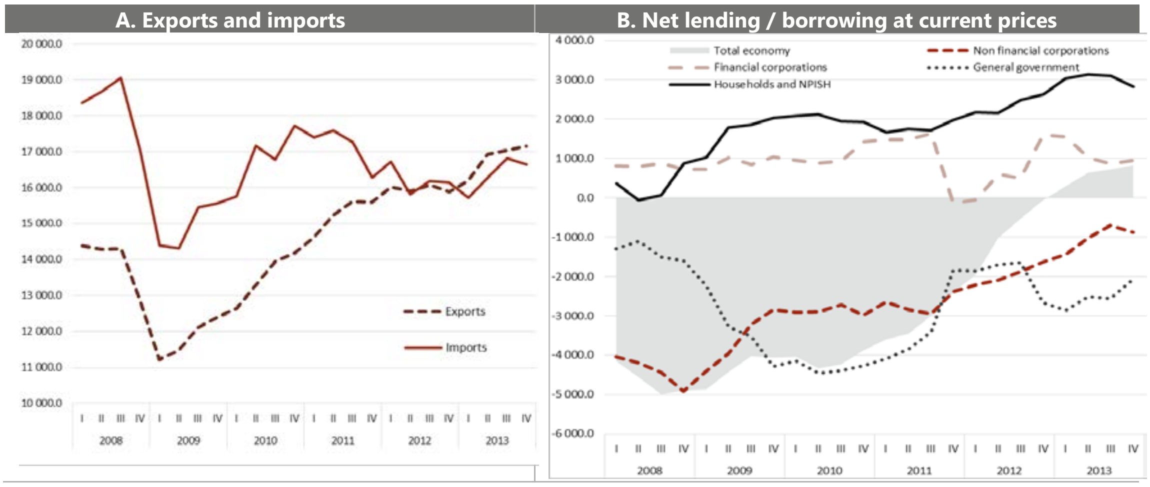


Source: INE, quarterly national accounts, March 2014. General government final consumption expenditure, chain-linked volume data (reference year = 2006) and by value (current prices).

In 2013 the Portuguese economy maintained a net lending capacity as external savings rose to the significant level of 3.6% of GDP in the 4th quarter (and 2.0% over the full year). The external imbalance correction process continued throughout 2013 and gave rise to increasing financing capacity over the year. Household financial savings were a deciding factor as well as the decline in non-financial corporations and general government borrowing requirements.

[9] Law no. 68/2013 of 29 August, which came into force in October 2013.

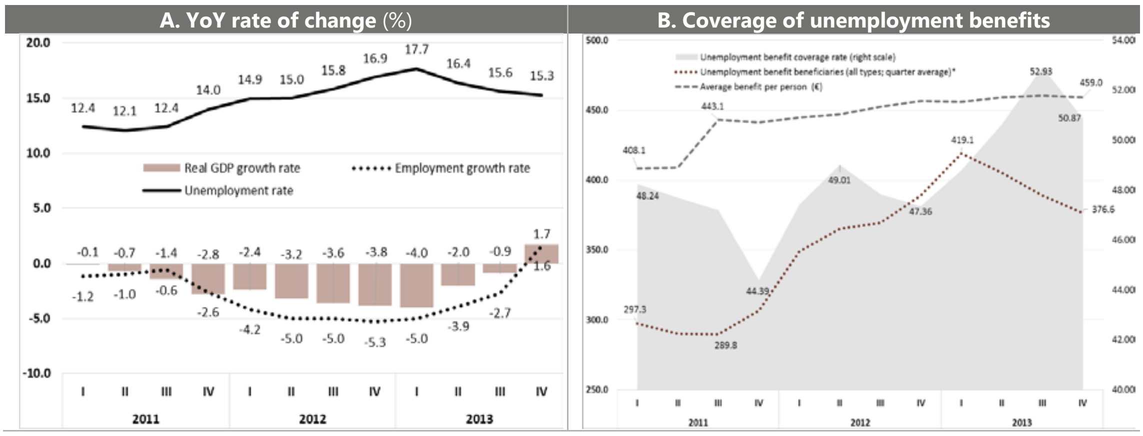
Chart 3 – Exports, imports and the Portuguese economy's lending/borrowing position (M€)



Source: INE Quarterly national accounts and quarterly accounts by Institutional Sector, April 2014. Exports and imports shown at current prices; economy's lending/borrowing position at current prices, rolling average over the 4 quarters of the year ending in the reference quarter.

The unemployment rate and, in particular, job creation recorded a significantly better performance than expected. The quarter-on-quarter change in employment was positive from the 2nd quarter of the year onwards and in the last quarter there was also a positive year-on-year change, that is to say, over the full year there was a net job creation (30,000) compared to the end of 2012.

Chart 4 – Economic growth, employment and unemployment



Source: INE, Quarterly national accounts, April 2014 and Employment Survey; Social Security Financial Management Institute. CFP calculations. | Notes: * - Includes Unemployment Benefit, Initial Unemployment Social Benefit, Subsequent Unemployment Social Benefit and Extension of Social Unemployment Benefit.

4 MAJOR GENERAL GOVERNMENT BUDGET DEVELOPMENTS

4.1 BUDGET BALANCES

The general government budget deficit net of temporary and one-off measures stood at 5.3% of GDP in 2013 (8,701 M€), falling for the fourth consecutive year.[10] However, the improvement recorded last year (0.7 p.p. of GDP) was the least significant of the last three years, and was only half that of the average fall in the period of 2010-12. This outcome is explained by the rise in expenditure caused by the restoring of bonuses to civil servants and pensioners (see left hand panel of Chart 5).

The result compares favourably with the forecasts revised by the MF over 2013. In adjusted terms the original deficit target underlying the SB/2013 was 4.6% of GDP, which was then revised upwards to 5.7% of GDP under the 1stASB/2013.[11] Last October the MF published a new estimate (2nd ASB/2013), which indicated a 2013 deficit of 5.9% of GDP.[12] Therefore the recorded deficit compares favourably with the target set in the 1st ASB/2013 (0.4 p.p. lower) and the latest MF estimate (0.7 p.p. lower).

Table 2 – Change and deviations in the general government balances in 2013 (% of GDP)

	2012	2013				Change	Deviations:		
	INE	Initial SB (oct 12)	1st ASB (may 13)	2nd ASB (oct 13)	INE (mar 14)	2012/13	Initial SB	1st ASB	2nd ASB
Budget balance:									
non adjusted (EDP)	-6.4	-4.5	-5.5	-5.9	-4.9	1.5	-0.4	0.6	1.0
adjusted	-6.0	-4.6	-5.7	-5.9	-5.3	0.7	-0.6	0.4	0.7
Primary balance:									
non adjusted (EDP)	-2.1	-0.2	-1.0	-1.6	-0.6	1.5	-0.5	0.4	0.9
adjusted	-1.7	-0.3	-1.1	-1.6	-1.0	0.7	-0.7	0.1	0.6

Source: Ministry of Finance and the INE. | Notes: the 1st ASB/2013 targets match those of the FSD 2013-17; the 2nd ASB/2013 Bill was not accompanied by a report (the review of the 2013 forecast was published in the context of the MF estimate, included in the SB/2014 report); the original version of the EFAP (May/2011) pointed to a deficit equal to 3% of GDP in 2013.

In adjusted terms the general government primary deficit fell to 1.0% of GDP. This result (which excludes expenditure on interest) compares favourably with the forecast in the 1st ASB/2013 and the MF estimate. In 2013 the shrinking of the economy continued to explain a more favourable development of the budget balances in nominal terms than as a share of output. In fact in monetary units the primary deficit totalled 1,637 M€, a fall of 1,088 M€

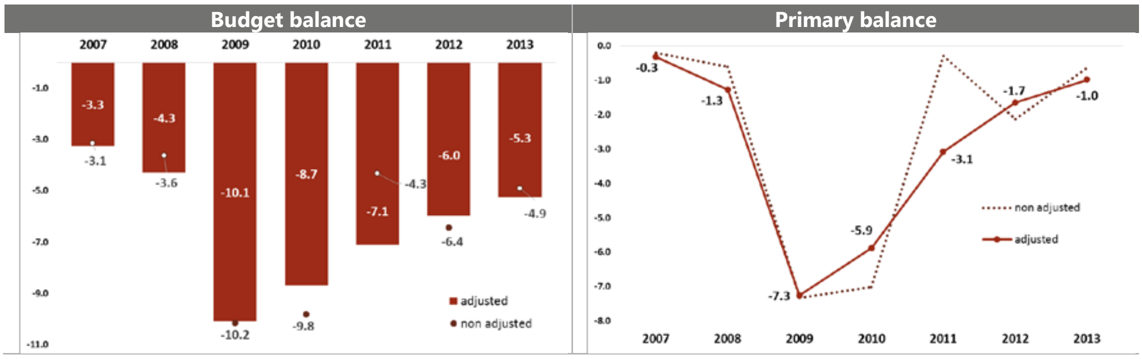
[10] In 2013 adjustments were made for two temporary measures: spending on the Banif recapitalisation operation (700 M€) and the revenue from the ESSD – Exceptional Scheme for the Settlement of Tax and Social Security Debts (1,280 M€) – see Table 14, attached.

[11] The revision undertaken in the 1st ASB/2013 was negotiated with the international institutions in March 2013, during the technical mission relating to the 7th Review of the EFAP, and it was also acknowledged in the Council Recommendation of 21 June 2013, under the EDP. It resulted above all from the restoring of the holiday bonuses to civil servants and to CGA and social security pensioners (following the Constitutional Court Decision no. 187/2013) and the deterioration in the macroeconomic scenario.

[12] Under the methodology used by the CFP, the balance underlying the estimate is identical before and after the adjustments, since the MF estimated that the revenue from the ESSD would be equal to the expenditure on the Banif recapitalisation operation.

compared to 2012. The fall occurred despite the expenditure rising.[13] In effect the growth in PIT revenue made up for the increase in current primary expenditure, stemming essentially from the restoring of holiday and Christmas bonuses. The reduction in the primary deficit achieved last year is slightly better than in 2008 (see right hand panel of Chart 5).

Chart 5 – General government balances (% of GDP)



Source: INE. CFP calculations. | Note: data compiled for the Excessive Deficit Procedure purposes.

The headline budget deficit was 4.9% of GDP in 2013.[14] This figure is below the target set in the 1st ASB/2013 (0.6 p.p. of GDP lower) and the MF estimate (1.0 p.p. of GDP lower). The improvement in the headline balance (1.5 p.p. of GDP) is greater than that in the balance net of "temporary and one-off measures and special factors" (0.7 p.p. of GDP) because their net effect on the balance was negative in 2012 and positive in 2013.

Throughout the three years that the EFAP was in force the adjusted balance recorded a lower improvement than the observed balance (to the tune of 1.5 p.p. of GDP) - see Chart 5, left hand panel. This was so because the negative impact of the special factors on the overall balance eased progressively over the period, and last year there were no special factors at all.[15]

[13] This increase is explained above all by the aforementioned restoring of bonuses. Nonetheless it should be noted that the MF sought to reduce the impact of this restoration by resorting to the use of the entire budget reserve (430 M€, which in the SB/2013 had been allocated to compensation of employees) and by implementing across the board measures in the context of the general government reform, with which it expected to get savings of 250 M€.

[14] It corresponds to the balance calculated under the EDP rules (-8,122 M€). The budget deficit in the national accounts (ESA95) published by the INE, which takes into account the effect of swap agreements related interest, was slightly higher (-8,241 M€), amounting to 5.0% of GDP.

[15] Note that while the temporary measures recorded greater annual variations (compared to the special factors) they were also more irregular and they ended up having zero impact on the change in the balance from 2010 to 2013 — details are given in Table 14.

Box 1 – From the public accounting balance to the national accounts balance

In 2013, the (headline) deficit calculated in line with the Excessive Deficit Procedure rules (4.9% of GDP) was 0.4 p.p. of GDP lower than the deficit recorded in the public accounts perspective (deficit of 5.3% of GDP).[1] Contrary to previous years, the outcome is less unfavourable than the figure from the public accounts perspective.[2] This is because in 2013 payments made by the Madeira Autonomous Region (RAM), Local Government (LG) and National Health Service (NHS) under debt settlement programs reflects expenditure that had already been recorded in the national accounts in previous years.

Thus, in 2013, the adjustment category relating to the "accrual principle" records a positive impact (+1.1 p.p. of GDP), unlike the "other adjustments" category which reflects a negative impact (-0.6 p.p. of GDP). In the former case the positive impact is due to the aforementioned payments of regional and local governments and the health sector arrears (1 p.p. of GDP), and to other adjustments concerning reclassified public corporations (0.5 p.p. of GDP). Over half of the latter adjustment was due to increases in the share of State capital in Estradas de Portugal, SA, Metropolitano de Lisboa, EPE and REFER, EPE, although with a lower impact than expected in the 1st ASB/2013. Adjustments with an opposite impact include the difference between interest paid and due (-0.1 p.p. of GDP) and the adverse impact of the cancelling-out of the revenue from the 2nd disbursement of the sale of the airport concession to ANA – Aeroportos de Portugal, SA, as well as the entire revenue from the sale of the concession to ANAM – Aeroporto da Madeira, S.A. (- 0.3 p.p. of GDP), which were recorded as a financial transaction in national accounts.

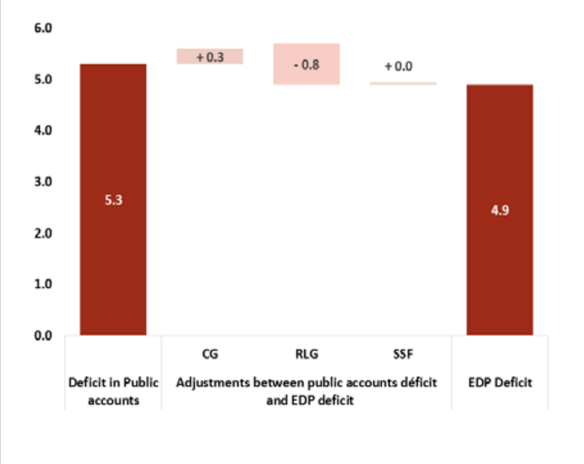
As regards "other adjustments", the negative impact of 0.6 p.p. of GDP is explained by the State capital injections in financial and non-financial corporations. The former include the Banif recapitalisation transaction (700 M€ or 0.4% of GDP), recorded as a capital transfer with an impact on the deficit. The latter encompasses the State capital injections in the RPC mentioned above, the impact of which is subject to consolidation between general government bodies and does not affect the deficit.

Adjustment between accounting systems (% of GDP of the period)

Table 3 – Adjustments between perspectives

	2012	2013
(1) Balance in Public Accounts	**-4.2**	**-5.3**
Central Government and Social Security funds	-4.7	-4.8
Regional and local Government	0.5	-0.5
(2) Adjustments to the EDP Balance	**-2.3**	**0.4**
Differences due to General Government universe	0.5	0.0
Accrual (cash - commitments adjustments)	-1.9	1.1
Taxes and social contributions *	-0.1	0.0
Differences between interested paid and accrued	-0.1	-0.1
Other time adjustments (of which):	-1.7	1.1
Cash Commitments HNS and CPS	0.5	0.2
Accrual of Public Corporation Sector incl. in GG	-0.2	0.5
Capital increase in RPC included in GG**	0.1	0.3
Local Government Adjustments	0.0	0.2
Arrears	0.1	0.6
Cancel. of concession revenue from ANA e ANAM	-0.5	-0.3
Other Adjustments	-0.9	-0.6
Capital injections	-1.0	-0.7
State financial support in RPC**	-0.1	-0.3
Other (Includes PPP)	0.2	0.1
(3) = (1)+(2) EDP Balance	**-6.4**	**-4.9**

Chart 6 – Adjustments by subsector



Source: INE. CFP calculations | Note: (*) Time adjustment (**) The RPC in question concern Estradas de Portugal, SA, in 2012. In the table positive/negative adjustments produce an increase/reduction of the deficit in national accounts *vis-à-vis* the deficit in public accounts. In the chart, the positive/negative figures contribute to an increase/decrease in the national accounts deficit. The symmetry between the signs in the table (balance perspective) and the chart (deficit perspective) is the result of the approach employed.

By subsector, regional and local governments (RLG) were responsible for the most signficant adjustments (0.8 p.p. of GDP) between accounting perspectives. The payment of arrears by RAM, as laid down in the EFAP-RAM, and by local government under the LEFAP, explains a higher balance in the public accounts than in national accounts for this subsector. The impact of this adjustment on the RLG more than offset the unfavourable central government adjustments (0.3 p.p. of GDP), which were influenced by the aforementioned recapitalisation transaction (0.4 p.p. of GDP).

[1] The general government balance in the public accounts, shown in Table 3 above, differs from that disclosed in the INE press release relating to the EDP. This is because the GG balance in that document excludes the payment of arrears under the LEFAP. The public accounts RLG balance shown in the aforesaid table is is the same balance disclosed in table 2C of the EDP report to *Eurostat* by the INE. For further information see Excessive Deficit Procedure Press Release.

[2] For further information on the reconciliation between the two accounting systems see CFP Notebook n.º1/2014 "From Public Accounts Balance to National Accounts Balance."

4.2 ANALYSIS OF REVENUE AND EXPENDITURE

In 2013 the general government fiscal adjustment stemmed essentially from the favourable performance of tax revenue, driven by direct tax revenue. Aggregate tax revenue increased 9.1% (3,419 M€), totalling 41,045 M€, when in the previous year it had fallen by 1,914 M€. Tax revenue accounted for 24.8% of GDP in 2013, standing at a higher level than in 2010 (before the start of the EFAP), which reflects the fiscal impact of a wide range of tax policy measures.

In adjusted terms,[16] general government revenue rose by 4,096 M€ (equal to 2.3 p.p. of GDP) compared to 2012 rising to 42.9% of GDP. This change was due to the performance of current revenue which increased 2.7 p.p. of GDP. However this was partially offset by a drop in capital revenue (0.4 p.p. of GDP) that stemmed, in part, from the unfavourable outturn of the local and central government subsectors, due to the reduction in investment grants and other capital funds provided by the EU.[17]

Table 4 – General government revenue (adjusted figures in M€)

	2010	2011	2012	2013	Change 2012/13			Change 2010/13		
					M€	%	Ctrc	M€	%	Ctrc
Total revenue	**69 100**	**70 253**	**67 034**	**71 130**	**4 096**	**6.1**	**6.1**	**2 030**	**2.9**	**2.9**
Current revenue	**67 079**	**68 389**	**64 892**	**69 628**	**4 736**	**7.3**	**7.1**	**2 548**	**3.8**	**3.7**
Tax revenue	38 262	39 540	37 626	41 045	3 419	9.1	5.1	2 784	7.3	4.0
Indirect taxes	23 040	23 499	22 539	22 213	-326	-1.4	-0.5	-827	-3.6	-1.2
Direct taxes	15 222	16 042	15 087	18 832	3 745	24.8	5.6	3 610	23.7	5.2
Social contributions	21 270	21 048	19 135	19 905	770	4.0	1.1	-1 364	-6.4	-2.0
of which: actual soc. contributions	15 725	16 060	14 989	15 097	108	0.7	0.2	-628	-4.0	-0.9
Sales and other current revenue	7 548	7 801	8 130	8 677	546	6.7	0.8	1 129	15.0	1.6
Sales of goods and services	4 356	4 306	4 609	4 508	-101	-2.2	-0.1	153	0.0	0.0
Other current revenue	3 192	3 495	3 522	4 169	647	18.4	1.0	977	0.3	0.0
Capital transfers received	**2 021**	**1 864**	**2 142**	**1 503**	**-640**	**-29.9**	**-1.0**	**-519**	**-25.7**	**-0.8**

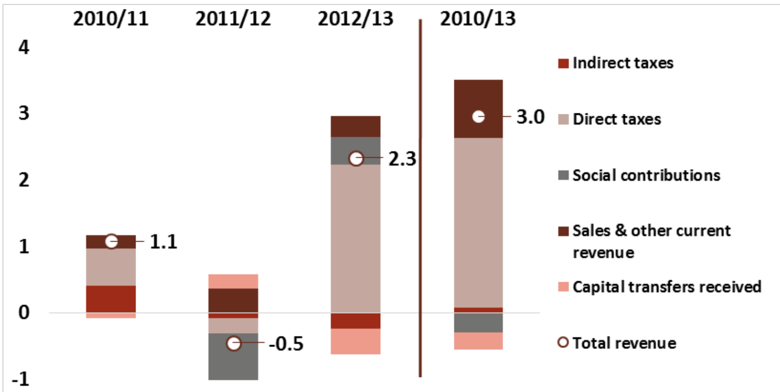
Source: INE. CFP calculations.| Note: Ctrc – contribution to rate of change.

The favourable developments in current revenue reflected above all the rise in tax and contributory revenue (+2.4 p.p. of GDP). This favourable outturn was a consequence of the increase in other current revenue (+0.4 p.p. of GDP) as a result of the rise in property income (+0.2 p.p. of GDP), in particular from dividends, of which 359.3 M€ came from Bank of Portugal profit sharing (18.7 M€ in 2012), and from the increase in interest received (+0.1 p.p. of GDP), which can be explained by the interest on contingent convertible bonds of the banking sector (CoCo bonds).

[16] In 2013 revenue was adjusted for the effects of the ESSD. That scheme was established by Decree-Law no. 151-A/2013 of 31 October and exempted payment of overdue and compensatory interest and administrative costs and provided for smaller fines. The ESSD stood at 1,280 M€.

[17] The case of the rail network operator, REFER – Rede Ferroviária Nacional, EPE, which received less European funds.

Chart 7 – Change in adjusted revenue (as p.p. of GDP)



Source: INE. CFP calculations.

The increase in tax revenue is explained by the change in PIT revenue (+2 p.p. of GDP) reflecting the considerable increase in the average effective rate.[18] This reflects the impact of the change from eight to five tax bands, the introduction of the 3.5% surcharge[19] and the changes to the so-called "solidarity tax"[20] which applies only to the highest earners. This effect was enhanced by the positive impact of the restoring of bonuses to civil servants and pensioners. Note that this result was also influenced by developments in the variables that most strongly determine changes in taxable personal income, namely employment and nominal salaries.[21]

Still in the field of direct taxes, CIT revenue was 4,973 M€, reflecting a growth of 0.2 p.p. of GDP, standing at a level even higher than in 2010. The 2013 outturn should reflect the legislative amendments introduced in the SB/2012 (which contributed favourably to the outcome of the self-settlement process that took place in May 2013), as well as the expected effect of several additional tax policy measures included in the SB/2013 (e.g. limitation of the deductibility of financing costs, reduction in the minimum limit for levying the maximum rate of the State Surtax and the changes to the prepayment scheme, among others).

Indirect taxes recorded a decrease of 0.2 p.p. of GDP, greater than in 2012 (-0.1 p.p. of GDP). This decline was less sharp due above all to the performance of real estate tax revenue, following the updating of taxable property values. VAT revenue adjusted for the impact of the ESSD fell 0.3 p.p. of GDP compared to 2012, although it recorded a turnaround in the final months.

[18] The effect was immediate on revenue in 2013 through the updating of the withholding at source tables. Note that when the Budget was submitted, the MF estimated that the changes in the PIT bands and rates alone would contribute to an increase in the average rate of PIT from 9.9% to 11.8%. This estimate can only be confirmed when PIT data becomes available. The minimum marginal rate increased from 11.5% to 14.5%, while the maximum marginal rate went from 46.5% to 48%.

[19] It corresponds to 3.5% of the earnings net of withholdings at source and compulsory Social Security and official health subsystem contributions that exceed the minimum monthly wage (485€).

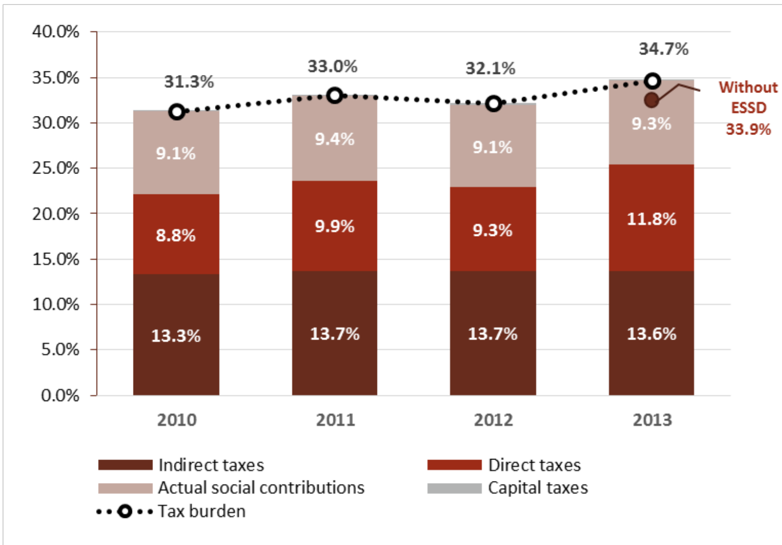
[20] The additional tax of 2.5% introduced in 2012 on taxable income over 153,300 € was applied in 2013 from 80,000 € upwards and the rate was increased by 5% on earnings over 250,000 €.

[21] According to INE data average earnings per employee increased 2.3% in 2013 and employment rose by 0.47% (national accounts).

Social contributions recorded an increase of 0.4 p.p. of GDP compared to 2012, increasing up to 19,905 M€ in adjusted terms. This increase resulted from the change in imputed contributions (662 M€), following the restoring of civil servant bonuses. Actual social contributions recorded a slight increase of 108 M€ to reach 15,097 M€, significantly below the MF estimate underlying the 2nd ASB/2013 (15,621M€). Other important factors contributing to the change in social contributions were the broadening of the contributory base for beneficiaries of the Civil Servants Pension Scheme (CGA) and the increase in the contribution rate from 1.5% to 2.25% to the public health systems (ADSE, ADM and SAD).[22] In adjusted terms the outturn of the "actual social contributions" budget item was more favourable in the central government subsector (growth of 141 M€) while the Social Security Funds (SSF) subsector it recorded a drop of 33 M€.

In 2013, the (non-adjusted) tax burden rose by 2.5 p.p. of GDP *versus* 2012, standing 3.4 p.p. above 2010. The increase over the period 2010-2013 (3.4 p.p.) was mainly due to direct taxes (3 p.p.), which from 2012-2013 alone rose 2.5 p.p. (PIT at 2 p.p. is of particular note), since indirect taxes and social contributions remained practically unchanged.[23,24] According to provisional Eurostat figures, from 2010 to 2013 Portugal has recorded the second largest increase in the tax burden in the EU, after France, with a rise of 2.3 p.p. of GDP (while the average for the Euro area was 1.9 p.p. and for the EU was 1.7 p.p.), essentially by way of direct taxes (1.2 p.p. in the Euro area and 0.9 p.p. in the EU).[25]

Chart 8 – Change in tax burden from 2010-2013 (as p.p. of GDP)



Source: INE. CFP calculations.

[22] Decree-Law no. 105/2013 of 30 July with effects from August 2013.

[23] The tax effect resulting from the change in 2011 of the normal VAT rate of 21% to 23% in mainland Portugal and from 15% to 16% in the Autonomous Regions, plus the restructuring of the VAT lists approved in SB/2012 (transferring some goods and services from the reduced rate list to the normal or intermediate rates lists), along with the changes to VAT rates in the Autonomous Regions, was offset by the drop in private consumption.

[24] It should also be noted that from 2010 to 2013 nominal GDP fell by 4.2%.

[25] On the other hand, according to the OECD, the tax burden falling on labour (i.e., the tax on labour income plus the employer's and employee's shares of the Single Social Tax) rose 3.5% in 2013 to stand at 41.1% of the cost of this factor (gross wage plus the employer's social security contribution). OECD (2014), *Taxing Wages 2014*. That percentage relates to a childless, single taxpayer with an average wage. In 2013 Portugal recorded the highest percentage increase in the entire OECD area.

In 2013, total spending increased by 1.6 p.p. of GDP (2,946 M€), reversing the trend of the previous two years, but remained below the 2010 level. This change was brought about by an increase of 1.9 p.p. of GDP in current primary expenditure. The reduction in capital expenditure (-0.2 p.p. of GDP) and interest (-0.1 p.p. of GDP) had the opposite effect. Notwithstanding this increase, over the last three years total expenditure fell by 0.5 p.p. of GDP (a decrease of 4,264 M€). The decreases in current primary expenditure and capital expenditure (down by 3,346 M€ and 3,131 M€, respectively) had practically an equal contribution to that effect. The rise in interest paid (up by 2,214 M€) offset around a third of the fall in expenditure in the other items.

Table 5 – General government expenditure (adjusted figures in M€)

	2010	2011	2012	2013	Change 2012/13			Change 2012/13		
					M€	%	Ctrc	M€	%	Ctrc
Total expenditure	**84 095**	**82 419**	**76 885**	**79 831**	**2 946**	**3.8**	**3.8**	**-4 264**	**-5.1**	**-5.1**
Primary expenditure	**79 245**	**75 530**	**69 760**	**72 767**	**3 008**	**4.3**	**3.9**	**-6 478**	**-8.2**	**-7.7**
Current primary expenditure	72 790	70 563	66 130	69 444	3 314	5.0	4.3	-3 346	-4.6	-4.0
Intermediate consumption	8 059	7 891	7 400	7 308	-92	-1.2	-0.1	-751	-9.3	-0.9
Compensation of employees	21 157	19 422	16 510	17 789	1 279	7.7	1.7	-3 369	-15.9	-4.0
Social transfers	37 895	37 775	37 139	38 834	1 695	4.6	2.2	939	2.5	1.1
Other than in kind	29 553	29 808	29 645	31 229	1 584	5.3	2.1	1 676	5.7	2.0
In kind	8 343	7 968	7 495	7 605	110	1.5	0.1	-738	-8.8	-0.9
Subsidies	1 283	1 184	968	1 117	149	15.4	0.2	-166	-12.9	-0.2
Other current expenditure	4 396	4 291	4 113	4 397	284	6.9	0.4	1	0.0	0.0
Capital expenditure	6 455	4 966	3 629	3 324	-306	-8.4	-0.4	-3 131	-48.5	-3.7
GFCF	5 195	4 010	2 745	2 376	-369	-13.5	-0.5	-2 819	-54.3	-3.4
Other capital expenditure	1 260	956	884	948	63	7.2	0.1	-312	-24.8	-0.4
Interest paid (EDP)	**4 850**	**6 890**	**7 126**	**7 064**	**-62**	**-0.9**	**-0.1**	**2 214**	**45.7**	**2.6**

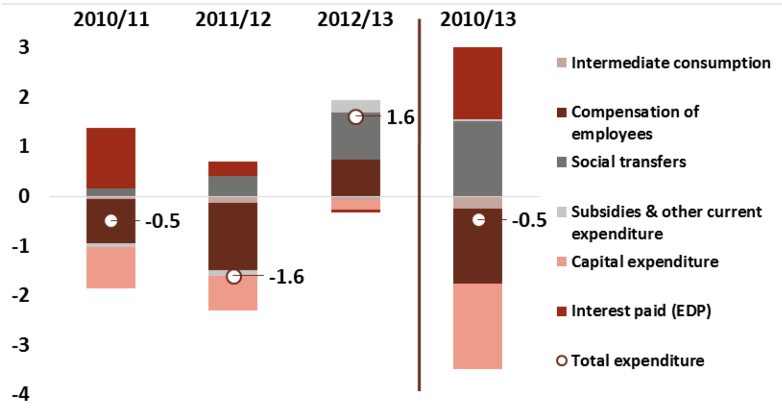
Source: INE. CFP calculations. | Note: For analysis purposes, the adjustment concerning the effect of interest on swap agreements, which are treated differently under the Excessive Deficit Procedure and under the national accounts (ESA95), was recorded entirely in expenditure. Note: Ctrc – contribution to rate of change.

The 2013 outturn suggests the budget consolidation measures on the expenditure side did not fully compensate the restoring of the bonuses. The amount pf expenditure cuts announced was similar to the impact of the restoring of the bonuses to civil servants and pensioners.[26] However, excluding the impact of non-discretionary increases in expenditure (such as the rise in unemployment benefits, the increase in the number of pensioners and the change in public-private partnerships costs), the implementation of such intentions is not evident in expenditure. In addition, the lack of specification of the proposed measures makes their proper monitoring impossible.[27]

[26] In the SB/2013 and 1st ASB/2013 Reports, measures on the expenditure side were identified (2,699.1 M€ and 250 M€ respectively, totalling 2,949.1 M€). Based on the estimate contained in the SB/2013 Report the restoring of the two bonuses to civil servants and pensioners would involve an increase in expenditure of around 3,200 M€ *vis-à-vis* 2012, without taking into account the impact of imputed contributions.

[27] In this respect mention is also made of the need for an adequate quantification of the impact of the proposed measures, as well as the importance of identifying their effects compared to the no policy change scenario or to the previous year.

Chart 9 – Change in adjusted expenditure (as p.p. of GDP)



Source: INE. CFP calculations.

Expenditure on social transfers grew by 1.5 p.p. of GDP (+1,695 M€), accounting for the largest contribution to the rise in spending. This change is mainly explained by the increase in social transfers other than in kind (up by 1,584 M€), in particular growth of spending on pensions (+1,300 M€). The latter is explained by factors with opposite effects: on the one hand, spending on pensions increased due to the restoring of the bonuses (the impact of which was around 1,600 M€)[28] and the increase in the number of pensioners (up by around 1%);[29] on the other hand, it fell due to the increase in the Extraordinary Solidarity Contribution (estimated at 542.4 M€[30] which, according to the available information, is recorded as a negative expenditure). Therefore, if the change in pensions and the increasing expenditure on unemployment benefits (+133 M€) are excluded from the change in social transfers expenditure, it is not possible to identify the budget impact of the announced measures relating to other social transfers (of around 800 M€).[31]

Excluding the effect of the bonuses restored, compensation of employees would have fallen 0.5 p.p. of GDP. Even considering the effect of this restoring, which explains the increase observed in 2013, this budget item has been the key driver of the fall in expenditure since 2010, having decreased by a total of 15.9%. Note that in 2013 the increase in the compensation of employees is lower than the impact of restoring the bonuses,[32] which demonstrates consolidation efforts (explained also by a decrease in public employment of 3.8%).[33] Nonetheless, the increase in compensation of employees' *vis-à-vis* 2012 is higher

[28] CFP estimate based on the data on page 47 of the SB/2013 Report.

[29] Total change in number of CGA and Social Security pensioners.

[30] *Ex-post* impact calculated according to the information provided by IGFSS and CGA.

[31] *Ex-ante* impact estimated in the SB/2013 Report: 621 M€ in other social transfers other than in kind and 181 M€ in social transfers in kind.

[32] The MF estimate refers to an impact of approximately 1,600 M€ from the restoring of the two bonuses to public sector workers (based on the *ex-ante* impact estimated in the SB/2013 Report), which corresponds to around 2,100 M€ in compensation of employees (due to the spending on imputed contributions). Therefore the impact of the across the board and sectoral measures must have been approximately 800 M€.

[33] Decrease in general government employment (22,005 employees) from December 2012 to December 2013 according to the "Statistical summary of public employment - 4th quarter 2013" published by DGAEP.

than expected bearing in mind the measures announced in the SB/2013 and in 1st ASB/2013.[34]

Subsidies and other current expenditure also contributed, although to a lesser extent, to the increase in expenditure (+0.3 p.p. of GDP or 433 M€). This is mainly explained by the 6.9% change in other current expenditure (+284 M€) due to transfers paid outside of general government (which returned to 2010 levels).[35] Subsidies also made an important contribution, increasing by 15.4% (+149 M€). These increases seem to have offset the budget consolidation efforts announced for these budget items.[36]

Capital expenditure, on the contrary, fell by 0.2 p.p. of GDP (-306 M€) and made the greatest contribution to the fall in expenditure. This result was achieved essentially by the decrease in public investment (GFCF) of 0.2 p.p. of GDP (-369 M€), which was more pronounced than estimated (252 M€).[37] This expenditure item has recorded the greatest percentage decrease in the last three years, and stands at around half of the 2010 levels. Given the permanent need for some investment (for example, infrastructure maintenance) the CFP considers there is increasingly less opportunity for budget consolidation through this item.

Despite the significant rise in the costs of public-private partnerships, intermediate consumption fell by 0.1 p.p. of GDP. In 2013 the cost of public-private partnerships rose 317 M€ which represents an increase of over 50%. Excluding this non-discretionary effect, intermediate consumption expenditure fell by 409 M€, a decrease which exceeded the savings in general government operating expenses disclosed in the SB/2013 (which totalled 125 M€).

After a sharp growth since 2010, expenditure on interest fell by 0.1 p.p. of GDP in 2013. Although the weight of this figure is not significant in explaining the change in total expenditure, this fall is actually relevant. First, because the decrease occurred when public debt was increasing, which means the price effect,[38] i.e. the country's financing terms (both official and market terms), has more than offset the volume effect. Second, this is the first nominal decrease in interest paid since 2010, which is noteworthy given that this budget item has increased 45.7% (2,214 M€) since the adjustment program began.

[34] *Ex-ante* impact estimates of 727 M€ in the SB/2013 Report and 200 M€ in the 1st ASB/2013 Report, which corresponds to around 1,200 M€ in compensation of employees (due to imputed contributions).

[35] They include, for example, the national contribution to the European Union budget.

[36] The estimated impact in the SB/2013 Report was 123 M€.

[37] *Ex-ante* impact estimated in the SB/2013 Report.

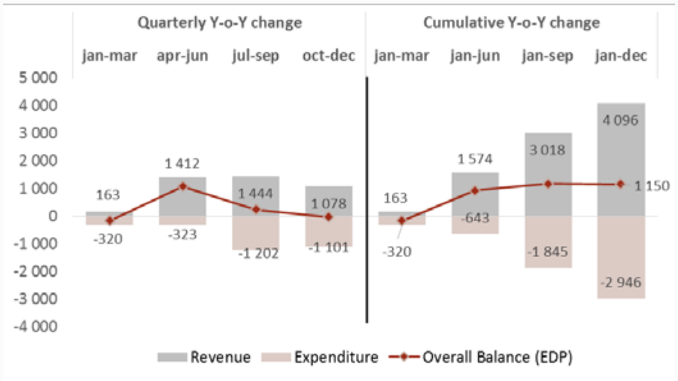
[38] The implicit debt interest rate reached the minimum value of 3.4% in 2010. In 2011 the figure rose to 4.2% before falling to 3.8% in 2012. In 2013 it returned to 3.4%, virtually equalling the historic low.

Box 2 – Infra-annual change in adjusted budget balance

The budget developments in 2013 show that revenue made a large contribution to the decrease in the public deficit. This contribution was clear from the 2nd quarter of the year onwards. The very positive change in tax and contributory revenue (4,189 M€) accounted for the growth in that aggregate, since all remaining revenue penalized the fiscal adjustment in 2013. The decline in capital revenue throughout every quarter explains the negative contribution of "other revenues", notwithstanding the positive performance of property income (greatly influenced by interest and dividends in the second half of the year).

Expenditure did not contribute to the correction of the budget imbalance. The unfavourable performance of current primary expenditure (-3,314 M€) over the four quarters reflected the increase in compensation of employees and social transfers, (impact of restoring the Christmas bonus in monthly instalments and the holiday bonus in June, July and November) [1] which was greater in the 2nd half of the year which concentrated three quarters of the annual expense. The unfavourable contribution of expenditure was partially offset by capital expenditure (- 306 M€) especially in the first two quarters of the year, and interest (-62 M€) most notably in the last quarter of the year.

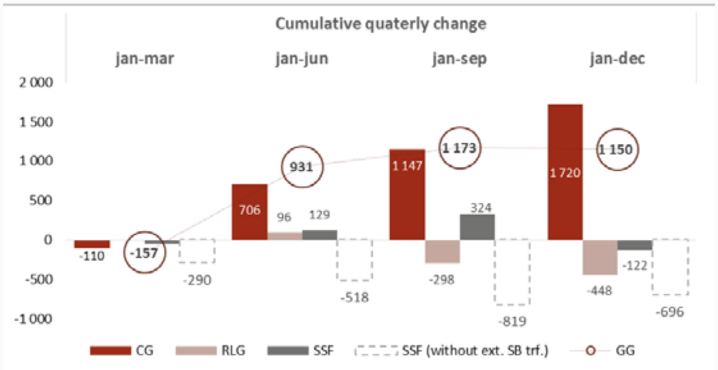
Chart 10 – Contribution of revenue and expenditure to the change in the balance (in M€)



Source: INE. CFP calculations.

By subsectors, central government (CG) was decisive for the reduction of the deficit. The large increase in tax revenue recorded in that subsector was sufficient to overcome the unfavourable contributions of the other subsectors. In infra-annual terms, at the end of the 1st half of the year all subsectors had recorded a positive contribution (mostly the result of the budget performance achieved in the 2nd quarter), contrary to the last two quarters when regional and local government made a negative contribution as well as the social security funds in the 4th quarter. In the former case this outcome was due entirely to local government, as a result of the sharp decline in capital revenue (881 M€) and the rise in capital expenditure (438 M€). As for the social security funds, despite the year-on-year decrease in spending in the last quarter, (as a result of the early payment of the Christmas bonus to pensioners in monthly instalments), the negative performance is explained by a significant year-on-year fall in revenue in that period. This fall stems from the base effect regarding the extraordinary transfer from the State which in 2012 took place in the last quarter. If in 2013 that transfer had taken place in the same period as in 2012, this subsector's quarterly contribution would have been negative.

Chart 11 – Contributions of subsectors to the change in balance (M€)



Source: INE. CFP calculations.

[1] Under the Law no. 39/2012, full payment of holiday bonuses under 600 €, and the partial payments to civil servants whose monthly wage is between 600 and 1100 € were paid in June. The remainder was paid in November, along with the bonuses of civil servants earning over 1100 €. In the Azores Autonomous Region this bonus was paid in July in line with Regional Legislative Decree no. 7/2013/A.

4.3 ANALYSIS BY SUBSECTORS

4.3.1 Fiscal position of social security funds

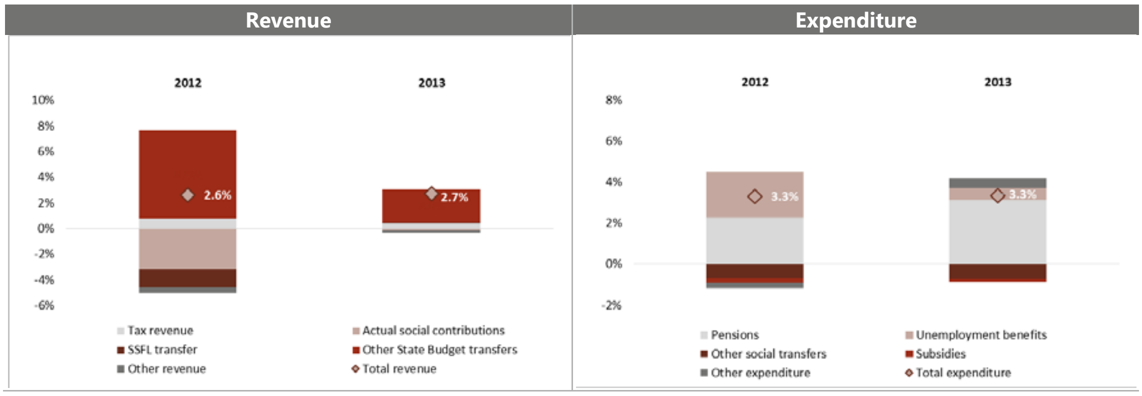
In 2013, the social security funds subsector recorded a positive balance of 178 M€, which compares with a balance of 300 M€ the previous year. Net of temporary measures the balance differs significantly from the headline balance (412 M€), which is explained by the inflows from the ESSD in the last quarter of 2013. Under that scheme Social Security received an extraordinary revenue of 234 M€.

The major factor contributing to this subsector's budget surplus was the extraordinary SB transfer. That transfer, amounting to 1,430 M€ (857 M€ in 2012), was meant to cover the budget deficit in the Pay-as-you-go Welfare System, which has existed since 2011 and reflects the unfavourable performance of the labour market that impacts on revenue from social contributions and the cost of social transfers.

Without such revenue the SSF subsector would have recorded a deficit of 1,253 M€, up by 696 M€ on 2012, due to the change in pensions expenditure. The decline in the balance, net of the extraordinary SB transfer, is essentially the result of restoring the holiday and Christmas bonuses to Social Security pensioners. In effect the cost of pensions grew by 4.7% compared to the previous year and contributed by 3.1 p.p. to the subsector's total increase in expenditure (3.3%).[39]

The expenditure on other social transfers contributed to a slowdown in the rate of growth of expenditure in 2013. Despite the payment in full of two subsidies to pensioners, total expenditure grew at the same rate as 2012 (3.3%). Unemployment benefits, which accounted for 13% of social transfers, rose less than forecast by the MF (5.1%). And the cost of other social transfers other than in kind, i.e. family allowances, Social Inclusion Income (SII), Old Age Solidarity Supplement (OASS), among others, fell by 7.9% compared to the previous year.

Chart 12 – Contribution to annual change (%)



Source: INE e IGFSS. CFP calculations.

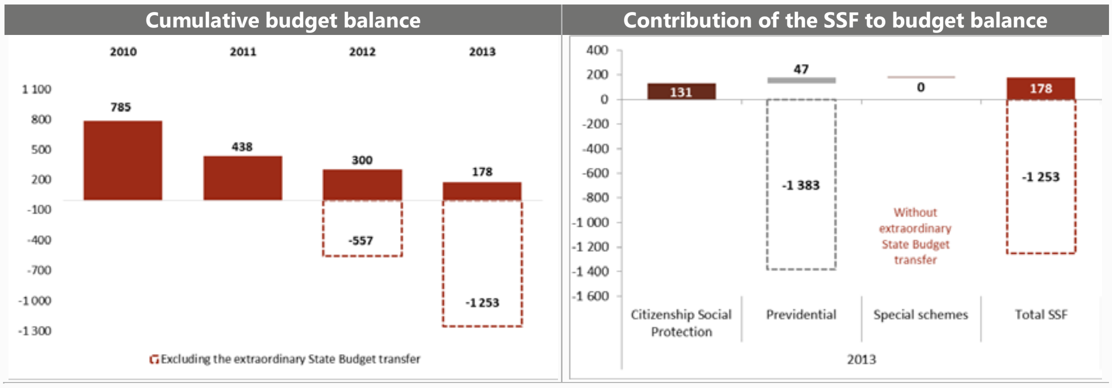
[39] The growth in pensions spending is mitigated by the Extraordinary Solidarity Contribution (ESC), the revenue from which is deducted from expenditure in the national accounts. Without this effect spending on that item would have risen by 5.7%.

On the revenue side, the growth stems essentially from the increase in current transfers. From 2012 to 2013, SSF revenue grew 2.7%, as a result of the extraordinary transfer from the State subsector (+2.6 p.p.). Mention should also be made to the less unfavourable change in social contributions revenue (which fell by 0.2%, whilst in 2012 it was down by 5.2%) and a significant increase in tax revenue (+8.5%), namely VAT aimed at financing the Social Emergency Program (SEP) and the Extraordinary Social Support to Energy Consumers (ASECE).

Box 3 – Budget outturn of social security funds

Social Security is comprised of various systems, in particular the Previdential System that channels most of the SSF financial resources to the payment of occupational benefits (pensions and other benefits, such as sickness, maternity/paternity and unemployment benefits). In recent years this system has been primarily responsible for the Social Security System budget imbalance, reflecting cyclical factors, leading to a decrease in its financing capacity by social contributions and to a rise in spending on unemployment benefits.

Chart 13 – SSF budget balance (in M€)



Source: INE and IGFSS. CFP calculations. Note: the dotted bars represent sums excluding the SB extraordinary transfer.

Since the fourth quarter of 2012 there has been an increase in the SB transfer to cover the budget deficit in the Previdential System which stood at 1,383 M€ in 2013 (+741 M€ compared to 2012). Considering the SB extraordinary transfer, the Welfare System budget balance recorded a positive figure of 47 M€. In 2013, the SSF balance, net of the extraordinary SB revenue, deteriorated as a result both of the fall in social contributions revenue and of the restoring of the two bonuses to pensioners, although at the beginning of the year the cut of 90% of the holiday bonus was expected to continue as budget consolidation measure. The unconstitutionality of that measure declared by the Constitutional Court, in April 2013, led to an increase in pensions spending.

The Citizenship Social Protection System, which represents around 30% of Social Security spending, recorded a surplus of 131 M€ in 2013. This system includes the solidarity subsystem that provides for non-contributory payments, *i.e.* social pensions, OASS and SII, the family protection subsystem, which covers family transfers such as family allowances, and the social assistance subsystem. It is mainly financed by SB transfers, under the Social Security Framework Law. In 2013, this financing source was relatively stable compared to the previous year, and the system benefitted from growth in other revenues from profits of fiscal monopolies (+3.7%) and VAT earmarked to finance SEP and ASECE (+252 M€, while in 2012 it had been 173.1 M€).

The Special Schemes System records the revenue and expenditure relating to the banking scheme and, generally, it is balanced, with expenditure exhibiting a downward trend (-2.0% in 2013).

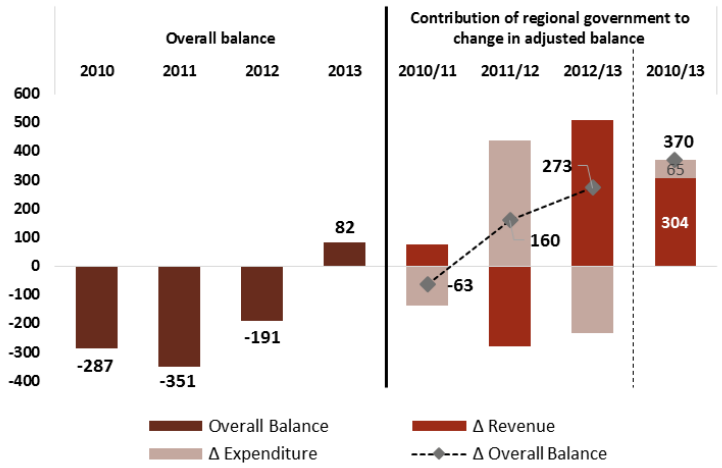
4.3.2 Fiscal position of regional and local government

In 2013 regional and local government interrupted its contribution to the decrease in the State deficit. The budget balance in 2013 was positive (355 M€), although lower than in the previous year (856 M€). In fact local government recorded a budget surplus below that of 2012 (by 720 M€), despite the regional government budget reached a surplus in 2013.

Regional government

In 2013 the budget consolidation trend was confirmed and regional government produced a surplus for the first time in recent years. The reversal of the deficit position means this subsector's budget imbalance correction process is moving towards a financial recovery. Overall regional government recorded a budget balance of 82 M€, made up of 90 M€ in the Madeira Autonomous Region (RAM) and -8 M€ in the Azores Autonomous Region (RAA), which accounts for a positive change of 273 M€ versus the same period of the previous year. The RAA balance shows a decrease in deficit compared to 2012, reflecting an increase in revenue (28%) greater than the rise in spending (26.8%). In the RAM the improvement in the balance (by 265 M€) reflects a reversal compared to the deficit recorded the previous year. This change stemmed from the growth in revenue (18.3%) and the decrease in expenditure (down by 3.1%).

Chart 14 – Change in regional government fiscal and financial framework (M€)

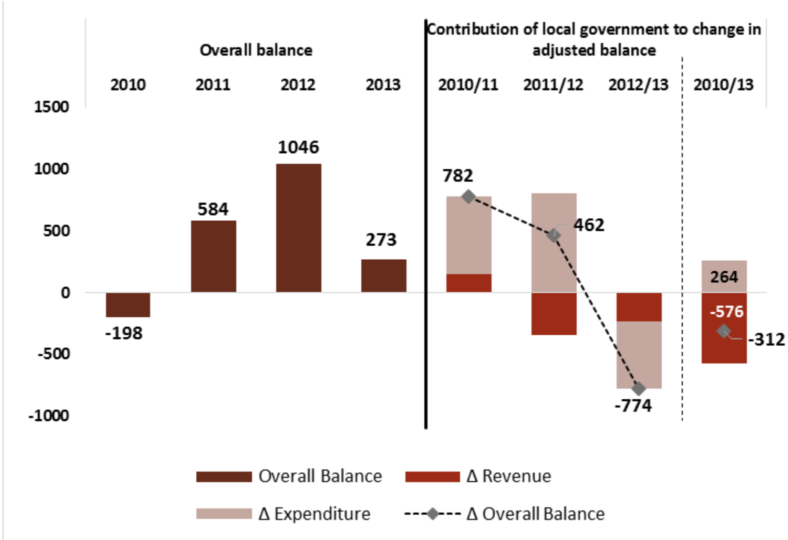


Source: INE. CFP calculations.

Local government

In 2013, local government recorded a significantly lower budget surplus (273 M€) than in 2012 (1,046 M€). This subsector's positive balance in 2013 was significantly lower than in 2012 (1,046 M€) as a result of the increase in expenditure combined with a fall in revenue, although less sharp.

Chart 15 – Change in local government fiscal and financial framework (M€)



Source: INE. CFP calculations.

Local authorities spending grew in 2013, reversing the downward trend of the previous two years. In 2013 local government's total expenditure grew by 7.2% compared to the previous year, as a consequence of the increase in primary expenditure and capital expenditure, which rose by 7.1 p.p. and 5.9 p.p., respectively. Capital expenditure reflects on the one hand, the increase in GFCF and, on the other, a base effect, stemming from the sale in 2012 of Lisbon municipality land to the State (Lisbon airport).

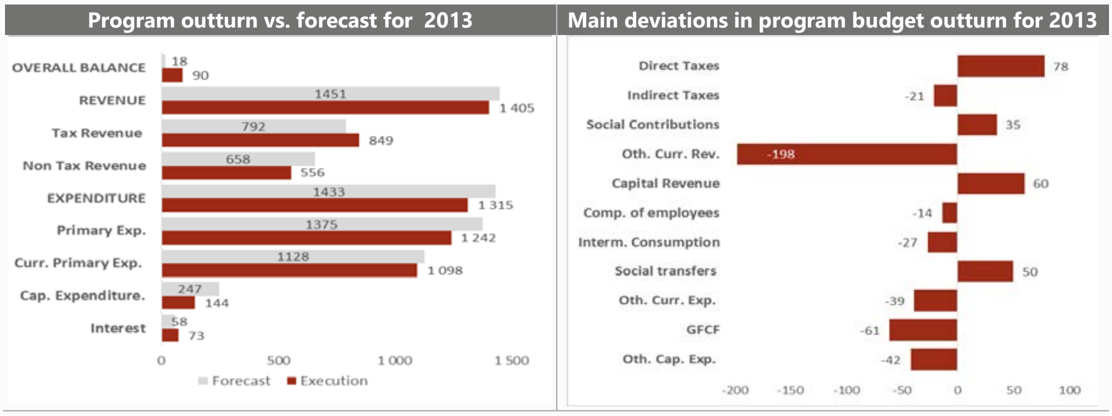
The decrease in this subsector's revenue was mainly the result of transfers from the rest of the world, essentially due to EU transfers. Revenue had a negative change of 2.1%, to which capital revenue was a major contributor falling 10.3 p.p., although this was partially offset by the positive contribution of current revenue which was up by 8.2 p.p. The change in the latter item was due both to a rise in tax revenue, following the revaluation of properties that led to the broadening of the tax base for IMI and IMT; and to the growth in the current Financial Equilibrium Fund (FEF). This was merely the result of an accounting transaction that changed the recording of this transfer *vis-à-vis* the previous year, to the detriment of capital, contributing this way to a sharp decline in capital revenue and an increase in current revenue.

Box 4 – Fiscal results of the Madeira Adjustment Program

Under the Economic and Financial Adjustment Program devised with the Madeira Autonomous Region (EFAP-RAM), the 2013 outturn shows that the budget imbalance correction which began in 2012 continues. The budgetary surplus (90 M€) exceeded the target set for the year by 72 M€. A lower than expected level of expenditure (-118 M€) contributed to this outcome and more than compensated for the unfavourable deviation in revenue (-46 M€). Around three quarters of the primary expenditure reduction (133 M€) is explained by capital expenditure (mainly investment). The remainder (29 M€) stems from current primary expenditure items, in particular, other current expenditure, intermediate consumption and compensation of employees. These savings were sufficient to absorb the rise in spending on interest (15 M€).

On the revenue side, despite tax and contributory revenue having exceeded the target by 92 M€ (in particular as a result of direct taxes and social contributions) and capital revenue (+60 M€) having benefitted from the increased volume in transfers from the rest of the world, the favourable performance of these two aggregates was not sufficient to offset the unfavourable bias of 198 M€ in other current revenue. However, a comparison of this figure with that of 2012 reveals a decrease of just 8 M€.

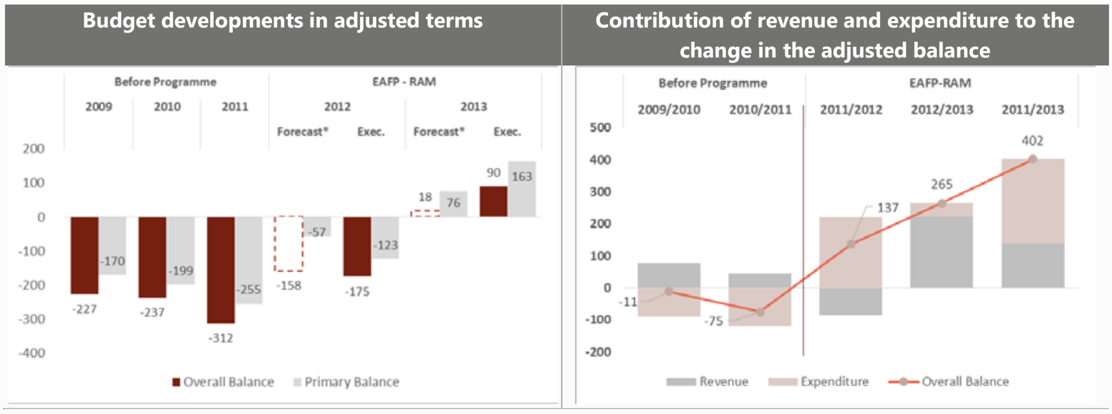
Chart 16 – EFAP-RAM outturn (in M€)



Source: INE and Quarterly EFAP-RAM Evaluation Reports. CFP calculations.

Two years after the program began, the results in adjusted terms suggest the budget imbalance correction is on track in the Madeira Autonomous Region. The 2013 outturn data show a marked change in the overall balance and in the primary balance compared to the forecasts and the figures recorded in the previous four years. From 2011-2013, the consolidation effort was based mainly on expenditure, three quarters of which in current primary expenditure, especially social transfers in kind. Notwithstanding expenditure's important contribution in this period, in 2013 there was a change in the adjustment profile. In that year approximately 85% of the budget imbalance correction was driven by revenue, three quarters of which came from tax revenue, in particular income tax.

Chart 17 – Change in Madeira budget position: 2009 - 2013 (in M€)

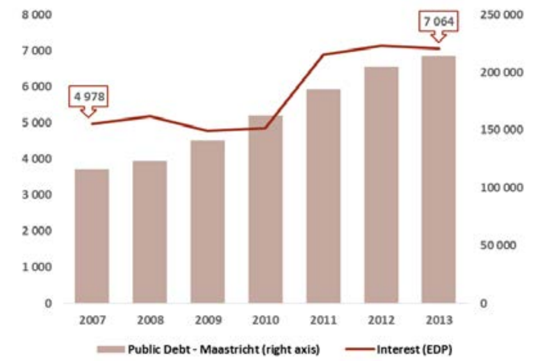
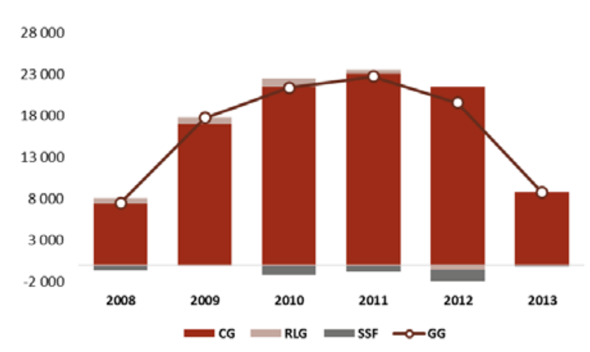


Source: INE and Quarterly EFAP-RAM Evaluation Reports. CFP calculations. | Note: (*) The forecasts for 2012 are those set out in the original version of the program, while the forecasts for 2013 correspond to those defined in the Madeira Amending Budget. Note that in the original version of the program the deficit forecast for 2013 was 39 M€.

5 CHANGE IN PUBLIC DEBT *(MAASTRICHT)*

In 2013 general government gross debt continued to rise reaching 213,600 M€. In 2013 the volume of public debt grew 8,800 M€, less than half the increase recorded in 2012 (19,600 M€). Despite this increase, public debt interest which was 7,100 M€ in 2013, fell slightly compared to the previous year (-0.9%). Note that in 2012 interest charges rose due to the growth in debt stock, while in 2013 the decrease stemmed solely from the fall in the implicit interest rate which went from 3.8% to 3.4%,[40] since debt volume continued to grow.

Chart 18 – Interest charges an change in debt by subsector (in M€)

Interest and public debt	Contribution of subsectors to the change in consolidated debt
	

Source: INE and Bank of Portugal. CFP calculations.

The increase in debt recorded in 2013 was similar to that in 2008, the year the financial crisis began. In terms of subsectors, central government continued to be the main subsector responsible for the increase in debt. From 2010 to 2012 the annual increase was partially offset by the purchase of public debt by the social security funds subsector.[41] However, in 2013 the contribution of the social security funds was less significant. The regional and local government subsector reversed the downward trend in borrowing requirements observed since 2011, although the increase in debt was financed by central government through loans linked to debt settlement programs under LEFAP and EFAP-RAM.

[40] In 2013 the implicit interest rate returned to the 2010 rate.

[41] Executive Order no. 216-A/2013 of 2 July provides for an increase in the relative weight of Portuguese public debt in the portfolio of the Social Security Financial Stabilisation Fund up to a limit of 90%, replacing the assets of other OECD States (which currently account for around 25% of the portfolio). The relative weight of Portuguese public debt currently stands at around 55% of the portfolio.

Table 6 – Stock-flow adjustments (in M€)

General Government						Accumulated effect		
	2007	2010	2011	2012	2013	2007/10	2010/13	2012/13
(1) Budget Deficit GG	**5 333**	**16 982**	**7 398**	**10 641**	**8 122**	**45 664**	**43 143**	**18 763**
(2) Stock-flow adjustments (difference) = (3)-(1)	**-1 236**	**4 437**	**15 369**	**8 978**	**649**	5 119	29 433	9 627
Net Acquisition of Financial Assets	-163	4 878	14 225	4 824	-329	7 023	23 598	4 496
Currency and deposits	-400	713	10 247	1 200	1 585	-783	13 746	2 786
Securities other than shares	-76	-510	142	6 184	-584	-1 205	5 232	5 600
Loans	-2 047	1 283	445	1 218	-34	-284	2 912	1 184
Shares and other equities	1 504	1 592	-336	-1 151	41	6 089	145	-1 110
Other financial assets	856	1 800	3 727	-2 626	-1 338	3 205	1 563	-3 964
Financial liabilities not included in Debt	-1 151	-1 123	-357	3 714	2 065	-2 430	4 300	5 780
Other changes in debt (Including valuations)	78	682	1 501	439	-1 087	526	1 535	-648
(3) Change in Debt GG	**4 097**	**21 418**	**22 767**	**19 619**	**8 771**	**50 784**	**72 576**	**28 390**
(4) Public debt (*Maastricht*)	**115 786**	**162 473**	**185 241**	**204 860**	**213 631**			
Public debt (% of GDP)	**68.4**	**94.0**	**108.2**	**124.1**	**129.0**			
Memo items:								
Interest (EDP)	4 978	4 850	6 890	7 126	7 064	19 796	21 080	14 190
Implicit interest rate (J/Dt-1)	4.5%	3.4%	4.2%	3.8%	3.4%			

Source: INE and Bank of Portugal. CFP calculations.

In 2013 the increase in public debt of 8,771 M€ was explained almost entirely by the budget deficit. The difference between the increase in debt and the budget deficit of 649 M€, corresponding to the stock-flow adjustment, was the smallest of the last four years.[42] The positive sign of this adjustment is explained by “financial liabilities not included in debt”. In 2013 these reflect to a large extent the payment of expenditure already recorded in the national accounts in previous years, and are related to the regional and local government and health sector debt settlement programs. This impact was mitigated by the contributions of “other changes in debt” and “net acquisition of financial assets”. In the former case the contribution to the reduction in public debt is explained, to a large extent, by the favourable difference between interest due and interest paid and by the impact of the change in debt volume. In the latter case that aggregate’s lower contribution (-328.7 M€) was due essentially to the decrease in securities other than shares (reflecting *CoCo* bond redemptions by BPI and Banif), as the amounts of “other financial assets” and “currency and deposits” practically offset each other, reflecting the financial inflow from the airport service concession to ANA – Aeroportos de Portugal.[43]

The financial inflow from the privatisation of CTT and ANA did not contribute to the decrease of public debt in 2013. As in 2012,[44] in 2013 general government shares and other equity did not reflect the impact of the privatisations of approximately 1,500 M€ that occurred that year. The recording of those transactions led to an increase in “currency and deposits” and a corresponding increase in public debt, reflecting the advance made to the State by Parpública.[45]

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[42] For further information on the meaning of the stock-flow adjustment see the CFP publication Public Debt Notebook.

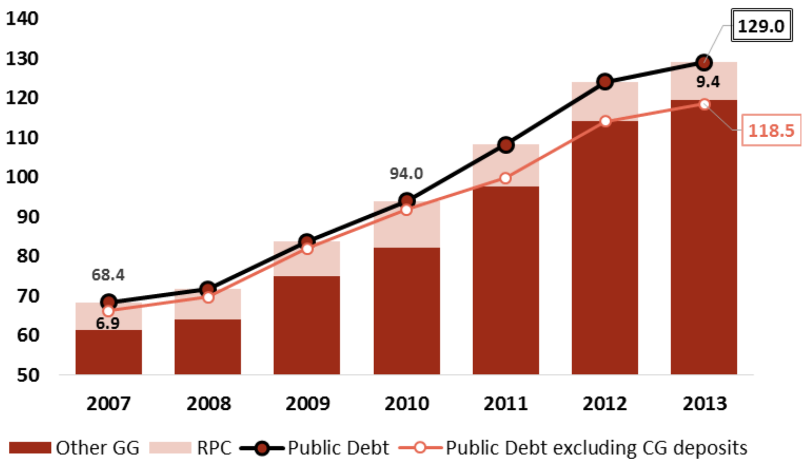
[43] Note that in 2012 the sale of the airport concession to ANA implied a decrease in shares and an increase in “other financial assets” since the revenue from the sale of the mentioned concession was not received until the end of December 2012.

[44] Bank of Portugal Annual Report 2012.

[45] The distribution of the proceeds from the sale of CTT and of ANA by the Ministry of Finance only occurred in 2014 by the Order no. 308/2014 of 8 January (CTT) and by Order no. 358/2014 of 9 January (ANA).

The debt of reclassified public corporations continued to rise in 2013. In 2013 there was an increase in the debt of reclassified public corporations (RPC) of around 200 M€, whereas the debt financed by general government increased by around 2,900 M€. Therefore, as in 2012, RPC consolidated debt fell to 15,500 M€ at the end of the year (9.4% of GDP); this was offset by an increase in debt financed by general government (Box 6).

Chart 19 – Trajectory of public debt (as % of GDP)



Source: Bank of Portugal. CFP calculations.

Net of central government deposits, public debt accounted for 118.5% of GDP (196,300 M€) at the end of 2013. This figure is in line with the SB/2014 Report forecast that estimated a ratio under 120% of GDP. At the end of 2013 central government deposits totalled 17,300 M€. Although this is the lowest quarterly figure recorded throughout 2013, this balance is still higher than the figure at the end of 2012 (16,600 M€). The increase in the deposits began in 2011 and reflect to a large extent the unused sums of the loans received under the financial assistance program and the creation of a buffer to meet 2014 borrowing requirements, which accounted for around 10.5% of gross debt at the end of 2013.

Table 7 – Debt dynamics

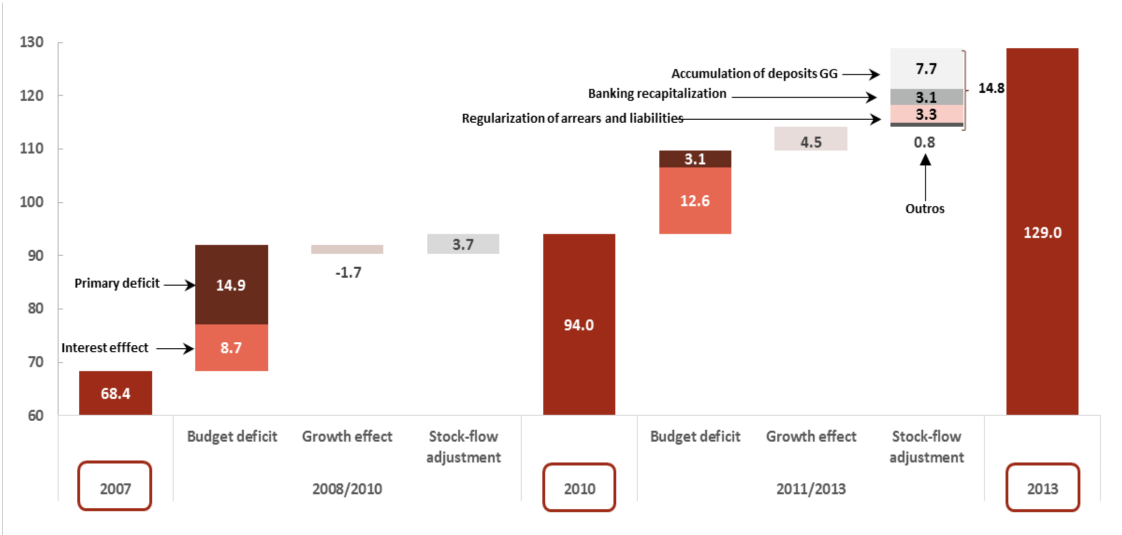
General Government	INE (EDP)					Cumulative Change	
	2007	2010	2011	2012	2013	2007/10	2010/13
Change in debt (in p.p. of GDP)	**-1.1**	**10.3**	**14.3**	**15.8**	**4.9**	**25.6**	**35.0**
Primary deficit	0.2	7.0	0.3	2.1	0.6	14.9	3.1
Dynamic effect (snow ball effect)	-0.5	0.7	5.0	8.3	3.8	7.0	17.1
- interest effect	2.9	2.8	4.0	4.3	4.3	8.7	12.6
- growth effect	-3.5	-2.1	1.0	3.9	-0.4	-1.7	4.5
Stock-flow adjustment (residual)	-0.7	2.6	9.0	5.4	0.4	3.7	14.8

Source: INE and Bank of Portugal. CFP calculations.

In 2013 the relative weight of public debt in GDP rose by 4.9 p.p., approximately one third of the increase recorded in 2011 and 2012. This was mainly due to a less expressive stock-flow adjustment in 2013 which was minor compared to the figures for the two previous years. Although the dynamic effect resulting from the difference between interest rates and the nominal output growth rate was the lowest of the last three years (3.8 p.p. of GDP), this factor made the largest contribution to the increase in the debt ratio in

2013. As a matter of fact, in 2013 the implicit nominal interest rate was 3.4%, much higher than the change in nominal GDP (0.3%), giving rise to an unfavourable dynamic effect (snowball effect). However, it should be noted that most of this effect stems from the relative weight of interest in GDP, which was not offset by output growth at current prices. The reversal of the debt ratio trend can only be achieved through primary surpluses and a decrease in the magnitude of the unfavourable dynamic effect. Despite the consolidation effort witnessed in the last three years the contribution of the primary balance was still unfavourable in 2013, standing at – 0.6 p.p. of GDP.

Chart 20 – Contributions to the change in public debt (as % of GDP)



Source: INE and Bank of Portugal. CFP calculations.

The significant increase in the debt ratio in the last three years (35 p.p. of GDP) was due, in descending order of importance, to the budget deficit, the stock-flow adjustment and the unfavourable change in output. Thus:

— 15.7 p.p. of GDP of that increase resulted from the accumulation of budget deficits from 2011 to 2013, split between cumulative primary deficits (3.1 p.p. of GDP) and interest charges (12.6 p.p. of GDP).

— 14.8 p.p. of GDP are explained by the stock-flow adjustments over the three-year period 2011/2013, which were driven by:

   i. the accumulation of central government deposits (7.7 p.p. of GDP), which reflect the loans under the adjustment program allocated to banking recapitalisation still unused, as well as advances to the State from Parpública in the context of privatisations;

   ii. the bank recapitalisation support given to CGD, BCP, BPI and Banif, net of redemptions (3.1 p.p. of GDP);

   iii. the settlement of arrears and debts from previous years in the health and regional and local government sectors, plus the settlement of liabilities to Parpública (3.3 p.p. of GDP);

   iv. and other effects (0.8 p.p. of GDP), corresponding mainly to other changes in debt, namely the difference between interest due and paid, the impact of changes in the value and volume of debt, resulting, for example, from the reclassification of entities to the general government sector;

— 4.5 p.p. of GDP represents the growth effect, resulting from the unfavourable economic environment.[46]

The increase in the public debt ratio, excluding the impact of bank recapitalisations and deposits accumulated up to the end of 2013, would be approximately the same as in the previous three-year period. Net of the mentioned impacts the public debt ratio increased by 24.2 p.p. of GDP from 2010 to 2013. In the previous three-year period (2007 – 2010), the increase in debt (25.6 p.p. of GDP) was almost entirely explained by the need to finance budget deficits which totalled 23.6 p.p. over that period.

At the end of 2013 the cumulative financing received under the EFAP was 73,800 M€, equal to 34.6% of the debt stock. Box 5 provides a detailed breakdown of financing by institutional sector. Mention must be made of the reduced importance of foreign financing other than the official EFAP loans. The latter represented 34.6% at the end of 2013 (63% in 2010).

Box 5 – Public debt by creditor type

Up to the end of 2013 financing received under the EFAP totalled 73,808 M€ (in nominal terms). Taking into account only the sum effectively received (the sum disbursed that corresponds to the inflow net of commissions) in 2013 (10,848 M€), around 60.5% (6,567 M€) came from the European Financial Stability Facility, while the remainder was provided by the International Monetary Fund (4,281 M€). At the end of 2013 the funding received under the financial assistance program accounted for approximately 93.5% of the total and it is foreseen that 2,500 M€ and 2,600 M€ will be disbursed in 2014 e 2015, respectively.

Table 8 – Loans received under EFAP

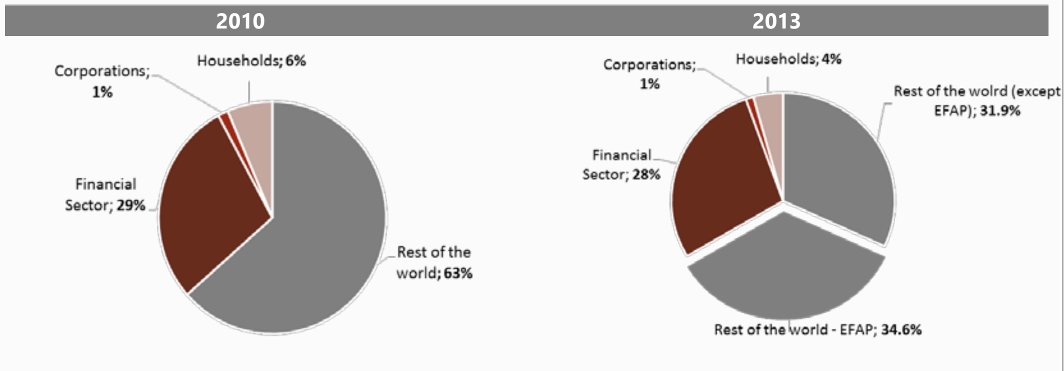
Loans received	2011	2012	2013	Until dec.2013		
	Dissbursement per year [*] (M€)			Nominal value (M€)	"*All in cost*" [**]	Average maturity (years)
EFSF	5 913	12 289	6 567	26 078	2.2%	20.6
EFSM	14 040	7 936	-	22 100	3.0%	12.4
IMF	13 081	8 140	4 281	25 630	3.7%	7.25
Financial Assistance Programme	**33 033**	**28 366**	**10 848**	**73 808**	**3.0%**	**13.5**

Source: IGCP. CFP calculations. | Notes: [*] corresponds to the inflows net of commissions; [**] estimated IRR including all associated costs (interest and commissions).

At the end of 2013 the structure of public debt holders showed a significant change *vis-à-vis* 2010, particularly in regard to debt held by foreign creditors. In effect, although approximately two thirds of public debt is still held abroad, half of that sum is now held by institutional creditors under the EFAP. In 2010 103,140 M€ of public debt (63% of the total) was held by the exterior sector, other than by the official sector, and at the end of 2013 that stock had fallen to 68,046 M€ (31.9% of the total). The decrease in this source of financing occurred in simultaneous with the increase of 23,400 M€ in the *Maastricht* debt stock, given that official creditors under the EFAP financed the remaining 73,808 M€ from abroad.

[46] For further information on the factors that explain the increase in the debt ratio see CFP publication Public Debt Notebook.

Chart 21 – Breakdown of debt by creditor (as %)



Source: Bank of Portugal. CFP calculations.

Box 6 – Non-Financial Public Corporation Debt (non-consolidated)

At the end of 2013 the total debt of non-reclassified public corporations (NRPC) stood at 19,638 M€, i.e. a decrease of around 0.8 M€ or 3.9% compared to the previous year. Total debt of RPC, on the contrary, rose by 200 M€, i.e. an increase of 7.8%. However, given that part of the debt was financed by the State, from a consolidated standpoint there was a decrease of 0.9 M€. Compared to the 2007 figure, RPC debt recorded an increase of 15,630 M€, which constitutes a very significant change of 133.3%.

NRPC debt under the form of trade credit, which accounts for around 15.6% of the total, has been decreasing since 2011 and reached 3,062 M€ at the end of 2013. In that year this figure represented more than the total trade credits of the general government sector (2,778 M€), which had fallen by 23.3%, due mainly to the regional and local government and health sector debt settlement programs.

Note however that in regard to the RPC, both trade credits and general government financed debt are not taken into account when calculating the Maastricht debt, since the former does not fall within the definition and in the case of the latter the effect is offset intersectoral consolidation.

Table 9 – Non-Financial Public Corporation Debt (non-consolidated)

Loans Public Corporations (*)	INE (EDP) / Bank of Portugal							M€	%	M€	%
	2007	2008	2009	2010	2011	2012	2013	2012/13		2010/13	
Debt RNPC (total)	**18 121**	**20 749**	**22 980**	**24 301**	**25 556**	**20 446**	**19 638**	**-808**	**-4%**	**-4 663**	**-19%**
of which:											
Debt financed by GG	37	814	644	541	142	143	135	-8.1	-6%	-405	-75%
Trade credits EPNR	2 025	1 750	2 089	2 771	3 346	3 114	3 062	-52	-2%	291	11%
Debt RPC (total)	**11 729**	**13 038**	**14 939**	**20 763**	**23 290**	**25 374**	**27 359**	**1 985**	**8%**	**6 596**	**32%**
of which:											
Debt financed by GG	0	26	135	135	5 267	8 918	11 835	2 917	33%	11 701	8700%
Memo item:											
Trade Credits GG	1 769	1 940	3 151	3 894	3 539	3 623	2 778	-844	-23.3%	-1 115	-29%

Source: INE and BoP. CFP calculations. | Notes: (*) Corresponds to non-financial Public Corporations, except for the Parpública group which is included in financial corporations.

6 COMPARISON WITH BUDGETARY PLANNING DOCUMENTS

The non-adjusted general government deficit in 2013 was lower than expected in the ASB/2013, but well above the targets set in the FSD/2012 and the SB/2013. As stated in section 2 - 2013 Forecast Framework, over the year important changes arose in the State Budget macroeconomic and institutional framework that called for significant corrections to the goals originally set and to the policies adopted to achieve them. Thus when comparing the outturn in 2013 with the goals set in the budgetary planning documents drawn up in 2012 (FSD/2012 and SB/2013), the headline balance presents an unfavourable deviation (of 1.9 p.p. and 0.4 p.p., respectively). However, this balance compares favourably, with the 1st ASB/2013 estimate (6 p.p.) and with the estimate underlying the 2nd ASB/2013(1 p.p.). Excluding the impact of temporary measures, the 2013 deficit was better than the latest MF estimate by 0.7 p.p. of GDP.

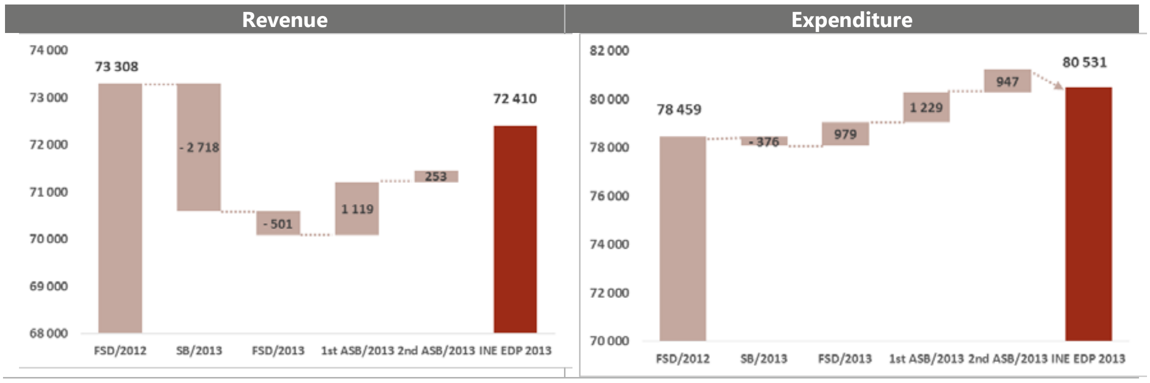
Table 10 – Fiscal forecasts

	Deviation (in M€) of INE (EDP) versus:					Deviation (in p.p. of GDP) of INE (EDP) versus:				
	FSD/2012	SB/2013	FSD/2013	1st ASB/2013	2nd ASB/2013	FSD/2012	SB/2013	FSD/2013	1st ASB/2013	2nd ASB/2013
	apr/2012	oct/2012	apr/2013	jul/2013	oct/2013	apr/2012	oct/2012	apr/2013	jul/2013	oct/2013
A. Headline figures										
Total Revenue	**-898**	**1 820**	**2 321**	**1 202**	**949**	**0.8**	**1.4**	**1.1**	**0.4**	**0.5**
Current revenue	**-177**	**1 391**	**2 691**	**1 863**	**1 389**	**1.2**	**1.1**	**1.3**	**0.8**	**0.8**
Tax revenue	-215	614	2 366	2 152	1 666	0.7	0.5	1.3	1.1	1.0
Indirect taxes	-2 767	-255	847	446	638	-1.2	-0.1	0.4	0.2	0.4
Direct taxes	2 552	869	1 519	1 706	1 028	1.9	0.6	0.8	1.0	0.6
Social contributions	-167	25	363	329	273	0.3	0.1	0.1	0.1	0.1
Sales and other current revenue	205	752	-38	-618	-550	0.3	0.5	-0.1	-0.4	-0.3
Capital revenue	**-722**	**429**	**-370**	**-661**	**-440**	**-0.4**	**0.3**	**-0.2**	**-0.4**	**-0.3**
Total Expenditure	**2 468**	**2 448**	**1 468**	**240**	**-707**	**2.7**	**1.8**	**0.5**	**-0.2**	**-0.5**
Primary expenditure	**3 295**	**2 548**	**1 607**	**629**	**-582**	**3.1**	**1.8**	**0.7**	**0.1**	**-0.4**
Current primary expenditure	3 847	2 053	735	184	-20	3.3	1.5	0.1	-0.2	-0.1
Intermediate consumption	252	-265	113	-155	-556	0.3	-0.1	0.0	-0.1	-0.3
Compensaton of employees	1 184	503	342	485	251	1.0	0.4	0.1	0.2	0.1
Social transfers	2 295	1 205	-404	284	435	1.8	0.9	-0.4	0.0	0.2
Subsidies and other current expenditure	115	610	685	-430	-150	0.2	0.4	0.4	-0.3	-0.1
Capital expenditure	-552	495	871	445	-562	-0.2	0.3	0.5	0.3	-0.3
GFCF	-382	-586	-713	-769	-709	-0.2	-0.3	-0.4	-0.5	-0.4
Other capital expenditure	-170	1 082	1 584	1 214	148	-0.1	0.7	1.0	0.7	0.1
Interest (EDP)	**-827**	**-100**	**-138**	**-390**	**-125**	**-0.4**	**0.0**	**-0.1**	**-0.3**	**-0.1**
Balance (EDP)	**-3 366**	**-628**	**853**	**962**	**1 656**	**-1.9**	**-0.4**	**0.6**	**0.6**	**1.0**
Primary balance (EDP)	-4 193	-728	715	573	1 531	**-2.2**	**-0.4**	**0.4**	**0.4**	**0.9**
B. Adjusted figures										
Total revenue	**-2 178**	**541**	**1 042**	**-77**	**370**	**0.0**	**0.6**	**0.3**	**-0.4**	**0.1**
Total expenditure	**1 372**	**1 748**	**541**	**-687**	**-707**	**2.3**	**1.4**	**0.0**	**-0.8**	**-0.5**
Balance (EDP)	**-3 550**	**-1 207**	**501**	**610**	**1 077**	**-2.2**	**-0.8**	**0.3**	**0.4**	**0.7**
Primary Balance (EDP)	**-4 376**	**-1 308**	**362**	**220**	**952**	**-2.6**	**-0.8**	**0.2**	**0.1**	**0.6**
Memo items:										
Public Debt	15 937	7 268	12 520	12 520	2 274	13.3	5.2	6.7	6.7	1.1
GDP at current market prices	-5 255	-1 128	1 175	1 175	334	:	:	:	:	:

Source: INE. Ministry of Finance. | Notes: In panel B the expenditure forecast in the FSD/2013 and in the 1st ASB/2013 was adjusted for the temporary measure relating to the Port of Lisbon concession (0.1% of GDP). The 2013 estimate published in November 2013 and the sum calculated by INE were corrected for the impact of the ESSD on the revenue side and Banif on the expenditure side. The ESSD adjustment to the November 2013 estimate was made in line with the figure estimated at the time. The 2nd ASB/2013 Bill was not accompanied by a report (the revised 2013 accounts were submitted by the MF in the SB/2014 report and underlying the 2nd ASB/2013). In regard to the balance biases, a negative figure corresponds to an unfavourable bias and a positive figure to a favourable bias.

The improvement of the budget balance *vis-à-vis* 2012 estimated in the FSD/2012 was achieved. As stated in section 4.1, the 2013 budget outturn shows an improvement in the headline balance of 1.5 p.p. of GDP compared to the previous year, which despite reflecting very different deficit levels from those of 2012 and 2013, corresponds to the annual change forecast in the FSD/2012. The 2013 budget outturn started from a more unfavourable level than expected in the FSD, which required very different budget consolidation measures on both the revenue and expenditure sides to ensure an equivalent improvement in the balance.[47]

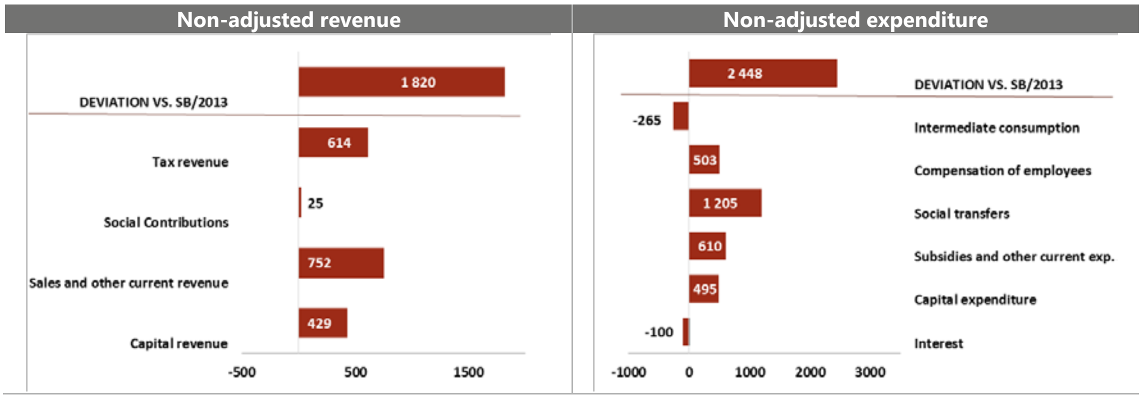
Chart 22 – Change in non-adjusted revenue and expenditure forecasts (M€)



Source: INE. Ministry of Finance.

Despite various revisions over the year non-adjusted revenue was 1,820 M€ higher than the original SB estimate. All revenue items contributed to this outcome (Chart 23, left hand panel). However it should be recalled that tax and contributory revenue benefitted from the impact of the ESSD (which totalled 1,280 M€) and the restoring of the bonuses, without which it would have fallen below the SB/2013 forecast.

Chart 23 – Deviations compared to the original SB/2013 (M€)



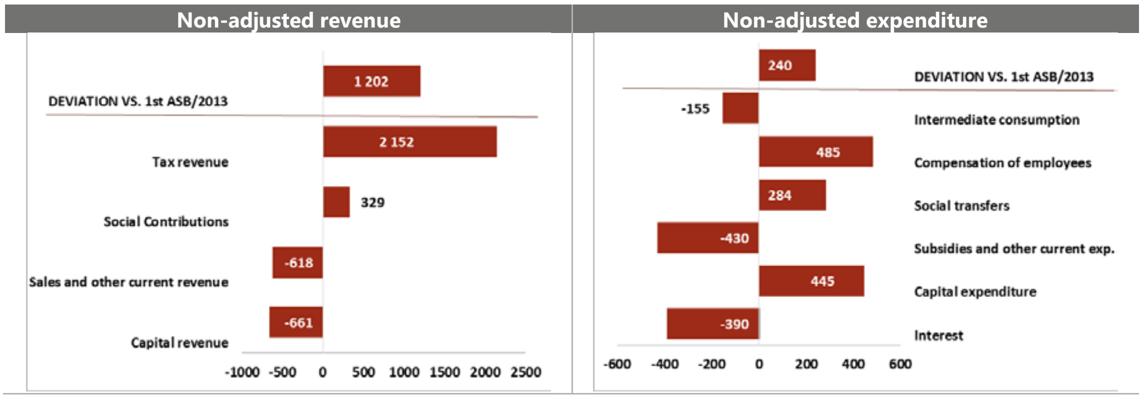
Source: INE. Ministry of Finance.

All expenditure items had an adverse outturn compared to the original SB forecasts except for intermediate consumption, GFCF and interest. Other capital expenditure reflects the unanticipated impact of the capital increase in Banif, which was mitigated by a fall in GFCF even greater than originally forecast. The unfavourable bias recorded in compensation of employees and social transfers are explained by the restoring of the holiday bonuses. The rise in spending in these two items (1,708 M€) was higher than expected in the SB/2013, which only considered the restoring of the Christmas bonus.[48]

[47] In the FSD/2012 the headline budget balance was expected to improve from 4.5% of GDP in 2012 to 3% in 2013. The target was not met and the deviation was 1.9 p.p. of GDP, similar to that recorded in 2013.

[48] And a further 10% of pensioners' holiday bonus.

Chart 24 – Deviations compared to the 1st ASB/2013 (in M€)



Source: INE. Ministry of Finance.

Budget developments on the revenue side produced significant deviations compared to the 1st ASB/2013. Comparing the forecasts in the 1st ASB/2013 and the figures reported by INE shows major differences in various items. The favourable deviation in revenue (+1,202 M€) is the result of a better performance of tax and contributory revenue (+2,481M€), explained by direct taxes in the CG subsector (+1,543 M€) and by the favourable deviation in social contributions (240 M€) and in SSF indirect taxes which stood at 955 M€. The latter suggests an incorrect classification of the revenue earmarked for SSF in the MF estimate.[49] In the opposite direction there was a deviation in capital and sales and other current revenue, which totalled 1,279 M€ and stemmed from a less favourable outturn in CG (742 M€) and RLG (413 M€).

The expenditure deviations seem to indicate problems in the estimates underlying the 1st ASB/2013. Expenditure shows an unfavourable deviation of 240 M€, as a result of a worse than expected outturn in compensation of employees (+485 M€) concentrated in CG, which reflects an inadequate forecast of imputed social contributions and an unfavourable deviation in RLG regarding salaries and wages (+137 M€). Social transfers also recorded spending above forecast to the tune of 284 M€, reflecting an unfavourable deviation in CG (457 M€), which was partially offset by lower SSF spending (264 M€). The decline in CG and RLG investment expenditure partially offset those deviations.

The general government Maastricht debt was higher than estimated in all budgetary planning documents. The deviations were 13.3 p.p., 5.2 p.p. and 6.7 p.p. of GDP compared to the figures in the FSD/2012, the SB/2013, and the FSD/2013 - 1st ASB/2013, respectively. The public debt ratio ended the year at 129.0% of GDP, higher than the most recent estimate submitted by the Ministry of Finance in the Draft SB/2014. Public debt increased by 15,900 M€ compared to the figures in the FSD/2012.

[49] Revenue arising from Social VAT and from SEP/ESSEC is recorded in the national accounts as indirect taxes in SSF revenue. From 2013 onwards, that revenue is recorded as a State transfer to the SSF subsector in public accounts.

However interest charges on this higher level of debt were 827 M€ lower than forecast in the FSD/2012.[50]

[50] According to the MF, the public debt estimate was revised upwards to 127.8 % of GDP because a higher cash buffer (under deposits) was foreseen at the end of the year, the purchase of Portuguese public debt by the SSF was postponed and the transfer of CGD shares to Parpública to settle State debts relating to privatisations did not occur.

ANNEXES

Table 11 – General government adjusted account (in M€)

	2010	2011	2012	2013	2012/13 M€	2012/13 %	2012/13 Ctrc (p.p.)
Total Revenue	**69 100**	**70 253**	**67 034**	**71 130**	**4 096**	**6.1**	**6.1**
Current revenue	**67 079**	**68 389**	**64 892**	**69 628**	**4 736**	**7.3**	**7.1**
Tax revenue	38 262	39 540	37 626	41 045	3 419	9.1	5.1
Indirect taxes	23 040	23 499	22 539	22 213	-326	-1.4	-0.5
Direct taxes	15 222	16 042	15 087	18 832	3 745	24.8	5.6
Social contributions	21 270	21 048	19 135	19 905	770	4.0	1.1
of which: actual social contributions	15 725	16 060	14 989	15 097	108	0.7	0.2
Sales and other current revenue	7 548	7 801	8 130	8 677	546	6.7	0.8
Sales	4 356	4 306	4 609	4 508	-101	-2.2	-0.1
Other current revenue	3 192	3 495	3 522	4 169	647	18.4	1.0
Capital revenue	2 021	1 864	2 142	1 503	-640	-29.9	-1.0
Total Expenditure	**84 095**	**82 419**	**76 885**	**79 831**	**2 946**	**3.8**	**3.8**
Primary expenditure	**79 245**	**75 530**	**69 760**	**72 767**	**3 008**	**4.3**	**3.9**
Current primary expenditure	72 790	70 563	66 130	69 444	3 314	5.0	4.3
Intermediate consumption	8 059	7 891	7 400	7 308	-92	-1.2	-0.1
Compensaton of employees	21 157	19 422	16 510	17 789	1 279	7.7	1.7
Social transfers	37 895	37 775	37 139	38 834	1 695	4.6	2.2
Other than kind	29 553	29 808	29 645	31 229	1 584	5.3	2.1
In kind	8 343	7 968	7 495	7 605	110	1.5	0.1
Subsidies	1 283	1 184	968	1 117	149	15.4	0.2
Other current revenue	4 396	4 291	4 113	4 397	284	6.9	0.4
Capital expenditure	6 455	4 966	3 629	3 324	-306	-8.4	-0.4
GFCF	5 195	4 010	2 745	2 376	-369	-13.5	-0.5
Other capital expenditure	1 260	956	884	948	63	7.2	0.1
Interest (EDP)	**4 850**	**6 890**	**7 126**	**7 064**	**-62**	**-0.9**	**-0.1**
Balance (EDP)	**-14 995**	**-12 166**	**-9 851**	-8 701	1 150		
Primary balance (EDP)	-10 145	-5 277	-2 726	-1 637	1 088		
Tax burden	53 987	55 601	52 615	56 144	3 529		
GDP at current market prices	**172 860**	**171 126**	**165 107**	**165 666**	**559**		

Source: INE. | Note: For analysing purposes, the adjustment relating to the effect of swap agreement related interest, which is treated differently under the Excessive Deficit Procedure and in the national accounts (ESA95), was charged entirely to expenditure.

Table 12 – General government non-adjusted account (in M€)

	2010	2011	2012	2013	2012/13 M€	2012/13 %	2012/13 Ctrc (p.p.)
Total Revenue	**71 991**	**77 043**	**67 574**	**72 410**	**4 835**	**7.2**	**7.2**
Current revenue	**67 079**	**69 229**	**65 077**	**70 907**	**5 830**	**9.0**	**8.6**
Tax revenue	38 262	40 380	37 811	42 091	4 279	11.3	6.3
Indirect taxes	23 040	23 499	22 539	22 568	30	0.1	0.0
Direct taxes	15 222	16 882	15 272	19 522	4 250	27.8	6.3
Social contributions	21 270	21 048	19 135	20 140	1 004	5.2	1.5
of which: actual social contributions	15 725	16 060	14 989	15 331	343	2.3	0.5
Sales and other current revenue	7 548	7 801	8 130	8 677	546	6.7	0.8
Sales	4 356	4 306	4 609	4 508	-101	-2.2	-0.1
Other current revenue	3 192	3 495	3 522	4 169	647	18.4	1.0
Capital revenue	4 912	7 814	2 497	1 503	-995	-39.8	-1.5
Total Expenditure	**88 973**	**84 442**	**78 215**	**80 531**	**2 316**	**3.0**	**3.0**
Primary expenditure	**84 123**	**77 552**	**71 090**	**73 467**	**2 378**	**3.3**	**3.0**
Current primary expenditure	74 220	70 751	66 232	69 444	3 212	4.8	4.1
Intermediate consumption	8 942	7 903	7 400	7 308	-92	-1.2	-0.1
Compensaton of employees	21 157	19 422	16 510	17 789	1 279	7.7	1.6
Social transfers	37 949	37 775	37 139	38 834	1 695	4.6	2.2
Other than kind	29 553	29 808	29 645	31 229	1 584	5.3	2.0
In kind	8 397	7 968	7 495	7 605	110	1.5	0.1
Subsidies	1 283	1 221	968	1 117	149	15.4	0.2
Other current revenue	4 889	4 429	4 215	4 397	182	4.3	0.2
Capital expenditure	9 902	6 801	4 857	4 024	-834	-17.2	-1.1
GFCF	6 497	4 473	2 745	2 376	-369	-13.5	-0.5
Other capital expenditure	3 406	2 327	2 112	1 648	-465	-22.0	-0.6
Interest (EDP)	4 850	6 890	7 126	7 064	-62	-0.9	-0.1
Balance (EDP)	**-16 982**	**-7 398**	**-10 641**	**-8 122**	**2 519**		
Primary balance (EDP)	**-12 132**	**-509**	**-3 515**	**-1 058**	**2 457**		
Tax burden	54 074	56 441	53 058	57 424	4 365		
GDP at current market prices	**172 860**	**171 126**	**165 107**	**165 666**	**559**		

Source: INE. | Note: For analysing purposes, the adjustment relating to the effect of swap agreement related interest, which is treated differently under the Excessive Deficit Procedure and in the national accounts (ESA95), was charged entirely to expenditure.

Table 13 – General government adjusted account (as % of GDP)

	2010	2011	2012	2013	2012/2013 p.p. of GDP	2010/2013 p.p. of GDP
Total Revenue	**40.0**	**41.1**	**40.6**	**42.9**	**2.3**	**3.0**
Current revenue	**38.8**	**40.0**	**39.3**	**42.0**	**2.7**	**3.2**
Tax revenue	22.1	23.1	22.8	24.8	2.0	2.6
Indirect taxes	13.3	13.7	13.7	13.4	-0.2	0.1
Direct taxes	8.8	9.4	9.1	11.4	2.2	2.6
Social contributions	12.3	12.3	11.6	12.0	0.4	-0.3
of which: actual social contributions	9.1	9.4	9.1	9.1	0.0	0.0
Sales and other current revenue	4.4	4.6	4.9	5.2	0.3	0.9
Sales	2.5	2.5	2.8	2.7	-0.1	0.2
Other current revenue	1.8	2.0	2.1	2.5	0.4	0.7
Capital revenue	**1.2**	**1.1**	**1.3**	**0.9**	**-0.4**	**-0.3**
Total Expenditure	**48.6**	**48.2**	**46.6**	**48.2**	**1.6**	**-0.5**
Primary expenditure	**45.8**	**44.1**	**42.3**	**43.9**	**1.7**	**-1.9**
Current primary expenditure	42.1	41.2	40.1	41.9	1.9	-0.2
Intermediate consumption	4.7	4.6	4.5	4.4	-0.1	-0.3
Compensaton of employees	12.2	11.3	10.0	10.7	0.7	-1.5
Social transfers	21.9	22.1	22.5	23.4	0.9	1.5
Other than kind	17.1	17.4	18.0	18.9	0.9	1.8
In kind	4.8	4.7	4.5	4.6	0.1	-0.2
Subsidies	0.7	0.7	0.6	0.7	0.1	-0.1
Other current revenue	2.5	2.5	2.5	2.7	0.2	0.1
Capital expenditure	3.7	2.9	2.2	2.0	-0.2	-1.7
GFCF	3.0	2.3	1.7	1.4	-0.2	-1.6
Other capital expenditure	0.7	0.6	0.5	0.6	0.0	-0.2
Interest (EDP)	**2.8**	**4.0**	**4.3**	**4.3**	**-0.1**	**1.5**
Balance (EDP)	**-8.7**	**-7.1**	**-6.0**	**-5.3**	**0.7**	**3.4**
Primary balance (EDP)	**-5.9**	**-3.1**	**-1.7**	**-1.0**	**0.7**	**4.9**
Tax burden	31.2	32.5	31.9	33.9	2.0	2.7
GDP at current market prices	44.9	45.3	44.4	46.2	1.8	1.3

Source: INE. | Note: For analysing purposes, the adjustment relating to the effect of swap agreement related interest, which is treated differently under the Excessive Deficit Procedure and in the national accounts (ESA95), was charged entirely to expenditure.

Table 14 – Temporary measures and special factors (as % of GDP)

	INE			
	2010	2011	2012	2013
Temporay & one-off measures ***(impact on b. balance)***	**0.3**	**3.6**	**0.0**	**0.3**
Revenue	**1.7**	**4.0**	**0.3**	**0.8**
Transfer of pension funds	1.6	3.5	0.1	
Taxes on repatriation of capitals	0.1		0.2	
Exceptional Scheme for Settling Tax Debts - VAT				0.2
Exceptional Scheme for Settling Tax Debts -PIT ; CIT				0.4
Exceptional Scheme for Settling Social Security Debts				0.1
PIT sucharge		0.5	0.1	
Expenditure	**1.3**	**0.3**	**0.4**	**0.4**
Proceeds from concessions	-0.1	0.0	-0.2	0.0
Capital transfers (Banking sector)	1.3	0.4	0.5	0.4
One-off payments to the EU Budget	0.1		0.1	
Special factors ***(impact on b. balance)***	**-1.5**	**-0.9**	**-0.5**	**0.0**
Expenditure	**1.5**	**0.9**	**0.5**	**0.0**
Delivery of submarines	0.5			
Capital transfers (Sagestamo)			0.5	
Reclassification of PPP into general government	0.4	0.1		
Recording of Madeira region debt	0.6			
Madeira capital transactions (SESARAM & reclass. of Via Madeira)		0.3		
Madeira region debts from programme contracts & football clubs		0.1		
Reclassification of support fund to health service		0.3		
Temporay, one-off measures & special factors	**-1.1**	**2.8**	**-0.5**	**0.3**

Source: INE and Bank of Portugal. CFP calculations. | Note: the totals do not necessarily correspond to the differences between the figures as a percentage of GDP due to rounding.

List of abbreviations

Abbreviation	Meaning
ADM	Military Health System
ADSE	Civil Servants Health System
ANA	ANA – Aeroportos de Portugal, S.A.
ANAM	ANAM – Aeroportos e Navegação Aérea da Madeira, S.A.
ASB	Amending State Budget
ASECE	Extraordinary Social Support to Energy Consumers
Banif	Banco Internacional do Funchal
BoP	Bank of Portugal
BPI	Banco Português de Investimento
CFP	Portuguese Public Finance Council
CG	Central Government
CGA	Civil Servants Pension Agency/Scheme
CGD	Caixa Geral de Depósitos
CIT	Corporate Income Tax
CoCo	Contingent convertible capital instruments
CPI	Consumer Price Index
Ctrc	Contributions to annual rate of change
CTT	CTT - Correios de Portugal, S.A.
DGAEP	Direção-Geral da Administração e do Emprego Público (Directorate-General for Administration and Public Employment)
DGO	Direção-Geral do Orçamento (Directorate-General for Budget)
EDP	Excessive Deficit Procedure
EFAP	Economic and Financial Assistance Program
EFAP-RAM	Madeira Autonomous Region Economic and Financial Adjustment Program
ESA	European System of National and Regional Accounts
ESC	Extraordinary Solidarity Contribution
ESSD	Exceptional Scheme for Settlement of Tax and Social Security Debts
EU	European Union
FSD	Fiscal Strategy Document
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GG	General Government
HCPI	Harmonised Consumer Price Index
IGCP	Agência de Gestão da Tesouraria e da Dívida Pública - IGCP, E.P.E.
IGFSS	Instituto de Gestão Financeira da Segurança Social
IMF	International Monetary Fund
IMI	Municipal Property Tax
IMT	Municipal Property Transfer Tax
INE	Statistics Portugal (Portuguese Statistical Authority)
IRR	Internal Rate of Return
LEFAP	Local Government Economic and Financial Adjustment Program
LG	Local Government
M€	Million Euros
MF	Ministry of Finance
NA	National Accounts
NHS	National Health Service
OASS	Old Age Solidarity Supplement
OECD	Organisation for Economic Co-operation and Development
p.p.	Percentage points
PA	Public Accounts
Parpública	PARPÚBLICA – Participações Públicas, SGPS, S.A.
PIT	Personal Income Tax
RAA	The Azores Autonomous Region
RAM	The Madeira Autonomous Region
Refer	Rede Ferroviária Nacional - REFER, E.P.E.
RLG	Regional and Local Government
RPC	Reclassified Public Corporations
SAD	Police Force Health System
SB	State Budget
SEP	Social Emergency Program
SII	Social Inclusion Income
SSA	Social Security Act
SSF	Social Security Funds
VAT	Value Added Tax

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